HAUN

October 31, 2022

Christopher J. Kirkpatrick
Secretariat
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Petition for Rulemaking - DAO-Participant Liability

Dear Mr. Kirkpatrick:

Haun Ventures respectfully petitions the U.S. Commodity Futures Trading Commission **("CFTC"** or the **"Commission")** to initiate a rulemaking process and promulgate a regulation to provide clarity and certainty related to the obligations of individuals participating in a decentralized autonomous organization **("DAO").** *See* 5 U.S.C. § 553(e); 17 C.F.R. § 13.1.

DAOs are a democratized governance structure for technology development that we expect will be a critical component of the next generation of innovation. On September 22, 2022, however, the Commission entered an order and commenced an enforcement action that threatens their continued vitality. Specifically, the Commission determined that anyone \vho votes using their tokens-evidently at any point and on any matter-becomes a "member" of the DAO and is thereby jointly and severally liable for any future unlav,1ul actions by the DAO. *See In re bZeroX, U,C, CVI'C* No. 22-31, slip op. at 9-11 (Sep. 22, 2022); Complaint, *CV/'C v. Ooki DAO,* No. 3:22-cv-05416 (N.D. Cal. Sep. 22, 2022).

Haun Ventures shares the CFTC's interest in preventing technology from being used for unlawful purposes. However, the approach taken by the Commission risks serious damage to American competitiveness and innovation, and it creates perverse disincentives for responsible actors to participate in good governance over key protocols. While the Commission's joint-and-several liability theory is immediately problematic in that it would punish DAO participants in a manner not licensed by law, even more worrisome is the shadow this action has already cast over the nascent web3 ecosystem. Tokenholders' fear of participating in DAOs due to the CFTC's aggressive approach to DAO-participant liability could severely restrict this nascent but flourishing technological innovation in the United States.

Haun Ventures therefore urges the Commission to propose for notice-and-comment a regulation that defines the scope of liability for DAO participants and that sensibly limits that liability to those who actively engage in or facilitate illegal activity.

I. Background

The Commission's actions come at a critical inflection point. The original success of the internet was contingent upon open, standardized, community-developed protocols. More recently, though, we have seen the emergence of centralized gatekeepers-behemoth, closed platforms that exploit individuals' data for commercial purposes. The results of a poll we recently commissioned of voters in swing states suggests that average Americans overwhelmingly want to see a better vision for technology in society than the broken status quo.[1]

We believe that a group of emerging technologies based on cutting-edge cryptography, commonly referred to as web3, could provide this better vision.[2]

DAOs play a critical role in web3 development.[3] A DAO consists of digital asset holders who vote their tokens to democratically govern communities or software protocols using blockchain-based rules.[4] This "unique governance mechanism" invites "anyone to contribute" to a project, which enables "maximum alignment with an organization's community of users."[5] Similarly, by "hand[ing] over decision-making and execution powers to [the] community at every level," DAOs "unlock[] a net new value proposition that wasn't previously possible."[6] And, even though the concept is still in its infancy, DAOs have already embarked on a wide range of projects aimed at furthering the common good, with uses as varied as building tools to support access to justice, raising money for the Ukrainian war effort, and improving the financial security of individuals worldwide.[7]

While DAO governance varies from project to project, the rules of a DAO are typically laid out in smart contracts, which are self-executing and publicly auditable code.[8] Once the DAO is launched, any community participant can submit a proposal at any time. Proposals can range from technical upgrades to treasury allocations or any other actions that concern the project. After a proposal is made, community participants may cast their votes (though no one is required to vote their tokens on any particular proposal). If the proposal achieves some predefined level of consensus, it is then accepted, implemented, and enforced by smart contracts. The process is typically quite transparent and auditable: "[t]he details of each proposal are readily available, voting history is continuously recorded, and even the voting records of particular token holders can be observed."[9]

[1] *See* Chris Lehane & Tomicah Tillemann, *The Web3 Voter*, Haun Ventures (Sep. 29, 2022), https://mirror.xyz/haunventures.eth/DtYIt_vAijoqRV41SMNAcu6kwCAM8Mc_p8GsjFTfP6o (detailing the findings of a poll showing, among other things, that "over 90% of voters express support for an internet that is community owned, community governed, and gives people greater control over their information").

[2] *See, e.g.*, Howard Wu, *How the Coming Privacy Layer Will Fix the Broken Web*, Future (June 15, 2021), https://future.com/a-privacy-layer-for-the-web-can-change-everything/.

[3] *See, e.g.*, Emilia La Capra, *What is the role of a decentralized autonomous organization in Web3?*, CoinTelegraph (Feb. 26, 2022), https://cointelegraph.com/explained/what-is-the-role-of-a-decentralized-autonomous-organization-in-web3 ("The network design of DAOs perfectly combines with the foundation of Web3, fueling a new creator economy and the future of work.").

[4] *See Decentralized autonomous organizations*, Ethereum https://ethereum.org/en/dao/ (last visited Oct. 15, 2022); Paul Kim, *Decentralized autonomous organizations (DAOs) are non-hierarchical communities operating on blockchain technology*, Business Insider (Jul. 22, 2022), https://www.businessinsider.com/personal-finance/what-is-a-dao.

[5] Chris Ahn, *Business-Governance Fit*, Haun Ventures (July 28, 2022), https://mirror.xyz/haunventures.eth/renjKDhQY8gXsPWUlhVzZ4z1yqVYEbTJZgWdE1T9o9U.

[6] *Id.*

[7] *See LexDAO,* DAO Central, https://daocentral.com/dao/lex (last visited Oct. 17, 2022) (building tools that support access to justice); Daniel Roberts, *What DAOs Can Do: $6.75M in Ethereum for Ukraine,* Decrypt (Mar. 5, 2022), https://decrypt.co/94386/ukraine-dao-millions-in-ethereum-shows-what-dao-can-do (raising crypto donations for the Ukrainian war effort against Russia); *The Maker Protocol: MakerDAO's Multi-Collateral Dai (MCD) System* https://makerdao.com/en/whitepaper/ (last visited Oct. 17, 2022) (using stablecoin to empower individuals without bank access or in countries with unstable currencies achieve financial security).

[8] David Shuttleworth, *What Is A DAO And How Do They Work?*, Consensys (Oct. 7, 2021), https://consensys.net/blog/blockchain-explained/what-is-a-dao-and-how-do-they-work/.

[9] *Id.*

The Commission's recent enforcement action concerns a particular DAO named Ooki DAO. In 2019, bZeroX, LLC designed and deployed a blockchain-based protocol that allowed for accepting orders for and facilitating margined and leveraged retail commodity transactions. bZeroX eventually decided to transfer control of the protocol to Ooki DAO. This transfer was done in an effort to "insulate the [Protocol] from regulatory oversight and accountability for compliance with U.S. law." Complaint, *supra* at 14. Last month, the CFTC responded by bringing a civil action against Ooki DAO in federal court. The agency sought to enjoin the DAO from engaging in any "commodity-related activity," and furthermore asked for the court to issue "civil monetary penalties" against it. *Id.* at 4.

In an accompanying consent order issued against bZeroX and its two founders, the Commission expressed its views that (1) Ooki DAO is an "unincorporated association," (2) the founders had become "members" of the association simply by voting their tokens, (3) Ooki DAO had violated the Commodity Exchange Act ("**CEA**") and a CFTC regulation, and (4) the founders, as voting members of Ooki DAO, were "personally liable" for the violations. *See In re bZeroX, LLC*, slip op. at 9–11. In reaching that conclusion, the Commission relied on a state-common-law doctrine providing that members of a for-profit unincorporated association are jointly and severally liable for the debts of that association. *See id.* at 11 (collecting cases). The Commission noted that it "d[id] not take a position . . . as to the appropriate monetary sanctions against the Ooki DAO" more generally, as its Order concerned the founders only. *Id.* at 11 n.12. But the Order's logic and the Commission's recent enforcement action suggest that it views the other voting members of the DAO as similarly liable for Ooki DAO's unlawful acts. *See* Complaint, *supra* at 17 ("The Ooki DAO is an unincorporated association comprised of Ooki Token holders who have voted those tokens to govern the Ooki Protocol.").

Commissioner Mersinger issued a dissenting statement. *See* Press Release, CFTC, *Dissenting Statement of Commissioner Summer K. Mersinger* (Sep. 22, 2022).[10] There, she made clear that she "d[id] not condone individuals or entities blatantly violating the CEA or [the CFTC's] rules." *Id.* And she took no issue with the agency's filing of an enforcement action against an unincorporated association generally. *See id.* But Commissioner Mersinger believed that the Commission "cannot arbitrarily decide who is accountable for those violations based on an unsupported legal theory amounting to regulation by enforcement." *Id.* She explained that the Commission's order (1) "fail[ed] to rely on any legal authority in the CEA" or "case law relevant to this type of action," (2) "arbitrarily define[d] the Ooki DAO unincorporated association in a manner that unfairly picks winners and losers," (3) "constitute[d] blatant 'regulation by enforcement' by setting policy based on new definitions and standards never before articulated by the Commission or its staff," and (4) ignored an alternative, aiding-and-abetting theory of liability "that is specifically authorized by Congress" and that could have been used to hold the founders liable. *Id.*; *see* 7 U.S.C. § 13c(a).

The CFTC's actions against Ooki DAO sent shockwaves through the web3 community.[11] Based on the Commission's sweeping approach to liability, individuals quite reasonably fear that the mere

[10] *Available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/mersingerstatement092222.

[11] *See, e.g.*, Olga Kharif & Allyson Versprille, *Crypto DAOs and Their Token Holders Aren't Safe from the CFTC*, Bloomberg (Sep. 23, 2022), https://www.bloomberg.com/news/articles/2022-09-23/are-crypto-daos-and-governance-token-holders-safe-from-the-cftc; Owen Fernau, *CFTC Action Against DAO Outrages Crypto and One of Its Own Commissioners*, The Defiant (Sep. 22, 2022), https://thedefiant.io/cftc-sues-dao; Guillermo Jimenez & Jason Nelson, *CFTC Sues a DAO, Raising Legal Questions for DeFi Founders and Users*, Decrypt (Sep. 23, 2022), https://decrypt.co/110407/cftc-ooki-dao-bzx-lawsuit-legal-questions-defi; Jana S. Farmer & John Cahill, *DAOs: A game changer in need of new rules*, Reuters (Oct. 7, 2022), https://www.reuters.com/legal/legalindustry/daos-game-changer-need-new-rules-2022-10-07/.

act of voting on a single proposal could place them on the hook for whatever the DAO may do. That has produced an instant chilling effect on DAO participation. After all, if a DAO stumbles into unforeseen legal trouble, then, based on the Order's rationale, individuals who voted their tokens on matters entirely unrelated to the activity in question could be held liable as members of the organization. The Commission's theory might extend to those who sold their tokens prior to the unlawful activity, or even to those who actively voted *against* the unlawful activity.[12]

A rulemaking is desperately needed to quell these concerns, gather insight from the community, and align the Commission's approach with that authorized by the CEA.

II. Statement of Interest

Founded by former prosecutor Kathryn Haun in 2022, Haun Ventures is a venture capital firm with $1.5 billion in assets under management, dedicated to making investments in web3 companies and projects. We are committed to helping builders work towards a web3 ecosystem that future generations will admire. Beyond providing capital to projects, Haun Ventures aims to deliver system change—helping policymakers build effective incentive structures for the web that can increase trust, transparency, privacy, and opportunity.

We have a direct stake in seeing this rule promulgated. A number of our portfolio projects are connected with DAOs, and we have a financial interest in seeing these projects succeed. We believe that a necessary prerequisite is an environment in which responsible actors can participate in good governance over protocols. Such an environment is not possible if tokenholders fear participating in DAOs due to the CFTC's aggressive approach to DAO-participant liability.

Haun Ventures is thus an "interested" party with respect to the proposed rule set out in this Petition. *See* 5 U.S.C. § 553(e).

III. Legal Authority to Promulgate the Rule

Haun Ventures submits this Petition pursuant to the Administrative Procedure Act, which gives any "interested [organization] the right to petition for the issuance . . . of a rule." 5 U.S.C. §§ 551(2), 553(e); *see also* 17 C.F.R. § 13.1. Congress gave the Commission the authority "to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of [the CEA]." 7 U.S.C. § 12a(5). Pursuant to that "broad grant of power," *CFTC v. Schor*, 478 U.S. 833, 843 (1986), the Commission can and should adopt the following proposed rule in accordance with the rulemaking requirements set out in 5 U.S.C. § 553.

IV. Text of the Proposed Rule

The Commission should amend 17 C.F.R. § 1.3 to include the following definition:

> *Decentralized Autonomous Organization ("DAO").* This term refers to an organization—
>
> > (1) the governance of which is primarily determined using software to allow for decision-making via a set of smart contracts; and

[12] *See In re bZeroX, LLC*, slip op. at 10 ("Once an Ooki Token holder votes his or her Ooki Tokens to affect the outcome of an Ooki DAO governance vote, that person has voluntarily participated in the group formed to promote the common objective of governing the Ooki Protocol and is thus a member of the Ooki DAO unincorporated association.").

(2) that is not economically or operationally controlled by any single person, entity, or group of persons or entities under common control.

For the purposes of this definition—

> The term "smart contract" means self-executing code, script, or programming language that executes defined rules when deployed to a digital ledger or database which is chronological, consensus-based, decentralized, and cryptographically-verified in nature.

The Commission should also propose for notice and comment, and then promulgate, the following rule that clarifies the scope of DAO-participant liability:

17 C.F.R. § __ Liability for a Decentralized Autonomous Organization's Violations

(a) ***Purpose.*** DAOs represent a novel structure for the development and governance of, and oversight over, new technologies. Although a DAO's participants are not entirely immune from liability should the DAO violate any of the provisions of the Commodity Exchange Act or any of the rules or regulations in this chapter, it is the intent of the Commission to limit individual liability to those who actively engage in or facilitate such violations.

(b) ***DAOs As "Persons."*** A DAO is considered a "person" as defined in § 1a(38) of the Commodity Exchange Act if it amounts to an association of individuals who have combined for a common cause.

(c) ***Limitations of Liability for DAO Participants.*** No person will be held liable or otherwise responsible for a DAO's violations of the Commodity Exchange Act or any of the rules or regulations in this chapter unless the person has—

> (1) Willfully caused the DAO to commit such violation;
>
> (2) Willfully aided, abetted, counseled, commanded, induced, or procured the commission of such violation; or
>
> (3) Acted in combination or concert with another person for the purpose of having the DAO commit such violation.

(d) ***Illustrations.*** The following are representative examples of persons who would not be held liable or otherwise responsible for a DAO's violations. These examples are illustrative only and are not meant to be exhaustive.

> (1) A person owns governance tokens in a DAO but never uses those tokens to vote on any governance proposal. The person is not liable for the DAO's violations by virtue of owning the governance tokens.
>
> (2) A person owns governance tokens in a DAO and uses them to vote only once on a name-change proposal. Later, it is discovered that the DAO violates one of the Commission's regulations. The person is not liable based on her vote in a matter unrelated to the illegal activity.

(3) A person owns governance tokens in a DAO and actively votes those tokens on all proposals. He later ceases all voting activity and sells all of his governance tokens. At the time of sale, the DAO has done nothing unlawful, but the Commission subsequently passes a regulation that renders the DAO not in compliance with the law. The person is not liable based on his prior voting activity.

(4) A person owns governance tokens in a DAO and actively votes those tokens on all proposals. A third party submits a proposal that would have the DAO engage in activity that violates the Commodity Exchange Act. The person votes her tokens against the third party's proposal, but it ultimately passes. The person is not liable based on her vote against the unlawful activity. (Nor would she be liable if she had abstained from voting.)

(5) A person owns governance tokens in a DAO and delegates his right to vote on all proposals to a third party. The person takes no action to aid, abet, counsel, command, induce, or procure the commission of a violation by the third party to violate the Commodity Exchange Act. The third party votes the delegated tokens in favor of a proposal that would result in a violation of the Commodity Exchange Act. The person is not liable based on his delegation of tokens to the third party.

V. Reasons to Promulgate the Rule

Haun Ventures believes that the proposed rule would be in the public interest, first because it would provide clear notice to the participants of a DAO concerning when their actions might expose them to potential liability, and second because the legal position relied upon in the Commission's recent order presents both legal and pragmatic issues. The Commission should accordingly promulgate the proposed rule to restore public confidence that the CFTC will work with interested parties to develop a regulatory regime that is suitably tailored for critical emerging technologies.

A. The Commission's Approach is Unlawful

The proposed rule is preferable to the Commission's current approach because the current approach goes beyond the text of the CEA. As Commissioner Mersinger explained, "[t]here is no provision in the CEA that holds members of a for-profit unincorporated association personally liable for violations of the CEA or CFTC rules committed by the association based solely on their status as members of that association." *Dissenting Statement*, *supra*. And the Commission's role is not to expand liability by administrative fiat; that job belongs to Congress. *See Cent. Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 176–77 (1994) (determining the scope of liability based on statutory text); *Pinter v. Dahl*, 486 U.S. 622, 653 (1988) (same).

Congress has authorized liability for CEA violations in just five circumstances, which are sufficiently comprehensive to capture individuals who participate in a DAO and who actively engage in or facilitate unlawful activity. But the CEA does not support imposing penalties against individuals who participate in a DAO and who simply vote their tokens in matters that do not further unlawful activity. The five circumstances are as follows.

First, one "who commits, or who willfully aids, abets, counsels, commands, induces, or procures the commission" of a violation can be held liable. 7 U.S.C. § 13c(a). But a person who votes her tokens on matters unrelated to a DAO's illegal activity (or who votes against that illegal activity) does not herself commit a violation. Nor does she willfully aid or abet a violation in any way. After all, as courts and the Commission have held, "a specific unlawful intent to further the underlying violation is necessary before one can be found liable for aiding and abetting." *Gracey v. J.P. Morgan Chase & Co. (In re Amaranth Nat. Gas Commodities Litig.)*, 730 F.3d 170, 181 (2d Cir. 2013) (quoting *In re Richardson Secs.*, CFTC No. 78-10, 1981 WL 26081, at *5 (Jan. 27, 1981)); *see also, e.g.*, *Damato v. Hermanson*, 153 F.3d 464, 472–73 (7th Cir. 1998). It is "not sufficient" that one is "[m]erely associat[ed]" with the violator. *Richardson*, CFTC No. 78-10, 1981 WL 26081, at *6 (first alteration in original) (quoting *Snyder v. United States*, 448 F.2d 716, 718 (8th Cir. 1971)).

Second, the CEA imposes liability against those "who act[] in combination or concert with" others "in [a] violation" of the Act or the Commission's rules. 7 U.S.C. § 13c(a). That similarly requires a guilty mens rea—specifically, an "agreement of two or more persons in a common plan or enterprise" to commit the violation. *Jeffers v. United States*, 432 U.S. 137, 148 n.14 (1977) (defining "concert"); *see also* Black's Law Dictionary 323 (10th ed. 2014) (defining "combination" as similar to a conspiracy); *Combination*, Wolters Kluwer Bouvier Law Dictionary Desk Edition (2012) ("By combination is understood, in a bad sense, a union of men for the purpose of violating the law."). Such an agreement to violate the law is lacking when a person votes her tokens on matters unrelated to a DAO's illegal activity—or, again, when she votes against such measures.

Third, one "who willfully causes an act to be done or omitted which if directly performed or omitted . . . would be a violation . . . may be held responsible for such violation." 7 U.S.C. § 13c(a). Clearly, the mere act of voting one's tokens on matters unrelated to illegal activity does not "willfully cause[]" that activity; nor does voting against it. *See Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 57 (2007) (requiring a showing of "knowledge" or, in some circumstances, "reckless[ness]," before concluding that one has acted "willfully").

Fourth, a "principal" can be held liable for the acts of its "agent" under the CEA. 7 U.S.C. § 2(a)(1)(B). But under no reasonable construction can a DAO that acts illegally be considered the "agent" of an individual who votes her tokens on matters entirely unrelated to the illegal activity. That would require a (nonsensical) showing that the DAO "act[ed] for" the innocent voter "within the scope of [the DAO's] employment or office" when it violated the law. *Id.*; *see* 17 C.F.R. § 1.2.

Fifth, and finally, one "who, directly or indirectly, controls any person who has violated" the Act or its implementing regulations "may" be held liable if the CFTC "prov[es] that the controlling person [1] did not act in good faith or [2] knowingly induced, directly or indirectly, the act or acts constituting the violation." 7 U.S.C. § 13c(b). To establish "control" for purposes of § 13c(b), "the Commission must show that the defendant 'actually exercised general control over the operation of the entity principally liable' *and* 'possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, even if such power was not exercised.'" *CFTC v. Baragosh*, 278 F.3d 319, 330 (4th Cir. 2002) (quoting *Monieson v. CFTC*, 996 F.2d 852, 859 (7th Cir. 1993)); *see also In re Johns*, CFTC No. 01-22, 2001 WL 951733 at *3 (Aug. 21, 2001). Absent ownership of a majority of a DAO's governance tokens, individual tokenholders are not likely to exercise such control over a DAO. And even then, the Commission would still have to show that the controlling tokenholder lacked good faith or knowingly induced a violation before she could be held liable.

Taking stock: the five circumstances for imposing liability in the CEA reflect a commonsense approach which enables the CFTC to punish those who actively engage in or facilitate illegal activity. These provisions can and should be used to target bad actors who leverage DAOs for unlawful means. *See Dissenting Statement, supra* (noting that "the Commission could have found [the two founders] personally liable for Ooki DAO's violations based on the aiding-and-abetting provisions" contained in 7 U.S.C. § 13c(a)). But in the CFTC's "anxiety to . . . protect[] the public," the agency "must take care not to extend the scope of the statute beyond the point where Congress indicated it would stop." *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 161 (2000) (quotation omitted). The CEA cannot be sensibly construed to permit the punishment of individuals who vote their tokens on matters unrelated to a DAO's illegal activity, or who vote against that activity.

In reaching a contrary conclusion, the CFTC's Order relied exclusively on three cases that applied state partnership law to hold individuals liable for the debts of an unincorporated association. *See In re bZeroX, LLC*, slip op. at 11 (citing *Karl Rove & Co. v. Thornburgh*, 39 F.3d 1273, 1285 (5th Cir. 1994); *Shortlidge v. Gutoski*, 484 A.2d 1083, 1086 (N.H. 1984); *Libby v. Perry*, 311 A.2d 527, 533 (Me. 1973)). None of those cases supports the Commission's sweeping approach to DAO-participant liability.

For one thing, the CEA does not provide that state partnership law should govern liability for statutory violations. As already explained, the CEA's text clearly and comprehensively sets forth who can be held responsible for violations. Those "express" provisions detailing who is legally responsible "impl[y] that there are no *other* circumstances" that would give rise to liability. *Jennings v. Rodriguez*, 138 S. Ct. 830, 844 (2018); *see* Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 107 (2012) ("The expression of one thing implies the exclusion of others[.]").

Yet even taking those state-law cases on their terms, they fail to support the Commission's approach. At common law, courts held members of for-profit unincorporated associations liable for the organization's debts in order "to protect third parties with whom the unincorporated association dealt." *Karl Rove*, 39 F.3d at 1285. There was otherwise no "judicial entity" to sue. *Id.* And because the individual members "contemplated" the potential for "profit and loss" due to their partners' dealings, it was only equitable to hold them jointly and severally liable for debts incurred in the course of the partnership's activities. *Blair v. S. Clay Mfg. Co.*, 121 S.W.2d 570, 572 (Tenn. 1938).

That rationale is fundamentally inapposite to CFTC enforcement actions. In those proceedings, the CFTC "is not simply collecting an unpaid contractual debt." *Dissenting Statement, supra*. It is instead acting to "punish" violations of the CEA, *Commodity Trend Serv., Inc. v. CFTC*, 149 F.3d 679, 688 (7th Cir. 1998), often "imposing sanctions that only the Government can impose," *Dissenting Statement, supra*. There is no sound reason—either in law or in equity—to impose such punishments against innocent DAO participants simply because they have voted their tokens. *Cf. United States v. A & P Trucking Co.*, 358 U.S. 121, 127 (1958) ("[T]he conviction of a partnership cannot be used to punish the individual partners, who might be completely free of personal guilt.").

In sum, the CEA precludes the Commission's aggressive approach to DAO-participant liability. The proposed rule, by contrast, respects and is consistent with the CEA's limitations. The Commission should thus abandon its ill-conceived enforcement approach, grant this Petition for Rulemaking, and promulgate a rule clarifying that DAO participants are not liable unless they actively engage in or facilitate illegal activity.

B. The Commission's Approach Will Produce Adverse Consequences

Beyond the legal difficulties with the Commission's approach, the practical concerns for the web3 community are equally troubling. As of this writing, there are nearly 5,000 DAOs.[13] And those DAOs—as well as the larger economy—benefit immensely from the participation of approximately 700,000 active participants, including both voters and proposal makers.[14] Yet the Commission's approach "affirmatively disincentivizes voting participation in DAO governance generally." *Dissenting Statement*, *supra*. That is because DAO participants must now worry that the simple act of voting their tokens on any governance matter could subject them to future liability should the DAO do something illegal. An analogy to successful collaborative projects of the past may be illustrative as to why that is so troubling: if Wikipedia contributors had been held jointly and severally liable for copyright violations in the early days of the platform, it is unlikely that it would have ever achieved sufficient uptake to become one of the largest repositories of human knowledge in history.

The sword of Damocles that now hangs over a DAO participant who votes her tokens will inevitably "have a chilling effect that discourages voting, thereby hindering good governance and the development of a culture of compliance in this setting." *Id.* Indeed, even if a voter wants to "encourage[] following the law," the risk that her vote won't ultimately carry the day might be reason enough not to vote in the first place. *Id.* And, because of that risk, the CFTC's aggressive approach could paradoxically lead to *more* illegal governance proposals passing.

And this is to say nothing of the detrimental effect it could have on existing protocols. Many protocols governed by DAOs that have already been deployed were built with minimum voting thresholds. To the extent that tokenholders are unable or unwilling to vote, these protocols could be stuck in stasis—unable to change their parameters or, worse, unable to patch vulnerabilities that have been identified, thereby exposing them to attack.

The chilling effect poses significant threats to the stability and future of all DAOs. By its own terms, the Order only explicitly extends liability to voting members of "for-profit" DAOs. *In re bZeroX, LLC*, slip op. at 11. But imposing what amounts to strict liability in those circumstances for the acts of others is itself problematic, and it raises a host of other questions too. For instance, will participants in "non-profit" DAOs similarly be held liable if the organization stumbles into legal trouble? If not, what is the dividing line between a "for-profit" and a "non-profit" DAO? Is it enough that governance tokens can be bought and sold for a profit? Or must a DAO "[seek] to be characterized as a non-profit organization in [a] federal or state registration or tax filing" to avoid subjecting its voting participants to joint and several liability? *Id.* The Commission's approach is painfully opaque and utterly divorced from the text of the CEA, which contains no dividing line based on for-profit status. Then there are the inevitable questions as to which DAO voting participants the CFTC will target. Does it matter if a

[13] *See Organizations*, DeepDAO, https://deepdao.io/organizations (last visited Oct. 26, 2022).

[14] *Id.*

tokenholder voted exclusively on matters unrelated to illegal activity? Is a tokenholder shielded from liability for organizational acts committed after the sale of her tokens, or does she remain a DAO participant by virtue of having voted in the past? What if a DAO participant votes against illegal activity but her vote does not ultimately tip the scales—is she too liable?

All these questions underscore the need for the CFTC to articulate clear, prospective rules that participants may abide by—and to do so quickly to mitigate the risk of crippling the responsible development of web3's architecture. The proposed rule meets these ends, offering a clear, sensible, and lawful approach to DAO-participant liability.

Should the Commission refuse to engage in rulemaking here, the negative effects would extend well beyond DAOs. Indeed, the CFTC's enforcement action "is the latest example of why an 'enforcement only' approach to web3 is bad for the rule of law, bad for the US economy, and bad for national security."[15]

Consider, first, the rule of law. The American people are "entitled to rely on the law as written." *Bostock v. Clayton County*, 140 S. Ct. 1731, 1749 (2020). And yet, until the CFTC issued its order, the web3 community had no notice—from any written law—that the simple act of voting their tokens could expose them to significant personal liability. *See Dissenting Statement*, *supra*. The problem does not stop with the CFTC's enforcement action against Ooki DAO. Those from all corners of the community now have reason to fear that similar, notice-less enforcement actions will be the CFTC's preferred approach for dealing with novel digital-asset-related issues moving forward. Such an oblique and aggressive enforcement strategy dissuades people from joining or participating in projects. To alleviate these concerns, it would be helpful for the Commission to fortify its commitment to engaging with the private sector[16] and to provide certainty about what the rules are with respect to the new universe of technologies embodied in web3.

In addition, if the CFTC "adopt[s] an enforcement-only approach as opposed to an enlightened partnership" with the web3 community, that will "push[] th[e] next generation of developers to go off-shore." Lehane & Tilleman, *supra* note 15. That, too, is a major problem. But this rulemaking would provide the government with an opportunity to stave off those consequences. By engaging in a collaborative rulemaking effort with interested parties to create a fair, sensible regulatory framework—one that punishes wrongdoing while fostering and incentivizing responsible development—the CFTC will show that it is willing to consider these novel and complex issues from every angle. That will help the country keep pace with technological developments so that the U.S. is positioned to attract the economic drivers of the future and not have them leave the country.

An enforcement-only approach—and its concomitant chilling effects on the web3 community—will risk the country's national security too. *Id.* This much is clear: the infrastructure of the internet is going to change. And that change "is going to take place amidst the global fight between democracies and autocracies." *Id.* As a result, the United States needs to

[15] Chris Lehane & Tomicah Tillemann, *CFTC, DAOs, and Why Regulation by Enforcement is Bad for the U.S.*, Haun Ventures (Sep. 28, 2022), https://mirror.xyz/haunventures.eth/o9BLyEU-88SljwYLVYOy1BUrLH_-1iXnC2P87X8fAto. The CFTC is not alone. In a similar haste to punish those who abuse blockchain technology, the Office of Foreign Assets Control ("**OFAC**") broadly sanctioned "Tornado Cash," a virtual currency mixer that relies on open-source code to protect financial privacy in Ethereum transactions. In doing so, however, OFAC appears to have overstepped its statutory authority—and it may have violated innocent Americans' constitutional rights along the way. *See* Katie Haun & James Rathmell, *OFAC Cannot Shut Down Open-Source Software*, Haun Ventures (Oct. 18, 2022), https://mirror.xyz/haunventures.eth/ITTj2t5XoTYLH-3bRrlVtg1joGSN89-wddRYbCkekPM.

[16] *See, e.g.*, Press Release, CFTC, *Chairman Benham Announces Technology and Customer Outreach Organization* (July 26, 2022), *available at* https://www.cftc.gov/PressRoom/PressReleases/8563-22; Press Release, CFTC, *CFTC Launches LabCFTC as Major Fintech Initiative* (May 17, 2017), *available at* https://www.cftc.gov/PressRoom/PressReleases/7558-17.

foster a regulatory environment that does not hamstring developers who are looking to build web3 responsibly. If the United States does not lead in supporting the developers for this next generation of the internet, it is going to cede its ability to shape what the future of the internet looks like.

In short, Haun Ventures respects the Commission's aims in seeking to crack down on any who seek to abuse technology for unlawful ends. But the CFTC also needs to consider the costs before adopting an overly aggressive stance that both chills lawful DAO participation and subjects innocent voters to liability. Rulemaking provides a prime opportunity to fully consider the complex issues at hand and "promote responsible innovation" in this novel policy arena. 7 U.S.C. § 5(b).

C. Rulemaking Will Benefit the Commission and Interested Parties

Beyond the issue of DAO-participant liability, Haun Ventures submits that the Commission ought to prioritize proactive rulemaking as the primary means for adapting its regime to emerging technologies of all stripes, including those underpinning web3.

Rulemaking "fosters logical and thorough consideration of policy," as well as administrative legitimacy. Lisa Schultz Bressman, *Beyond Accountability: Arbitrariness and Legitimacy in the Administrative State*, 78 N.Y.U. L. Rev. 460, 542, 546 (2003). Utilizing rulemaking procedures "opens up the process of agency policy innovation to a broad range of criticism, advice and data that is ordinarily less likely to be forthcoming in adjudication." *Nat'l Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 683 (D.C. Cir. 1973). And "the legislative form of rules may allow for a better-crafted decision, with exceptions when appropriate." Jack M. Beermann, *Inside Administrative Law* 179 (2011). The Commission's Ooki DAO Order, by contrast, shows why adjudication may not work effectively as a means for adapting old laws to new technologies. Without the benefit of public input, the Commission has articulated an unduly broad and sweeping approach to DAO-participant liability that we believe to be contrary to law, uncertain in scope, and unwise. Rulemaking would give the Commission the opportunity to hear from all interested parties before doubling down on this course.

Proceeding by rulemaking also has the advantage of "promot[ing] fairness values." Keith Werhan, *Principles of Administrative Law* 196 (3d ed. 2019). Unlike the Commission's ad hoc, regulation-by-enforcement approach, rulemaking "provid[es] advance notification to affected individuals" of their legal rights and obligations. *Id.* This is particularly important for those in the web3 community who operate at the bleeding-edge of technology and are seeking to responsibly "advance new ideas that will serve the common good." Lehane & Tillemann, *supra* note 15. By and large, those individuals "want to follow the law and will do so." *Id.* But those laws need to be established upfront through transparent, democratic processes—lest the government stifle innovation in decentralized governance and unfairly punish those trying to lawfully build the next generation of the internet.

VI. Conclusion

DAOs represent a unique opportunity to leverage the underlying technology of web3 to open the field for a new organizational form that provides better, more democratized participation in technology development and innovation. Yet the Commission's approach to DAO-participant liability unduly, unfairly, and unlawfully chills this innovation in governance. As with almost any technology, web3 platforms can be harnessed for good and bad—and we need clear rules of the road to help promote the growth of the good and suppress the bad. The proposed rule serves both of those worthy ends. It comports with the CEA's text and purposes, enables the CFTC to target bad actors, and ensures that innocent actors are not arbitrarily swept up and held liable for a DAO's illegal activity. The Commission should therefore initiate a notice-and-comment rulemaking process and promulgate the proposed rule set forth in this Petition.

Sincerely,

James Rathmell
General Counsel, Haun Ventures

cc: Steven A. Engel, Dechert LLP

MANAGED FUNDS ASSOCIATION

The Voice of the Global Alternative Investment Industry

WASHINGTON, DC | NEW YORK

LEG 5/36

October 22, 2015

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Petition for Rulemaking to Amend Certain CFTC Regulations in Parts 1 (General Regulations under the Commodity Exchange Act), 37 (Swap Execution Facilities), 38 (Designated Contract Markets), 39 (Derivatives Clearing Organizations, Subpart B – Compliance with Core Principles) and 43 (Real-Time Public Reporting)

Dear Mr. Kirkpatrick:

Managed Funds Association[1] ("**MFA**") respectfully petitions the Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") under Commission regulation 13.2 to amend certain provisions in Parts 1, 37, 38, 39 and 43 of the Commission's regulations.

For the reasons set forth below, we request that the Commission amend certain provisions of its regulations related to swap trading rules on registered swap execution facilities ("**SEFs**") and designated contract markets ("**DCMs**"). Our proposed amendments would: (1) codify existing CFTC staff guidance around the implementation of the Commission's impartial access requirements; (2) codify existing CFTC staff guidance around the implementation of the Commission's straight-through processing ("**STP**") requirements; (3) clearly prohibit post-trade name disclosure by SEFs for swaps that are executed anonymously; (4) facilitate SEF/DCM execution of package transactions by requiring the package transaction as a whole to become "made available to trade" ("**MAT**") in order to be subject to the CFTC's trade execution requirement; (5) provide a mandatory public comment period for every MAT determination submission by a SEF/DCM under Part 40 of the Commission's regulations; (6) establish a clear process for determining when a swap product is no longer available to trade on a SEF/DCM; (7) codify existing CFTC staff guidance and no-action relief around rejection of swaps from clearing

[1] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

and resubmission for operational and clerical errors; (8) clarify the order interaction requirements between different SEF trading protocols; and (9) modify the definition of "block trade" in Part 43 of the Commission's regulations to authorize on-SEF execution of a block trade as a "permitted transaction" as defined in section 37.9(c) in order to facilitate pre-execution credit checks of block trades that are intended to be cleared.

The information required by Commission regulation 13.2 follows. In describing certain amendments, we refer you to Appendix A to this letter for the proposed textual changes that are marked against the final rule text.

Nature of Petitioner's Interest

MFA has over 3,000 members from firms engaging in many alternative investment strategies all over the world. MFA's members are among the most sophisticated institutional investors and play an important role in our financial system. They are active participants in the commodity and securities markets, including over-the-counter ("**OTC**") derivatives markets. MFA supported the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[2] In particular, MFA has consistently supported the Dodd-Frank Act's Title VII reforms to the OTC derivatives markets that decrease systemic risk, increase transparency, and promote an open, competitive, and level playing field. We welcomed the market's transition to central clearing for liquid, standardized swaps that occurred over the course of 2013, and actively engaged in the market's evolution of trading liquid, standardized, cleared swaps on SEFs and DCMs that commenced in early 2014. Nearly two years after the launch of the SEF marketplace, MFA is concerned that the swaps market remains bifurcated between "dealer-to-dealer" SEFs that exclude most buy-side firms and "dealer-to-customer" SEFs. MFA is also concerned with the SEF trading challenges posed by certain types of package transactions that are expected to continue after the existing CFTC staff no-action relief expires.

We are proposing rule amendments to certain provisions in Parts 1, 37, 38, 39 and 43 of the Commission's regulations to offer suggested rule fixes based on MFA members' SEF trading experiences to date and the "lessons learned" through the implementation process.

Proposed Rule Amendments with Supporting Arguments

1. Codify Existing CFTC Staff Guidance: Impartial Access

- Revise § 37.202(c) (*Limitations on access*) by adding new clauses (2) and (3) as set forth in Appendix A, at page 12.

[2] Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010), available at: http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm.

Explanation and Supporting Arguments for the Proposed Amendments

MFA's proposed amendments to section 37.202(c) would codify existing staff guidance to prohibit the use of enablement mechanisms and breakage agreements for swaps that are intended to be cleared on SEFs.[3] A SEF that requires or permits such arrangements imposes barriers to the buy-side's access to that SEF and contravenes the Commission's impartial access requirements. In addition, our proposed amendments prohibit a SEF from limiting access to certain types of eligible contract participants in a discriminatory manner. Such access limitations could be based on the manner in which certain types of eligible contract participants typically interact in the market, anticipated levels of trading activity, or entity registration status. These and other status-based access criteria also act as artificial barriers to the buy-side's access to SEFs.

2. Codify Existing CFTC Staff Guidance: STP

- Revise § 1.73 (*Clearing futures commission merchant risk management*) to read as set forth in Appendix A, at page 31.
- Revise § 1.74 (*Futures commission merchant acceptance for clearing*) to read as set forth in Appendix A, at pages 31 and 32.
- Revise § 39.12(b)(7) (*Time frame for clearing*) to read as set forth in Appendix A, at page 35.

Explanation and Supporting Arguments for the Proposed Amendments

MFA's proposed amendments to section 1.73 would codify existing CFTC staff guidance that any order that is screened in accordance with paragraph (a)(2)(i) or (ii) and falls within the pre-execution risk-based limits of the clearing futures commission merchant ("**FCM**") would be deemed accepted for clearing by the FCM and thereby subject to a guarantee by such FCM upon execution. In addition, our proposed amendments would clarify that a clearing FCM may not reject a screened trade for clearing that falls within the clearing FCM's pre-execution risk-based limits.

Consistent with current CFTC staff guidance, MFA's proposed amendments to section 1.74 would establish an outer boundary of 60 seconds after submission of a trade to the clearing FCM for acceptance for clearing. Our proposed amendments would retain the current timing standard of "as quickly as technologically practicable if fully automated systems were used" ("**ASATP**") to require timing reductions for clearing acceptance from the 60-second outer boundary that continuing improvements in technology will enable.

[3] *See* "Division of Clearing and Risk, Division of Market Oversight and Division of Swap Dealer and Intermediary Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities", issued Nov. 14, 2013.

Consistent with current CFTC staff guidance, MFA's proposed amendments to section 39.12(b)(7) would establish an outer boundary of 10 seconds after submission of any trade for clearing to a DCO (whether or not the trade is executed on or subject to the rules of a SEF or DCM) for the DCO to accept or reject a trade for clearing. Our proposed amendments would retain the ASATP standard to require timing reductions for clearing acceptance from the 10-second outer boundary that continuing technology improvements will enable.

3. Clearly Prohibit Post-Trade Name Give-up

- Add new paragraph (b) in § 37.7 (*Prohibited use of data collected for regulatory purposes*):

  (b) A swap execution facility shall not, and shall ensure any third-party service provider it uses does not, disclose to either party to a transaction the identity of its counterparty if the transaction was originally executed anonymously. A swap execution facility shall not condition access to its market(s) or market services on a person's consent to the use of any service provided by any third party if use of that service could result in the disclosure of the identity of any counterparty to a transaction that was executed anonymously.

Explanation and Supporting Arguments for the Proposed Amendments

MFA strongly believes that the legacy practice of post-trade name disclosure or "name give-up" on any SEF that offers anonymous execution of swap transactions contravenes the intent of both: (1) the impartial access mandate under Title VII of the Dodd-Frank Act by deterring participation of eligible buy-side firms on such SEFs, and (2) the Commission's important revision to Section 49.17(f)(2) of its final rules on "Swap Data Repositories: Registration Standards, Duties and Core Principles".[4] As explained in MFA's position paper on name give-up, this practice has no legitimate business justification in cleared swaps markets.[5] Prior justifications concerning the need to assess counterparty creditworthiness and credit-related risk management are no longer relevant, as central clearing with STP eliminates bilateral counterparty credit risk. Given that inter-dealer broker ("**IDB**") SEFs offer anonymous trade

[4] CFTC Final Rule on "Swap Data Repositories: Registration Standards, Duties and Core Principles", 76 Fed. Reg. 54538 (Sept. 1, 2011); amended by CFTC Interim Final Rule on "Swap Data Repositories - Access to SDR Data by Market Participants", 79 Fed. Reg. 16672 (March 26, 2014) (providing that the data and information maintained by the registered swap data repository ("**SDR**") that may be accessed by either counterparty to a particular swap shall not include the identity or the legal entity identifier of the other counterparty to the swap, or the other counterparty's clearing member for the swap, if the swap is executed anonymously on a swap execution facility or designated contract market, and cleared in accordance with CFTC regulations).

[5] *See* "MFA Position Paper: Why Eliminating Post-Trade Name Disclosure will Improve the Swaps Market", issued on March 31, 2015, available at: https://www.managedfunds.org/wp-content/uploads/2015/04/MFA-Position-Paper-on-Post-Trade-Name-Disclosure-Final.pdf.

execution, MFA strongly believes that such cleared swaps should remain anonymous throughout the trade cycle for all participants on such SEFs.

If left to market dynamics to resolve the name give-up issue without regulation to prohibit the practice, MFA fears that other market participants will exert influence on IDB SEFs to resist attempts to dismantle it. In our view, the unintended consequence will be that U.S. swaps markets will maintain a fragmented, two-tier structure. This structure largely confines buy-side firms to trading via the request for quote ("**RFQ**") trading protocol on the dominant dealer-to-customer SEFs. This outcome falls short of effectively implementing the impartial access mandate for SEFs and the Dodd-Frank Act goals of improving transparency, efficiency and competition in swaps trading.

4. More Clearly Address Package Transactions in MAT Determination Process

- Revise § 37.9 (*Methods of execution for required and permitted transactions*) to read as set forth in Appendix A, at pages 7 and 8.
- Revise § 37.10 (*Process for a swap execution facility to make a swap available to trade*) to read as set forth in Appendix A, at pages 8 and 9.
- Revise § 37.12 (*Trade execution compliance schedule*) to read as set forth in Appendix A, at page 9.
- Revise § 38.11 (*Trade execution compliance schedule*) to read as set forth in Appendix A, at page 28.
- Revise § 38.12 (*Process for a designated contract market to make a swap available to trade*) to read as set forth in Appendix A, at page 29.

Explanation and Supporting Arguments for the Proposed Amendments

MFA's proposed amendments to section 37.9 would revise the definition of a "required transaction" to include "any transaction involving a stand-alone swap or any package transaction that is subject to the trade execution requirement in section 2(h)(8) of the [Commodity Exchange] Act". Our revised definition would also define a "package transaction" as follows:

> Package transaction means a transaction involving two or more instruments: (1) that is executed between two or more counterparties; (2) that is priced or quoted as one economic transaction with simultaneous or near simultaneous execution of all components; (3) where the execution of each component is contingent upon the execution of all other components; and (4) where the risk of the offsetting components is reasonably equivalent.

A transaction meeting this definition would not be deemed a required transaction unless the package transaction as a whole has become subject to the Commission's trade execution requirement in section 2(h)(8) of the Commodity Exchange Act, as amended ("**CEA**"). If the package transaction as a whole has not become subject to the Commission's trade execution requirement, it would be a "permitted transaction" and thus would not be restricted to the order book or RFQ methods of execution.

In an earlier comment letter submitted prior to implementation of the final SEF rules, MFA recommended to the Commission that it should expand the definition of "permitted transaction" to also include package transactions and other transactions that may not be suitable for SEF execution.[6] However, based on the implementation experiences of MFA members, we believe the fundamental issue for CFTC rule fine-tuning is a transaction-level determination of liquidity of the whole package transaction under the Commission's MAT factors in section 37.10. This approach would avoid the need for CFTC staff to resort to issuing serial no-action relief as the industry continues to work on the remaining execution challenges and infrastructure solutions for many types of package transactions.

Through MFA's proposed amendments to section 37.10, we propose to require SEFs to make MAT determinations separately for a given swap when executed on a stand-alone basis and for different types of package transactions that include such a swap. This differs from the current process, under which a MAT determination has implications not just for the execution of a given swap on a stand-alone basis, but also for all package transactions that include such a swap. Both the liquidity profile and the ability of market infrastructure to facilitate trading of swaps executed on an outright or stand-alone basis versus as part of a package transaction can vary widely. Therefore, our changes to section 37.10 would require SEFs to apply the CFTC's MAT determinations criteria separately at the package level to avoid execution challenges and the need for extended or permanent staff no-action relief from the trade execution requirement for certain types of package transactions. We also propose to make conforming changes to section 37.12 to account for any package transaction as a whole that may become subject to the Commission's trade execution requirement in section 2(h)(8) of the CEA.

5. Provide Public Comment Period for MAT Determinations

- Revise § 37.10(a)(1) (*Required submission*) to read as set forth in Appendix A, at pages 8 and 9.
- Revise § 38.12(a)(1) (*Required submission*) to read as set forth in Appendix A, at pages 29 and 30.

[6] *See* MFA's comments on the Commission's Notice of Proposed Rulemaking on "Core Principles and Other Requirements for Swap Execution Facilities", 76 Fed. Reg. 1214 (Jan. 7, 2011), available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31242.

Explanation and Supporting Arguments for the Proposed Amendments

MFA's proposed amendments would require a public comment period with respect to each MAT determination submission by a SEF or DCM. We believe a mandatory public comment period would provide market participants with a critical opportunity to inform the Commission as to a swap product's suitability and the industry's technological and operational readiness to move the product from the OTC market to a SEF or DCM platform. Public comments would also lend needed objectivity to the SEF/DCM-initiated MAT determination process. In this regard, a mandatory public comment period would serve as an important "check and balance" mechanism on every SEF/DCM submission, providing a broader range of perspectives for the Commission's consideration in deciding whether to approve or disapprove a SEF/DCM submission. We also suggest that our proposed amendments would enable the Commission to perform a more meaningful oversight role, thereby moving the Commission's current process a step closer in comparability to the proposed processes of other regulators.

6. Establish a Process for de-MAT Determinations

- Revise § 37.10(d)(1) (*Removal*) to read as set forth in Appendix A, at page 9.
- Revise § 38.12(d)(1) (*Removal*) to read as set forth in Appendix A, at pages 29 and 30.

Explanation and Supporting Arguments for the Proposed Amendments

MFA's proposed amendments would establish a clear process for determining when a stand-alone swap or package transaction is no longer available to trade on a SEF or DCM (a "**de-MAT determination**"), based on the Commission's current six MAT factors.[7] We believe the Commission should administer this process by retaining its authority to make such a determination on an annual basis by undertaking a targeted review of a subset of available-to-trade swaps. We suggest that this subset could comprise the bottom 10% of the least actively traded available-to-trade swap products based on trading data. The Commission's targeted annual assessment of any available-to-trade swap in this subset would enable the Commission to determine whether such swap continues to be "made available to trade" based on a consideration of the six MAT factors. It would also introduce some comparability with the annual reassessment of the liquidity of a class of derivatives (or a sub-class thereof) by the European Securities and Markets Authority ("**ESMA**") for purposes of the transparency requirements for derivatives under the EU's Markets in Financial Instruments Directive and related Regulation ("**MiFID II/MiFIR**").[8] In addition to the Commission's annual assessment, we propose that the

[7] *See* CFTC Regulations § 37.10(b) (SEFs) and § 38.12(b) (DCMs) for the six MAT factors.

[8] *See* ESMA's Final Report on Draft Regulatory and Implementing Technical Standards under MiFID II/MiFIR published on 28 September 2015, at section 2.2, para. 21.

Commission should assess the available-to-trade status of a swap if the Commission receives notice of de-listing submissions from at least two SEFs or DCMs for that swap.[9] Consistent with our request for MAT determinations, our proposed amendments would also require a public comment period to further inform the Commission's consideration of any de-MAT determination.

As we explained in our prior comment letter, we believe that a separate de-MAT determination process would serve as an important check-and-balance mechanism, rather than a process that relies exclusively on determinations of SEFs/DCMs.[10] If none of the six MAT factors support a determination that a stand-alone swap or a package transaction is made available to trade, as confirmed objectively by the Commission's broader view of market trading data for the product in question, the Commission should issue a public de-MAT determination order that will suspend the trade execution requirement for that product. That suspension would apply universally to all SEFs and DCMs.

7. Codify Existing CFTC Staff Guidance and No-Action Relief: Rejection from Clearing and Resubmission

- Add new § 37.13 (*Re-execution of trades due to operational and clerical error*) to read as set forth in Appendix A, at pages 9 through 11.
- Add new paragraph (e) to § 37.200 (*Core Principle 2 Compliance with rules*), to read as set forth in Appendix A, at pages 11 and 12.
- Conforming change in § 37.203 (*Rule enforcement program*), to read as set forth in Appendix A, at page 13.
- Revise § 38.150 (*Core Principle 2*) to read as set forth in Appendix A, at page 30.
- Revise § 39.12(b)(7) (*Time frame for clearing*) to read as set forth in Appendix A, at page 35.

Explanation and Supporting Arguments for the Proposed Amendments

MFA's proposed amendments would codify, with clarifying modifications, existing CFTC staff no-action letter 15-24 ("**NAL 15-24**") to authorize pre-arranged transactions in the following circumstances set forth in the first condition of this relief: "(1) the correction of an operational or clerical error or omission made by a SEF, DCM, one of the counterparties, or an agent of one of the counterparties that causes a trade to be rejected and void *ab initio,* or (2) for the purpose of

[9] Under CFTC Regulation § 40.6(a), the Commission would receive notice that a SEF or DCM has de-listed a swap through a submission, submitted in compliance with §§ 40.6(a)(1) and (2) and 40.6(a)(7).

[10] *See* MFA's comments on the Commission's Further Notice of Proposed Rulemaking on "Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade", 76 Fed. Reg. 77728 (Dec. 14, 2011), at p. 4, available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=56968.

offsetting swaps carried on a DCO's books where a clerical or operational error or omission made by the SEF, DCM, counterparty, or an agent of the counterparty is not identified until after the trade has been cleared. In the latter situation, a new transaction that corrects the errors in the original transaction also is subject to this relief." [11] Our proposed amendments would define a "new correcting trade" in either scenario as "a new pre-arranged trade executed on or subject to the rules of a SEF with terms and conditions that match the terms and conditions of an erroneous trade, other than any operational or clerical error and the time of execution, that is executed as a result of an erroneous trade". In Appendix A, we have annotated our other proposed amendments for your reference to reflect other conditions in NAL 15-24. MFA's proposed amendments would also further codify the consequence of an intended-to-be-cleared swap being rejected from clearing (*i.e.*, void *ab initio*), which MFA strongly supports.[12]

We note that ESMA included both void *ab initio* and a resubmission procedure in its recently published regulatory technical standards under the EU's MiFID II/MiFIR. As a result, codifying these points would further facilitate harmonization between SEFs/DCMs and MiFID II trading venues.

8. Clarify RFQ and Order Interaction

- Revise § 37.9(a)(3)(i) (*Request for quote system*) as set forth in Appendix A, at page 7.

Explanation and Supporting Arguments for the Proposed Amendments

MFA's proposed amendments to section 37.9(a)(3)(i) involve the Commission's requirement that firm bids and offers must be taken into account and communicated to an RFQ requester along with the RFQ responses. These amendments would further clarify that any firm bid or offer that is communicated to an RFQ requester in this situation must be provided in an executable form so that the RFQ requester can easily access such price if so desired. In addition, as SEFs continue to make innovations in trading protocols, it is important that the order interaction requirement not be construed so narrowly as to render it inapplicable for these new trading protocols. As a result, these amendments would clarify that a SEF must communicate to an RFQ requester any firm bid or offer pertaining to the same instrument resting on any of the SEF's markets, trading systems or platforms. We believe these amendments promote pre-trade price transparency by ensuring the RFQ requester has the ability to view and access competitive firm quotes anywhere on the SEF.

[11] *See* CFTC No-Action Letter 15-24, "No-Action Relief for Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market", issued April 22, 2015, at p. 5.

[12] *See* CFTC "Staff Guidance on Swaps Straight-Through Processing", issued Sept. 26, 2013.

9. Codify Existing CFTC Staff No-Action Relief: Eliminate "Occurs Away" Requirement for Authorized On-SEF Execution of Block Trades

- Revise § 43.2 (*Definitions Block trade*) to read as set forth in Appendix A, at page 36.

Explanation and Supporting Arguments for the Proposed Amendments

MFA's proposed amendments would codify, with modification, existing CFTC staff no-action letter 14-118 by eliminating the "occurs away" requirement for block trades.[13] More specifically, our proposed amendments would expressly authorize on-SEF execution of any block trade as a permitted transaction. By doing so, a block trade can be executed by RFQ to 1 or by voice to facilitate the requisite pre-execution credit checks of block trades that are intended to be cleared.

MFA respectfully petitions the Commission to amend Parts 1, 37, 38, 39 and 43 as described above. Please do not hesitate to contact the undersigned or Laura Harper Powell at (202) 730-2600 with any questions the Commission or its staff might have regarding this petition.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President, Managing Director &
General Counsel

cc: The Hon. Timothy G. Massad, Chairman
The Hon. Sharon Y. Bowen, Commissioner
The Hon. J. Christopher Giancarlo, Commissioner

[13] *See* CFTC No-Action Letter 14-118, "No-Action Relief for Swap Execution Facilities from Certain 'Block Trade' Requirements in Commission Regulation 43.2", issued September 19, 2014.

Appendix A

SEF Rules

§ 37.1 Scope.
The provisions of this part shall apply to every swap execution facility that is registered or is applying to become registered as a swap execution facility under section 5h of the Commodity Exchange Act ("the Act"); provided, however, nothing in this provision affects the eligibility of swap execution facilities to operate under the provisions of parts 38 or 49 of this chapter.

§ 37.2 Applicable provisions.
A swap execution facility shall comply with the requirements of this part and all other applicable Commission regulations, including § 1.60 and part 9 of this chapter, and including any related definitions and cross-referenced sections.

§ 37.3 Requirements and procedures for registration.
(a) Requirements for registration.
(1) Any person operating a facility that offers a trading system or platform in which more than one market participant has the ability to execute or trade swaps with more than one other market participant on the system or platform shall register the facility as a swap execution facility under this part or as a designated contract market under part 38 of this chapter.
(2) Minimum trading functionality. A swap execution facility shall, at a minimum, offer an Order Book as defined in paragraph (a)(3) of this section.
(3) Order book means:
(i) An electronic trading facility, as that term is defined in section 1a(16) of the Act;
(ii) A trading facility, as that term is defined in section 1a(51) of the Act; or
(iii) A trading system or platform in which all market participants in the trading system or platform have the ability to enter multiple bids and offers, observe or receive bids and offers entered by other market participants, and transact on such bids and offers.
(b) Procedures for full registration.
(1) An applicant requesting registration as a swap execution facility shall:
(i) File electronically a complete Form SEF as set forth in appendix A to this part, or any successor forms, and all information and documentation described in such forms with the Secretary of the Commission in the form and manner specified by the Commission;
(ii) Provide to the Commission, upon the Commission's request, any additional information and documentation necessary to review an application; and
(iii) Request from the Commission a unique, extensible, alphanumeric code for the purpose of identifying the swap execution facility pursuant to part 45 of this chapter.
(2) Request for confidential treatment.
(i) An applicant requesting registration as a swap execution facility shall identify with particularity any information in the application that will be subject to a request for confidential treatment pursuant to § 145.9 of this chapter.
(ii) Section 40.8 of this chapter sets forth those sections of the application that will be made publicly available, notwithstanding a request for confidential treatment pursuant to § 145.9 of this chapter.
(3) Amendment of application prior or subsequent to full registration. An applicant amending a pending application for registration as a swap execution facility or requesting an amendment to an order of registration shall file an amended application electronically with the Secretary of the Commission in the manner specified by the Commission. A swap execution facility shall file any amendment to an application subsequent to registration as a submission under part 40 of this chapter or as specified by the Commission.
(4) Effect of incomplete application. If an application is incomplete pursuant to paragraph (b)(1) of this section, the Commission shall notify the

applicant that its application will not be deemed to have been submitted for purposes of the Commission's review.

(5) Commission review period. For an applicant who submits its application for registration as a swap execution facility on or after August 5, 2015 the Commission shall review such application pursuant to the 180–day timeframe and procedures specified in section 6(a) of the Act.

(6) Commission determination.

(i) The Commission shall issue an order granting registration upon a Commission determination, in its own discretion, that the applicant has demonstrated compliance with the Act and the Commission's regulations applicable to swap execution facilities. If deemed appropriate, the Commission may issue an order granting registration subject to conditions.

(ii) The Commission may issue an order denying registration upon a Commission determination, in its own discretion, that the applicant has not demonstrated compliance with the Act and the Commission's regulations applicable to swap execution facilities.

(c) Temporary registration. An applicant seeking registration as a swap execution facility may request that the Commission grant the applicant temporary registration by complying with the requirements in paragraph (c)(1) of this section.

(1) Requirements for temporary registration. The Commission shall grant a request for temporary registration upon a Commission determination that the applicant has:

(i) Completed all of the requirements under paragraph (b)(1)(i) of this section; and

(ii) Submitted a notice to the Commission, concurrent with the filing of the application under paragraph (b)(1)(i) of this section, requesting that the Commission grant the applicant temporary registration. An applicant that is currently operating a swaps-trading platform in reliance upon either an exemption granted by the Commission or some form of no-action relief granted by the Commission staff shall include in such notice a certification that the applicant is operating pursuant to such exemption or no-action relief.

(iii) The Commission may deny a request for temporary registration upon a Commission determination that the applicant has not met the requirements under paragraphs (c)(1)(i) and (c)(1)(ii) of this section.

(2) Operation pursuant to a grant of temporary registration. An applicant may operate as a swap execution facility under temporary registration upon receipt of a notice from the Commission granting such temporary registration, but in no case may begin operating as a temporarily registered swap execution facility before August 5, 2013.

(3) Expiration of temporary registration. The temporary registration for a swap execution facility shall expire on the earlier of the date that:

(i) The Commission grants or denies registration of the swap execution facility as provided under paragraph (b) of this section;

(ii) The swap execution facility withdraws its application for registration pursuant to paragraph (f) of this section; or

(iii) Temporary registration terminates pursuant to paragraph (c)(5) of this section.

(4) Effect of temporary registration. A grant of temporary registration by the Commission does not affect the right of the Commission to grant or deny registration as provided under paragraph (b) of this section.

(5) Termination of temporary registration. Paragraph (c) of this section shall terminate two years from the effective date of this regulation except as provided for under paragraph (c)(6) of this section and except for an applicant who requested that the Commission grant the applicant temporary registration by complying with the requirements in paragraph (c)(1) of this section before the termination of

paragraph (c) of this section and has not been granted or denied registration under paragraph (b)(6) of this section by the time of the termination of paragraph (c) of this section. Such an applicant may operate as a swap execution facility under temporary registration upon receipt of a notice from the Commission granting such temporary registration until the Commission grants or denies registration pursuant to paragraph (b)(6) of this section. On the termination date of paragraph (c) of this section, the Commission shall review such applicant's application pursuant to the time period and procedures in paragraph (b)(5) of this section.

(6) Temporary registration for applicants that are operational designated contract markets. An applicant that is an operational designated contract market and is also seeking to register as a swap execution facility in order to transfer one or more of its contracts may request that the Commission grant the applicant temporary registration by complying with the requirements in paragraph (c)(1) of this section. The termination of temporary registration provision in paragraph (c)(5) of this section shall not apply to an applicant that is a non-dormant designated contract market as described in this paragraph.

(d) Reinstatement of dormant registration. A dormant swap execution facility as defined in section 40.1 of this chapter may reinstate its registration under the procedures of paragraph (b) of this section. The applicant may rely upon previously submitted materials if such materials accurately describe the dormant swap execution facility's conditions at the time that it applies for reinstatement of its registration.

(e) Request for transfer of registration.

(1) A swap execution facility seeking to transfer its registration from its current legal entity to a new legal entity as a result of a corporate change shall file a request for approval to transfer such registration with the Secretary of the Commission in the form and manner specified by the Commission.

(2) Timeline for filing a request for transfer of registration. A request for transfer of registration shall be filed no later than three months prior to the anticipated corporate change; or in the event that the swap execution facility could not have known of the anticipated change three months prior to the anticipated change, as soon as it knows of such change.

(3) Required information. The request for transfer of registration shall include the following:

(i) The underlying agreement that governs the corporate change;

(ii) A description of the corporate change, including the reason for the change and its impact on the swap execution facility, including its governance and operations, and its impact on the rights and obligations of market participants;

(iii) A discussion of the transferee's ability to comply with the Act, including the core principles applicable to swap execution facilities, and the Commission's regulations thereunder;

(iv) The governing documents of the transferee, including, but not limited to, articles of incorporation and bylaws;

(v) The transferee's rules marked to show changes from the current rules of the swap execution facility;

(vi) A representation by the transferee that it:

(A) Will be the surviving entity and successor-in-interest to the transferor swap execution facility and will retain and assume, without limitation, all of the assets and liabilities of the transferor;

(B) Will assume responsibility for complying with all applicable provisions of the Act and the Commission's regulations promulgated thereunder, including this part and appendices thereto;

(C) Will assume, maintain, and enforce all rules implementing and complying with the core principles applicable to swap execution facilities, including the adoption of the transferor's rulebook, as amended in the request, and that any such amendments will be submitted to the Commission pursuant to section 5c(c) of the Act and part 40 of this chapter;

(D) Will comply with all self-regulatory responsibilities except if otherwise indicated in the request, and will maintain and enforce all self-regulatory programs; and

(E) Will notify market participants of all changes to the transferor's rulebook prior to the transfer and will further notify market participants of the concurrent transfer of the registration to the transferee upon Commission approval and issuance of an order permitting this transfer.

(vii) A representation by the transferee that upon the transfer:

(A) It will assume responsibility for and maintain compliance with core principles for all swaps previously made available for trading through the transferor, whether by certification or approval; and

(B) None of the proposed rule changes will affect the rights and obligations of any market participant.

(4) Commission determination. Upon review of a request for transfer of registration, the Commission, as soon as practicable, shall issue an order either approving or denying the request.

(f) Request for withdrawal of application for registration. An applicant for registration as a swap execution facility may withdraw its application submitted pursuant to paragraph (b) of this section by filing a withdrawal request electronically with the Secretary of the Commission. Withdrawal of an application for registration shall not affect any action taken or to be taken by the Commission based upon actions, activities, or events occurring during the time that the application was pending with the Commission.

(g) Request for vacation of registration. A swap execution facility may request that its registration be vacated under section 7 of the Act by filing a vacation request electronically with the Secretary of the Commission. Vacation of registration shall not affect any action taken or to be taken by the Commission based upon actions, activities, or events occurring during the time that the swap execution facility was registered by the Commission.

(h) Delegation of authority. The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, upon consultation with the General Counsel or the General Counsel's delegate, authority to notify an applicant seeking registration that its application is incomplete and that it will not be deemed to have been submitted for purposes of the Commission's review, to notify an applicant seeking registration under section 6(a) of the Act that its application is materially incomplete and the running of the 180–day period is stayed, and to notify an applicant seeking temporary registration that its request is granted or denied. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

§ 37.4 Procedures for listing products and implementing rules.

(a) An applicant for registration as a swap execution facility may submit a swap's terms and conditions prior to listing the product as part of its application for registration.

(b) Any swap terms and conditions or rules submitted as part of a swap execution facility's application for registration shall be considered for approval by the Commission at the time the Commission issues the swap execution facility's order of registration.

Appendix A

(c) After the Commission issues the order of registration, a swap execution facility shall submit a swap's terms and conditions, including amendments to such terms and conditions, new rules, or rule amendments pursuant to the procedures under part 40 of this chapter.

(d) Any swap terms and conditions or rules submitted as part of an application to reinstate the registration of a dormant swap execution facility, as defined in § 40.1 of this chapter, shall be considered for approval by the Commission at the time the Commission approves the dormant swap execution facility's reinstatement of registration.

§ 37.5 Information relating to swap execution facility compliance.

(a) Request for information. Upon the Commission's request, a swap execution facility shall file with the Commission information related to its business as a swap execution facility in the form and manner and within the time period as the Commission specifies in its request.

(b) Demonstration of compliance. Upon the Commission's request, a swap execution facility shall file with the Commission a written demonstration, containing supporting data, information, and documents that it is in compliance with one or more core principles or with its other obligations under the Act or the Commission's regulations as the Commission specifies in its request. The swap execution facility shall file such written demonstration in the form and manner and within the time period as the Commission specifies in its request.

(c) Equity interest transfer—

(1) Equity interest transfer notification. A swap execution facility shall file with the Commission a notification of each transaction that the swap execution facility enters into involving the transfer of fifty percent or more of the equity interest in the swap execution facility. The Commission may, upon receiving such notification, request supporting documentation of the transaction.

(2) Timing of notification. The equity interest transfer notice described in paragraph (c)(1) of this section shall be filed electronically with the Secretary of the Commission at its Washington, DC headquarters at submissions@cftc.gov and the Division of Market Oversight at DMOSubmissions@cftc.gov, at the earliest possible time but in no event later than the open of business ten business days following the date upon which the swap execution facility enters into a firm obligation to transfer the equity interest.

(3) Rule filing. Notwithstanding the foregoing, if any aspect of an equity interest transfer described in paragraph (c)(1) of this section requires a swap execution facility to file a rule as defined in part 40 of this chapter, then the swap execution facility shall comply with the requirements of section 5c(c) of the Act and part 40 of this chapter, and all other applicable Commission regulations.

(4) Certification. Upon a transfer of an equity interest of fifty percent or more in a swap execution facility, the swap execution facility shall file electronically with the Secretary of the Commission at its Washington, DC headquarters at submissions@cftc.gov and the Division of Market Oversight at DMOSubmissions@cftc.gov, a certification that the swap execution facility meets all of the requirements of section 5h of the Act and the Commission regulations adopted thereunder, no later than two business days following the date on which the equity interest of fifty percent or more was acquired.

(d) Delegation of authority. The Commission hereby delegates, until it orders otherwise, the authority set forth in this section to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

§ 37.6 Enforceability.

(a) A transaction entered into on or pursuant to the rules of a swap execution facility shall not be void, voidable, subject to rescission, otherwise invalidated, or rendered unenforceable as a result of:

(1) A violation by the swap execution facility of the provisions of section 5h of the Act or this part;

(2) Any Commission proceeding to alter or supplement a rule, term, or condition under section 8a(7) of the Act or to declare an emergency under section 8a(9) of the Act; or

(3) Any other proceeding the effect of which is to:

(i) Alter or supplement a specific term or condition or trading rule or procedure; or

(ii) Require a swap execution facility to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

(b) A swap execution facility shall provide each counterparty to a transaction that is entered into on or pursuant to the rules of the swap execution facility with a written record of all of the terms of the transaction which shall legally supersede any previous agreement and serve as a confirmation of the transaction. The confirmation of all terms of the transaction shall take place at the same time as execution; provided that specific customer identifiers for accounts included in bunched orders involving swaps need not be included in confirmations provided by a swap execution facility if the applicable requirements of § 1.35(b)(5) of this chapter are met.

§ 37.7 Prohibited use of data collected for regulatory purposes.

(a) A swap execution facility shall not use for business or marketing purposes any proprietary data or personal information it collects or receives, from or on behalf of any person, for the purpose of fulfilling its regulatory obligations; provided, however, that a swap execution facility may use such data or information for business or marketing purposes if the person from whom it collects or receives such data or information clearly consents to the swap execution facility's use of such data or information in such manner. A swap execution facility shall not condition access to its market(s) or market services on a person's consent to the swap execution facility's use of proprietary data or personal information for business or marketing purposes. A swap execution facility, where necessary for regulatory purposes, may share such data or information with one or more swap execution facilities or designated contract markets registered with the Commission.

(b) A swap execution facility shall not, and shall ensure any third-party service provider it uses does not, disclose to either party to a transaction the identity of its counterparty if the transaction was originally executed anonymously. A swap execution facility shall not condition access to its market(s) or market services on a person's consent to the use of any service provided by any third party if use of that service could result in the disclosure of the identity of any counterparty to a transaction that was originally executed anonymously.

§ 37.8 Boards of trade operating both a designated contract market and a swap execution facility.

(a) An entity that intends to operate both a designated contract market and a swap execution facility shall separately register the two entities pursuant to the designated contract market designation procedures set forth in part 38 of this chapter and the swap execution facility registration procedures set forth in this part. On an ongoing basis, the entity shall comply with the core principles for designated contract markets under section 5(d) of the Act and the regulations under part 38 of this chapter and the core principles for swap execution facilities under section 5h of the Act and the regulations under this part.

(b) A board of trade, as defined in section 1a(6) of the Act, that operates both a designated contract market and a swap execution facility and that uses the same electronic trade execution system for executing and trading swaps on the designated contract market and on the swap execution facility shall clearly identify to market participants for each swap whether the execution or trading of such swaps is taking place on the designated contract market or on the swap execution facility.

§ 37.9 Methods of execution for required and permitted transactions.

(a) Execution methods for required transactions.

(1) (i) Required transaction means any transaction involving a ~~swap~~stand-alone swap or any package transaction that is subject to the trade execution requirement in section 2(h)(8) of the Act. A package transaction shall not be deemed a required transaction unless the package transaction as a whole has become subject to the trade execution requirement in section 2(h)(8) of the Act. (ii) Package transaction means a transaction involving two or more instruments: (1) that is executed between two or more counterparties; (2) that is priced or quoted as one economic transaction with simultaneous or near simultaneous execution of all components; (3) where the execution of each component is contingent upon the execution of all other components; and (4) where the risk of the offsetting components is reasonably equivalent.

(2) Execution methods.

(i) Each ~~Required Transaction~~required transaction that is ~~not~~neither a block trade as defined in § 43.2 of this chapter nor a correcting trade executed in accordance with § 37.13 of this chapter shall be executed on a swap execution facility in accordance with one of the following methods of execution:

(A) An Order Book as defined in § 37.3(a)(3); or

(B) A Request for Quote System, as defined in paragraph (a)(3) of this section, that operates in conjunction with an Order Book as defined in § 37.3(a)(3).

(ii) In providing either one of the execution methods set forth in paragraph (a)(2)(i)(A) or (B) of this section, a swap execution facility may for purposes of execution and communication use any means of interstate commerce, including, but not limited to, the mail, internet, email, and telephone, provided that the chosen execution method satisfies the requirements provided in § 37.3(a)(3) for Order Books or in paragraph (a)(3) of this section for Request for Quote Systems.

(3) Request for quote system means a trading system or platform in which a market participant transmits a request for a quote to buy or sell a specific instrument to no less than three market participants in the trading system or platform, to which all such market participants may respond. The three market participants shall not be affiliates of or controlled by the requester and shall not be affiliates of or controlled by each other. A swap execution facility that offers a request for quote system in connection with ~~Required Transactions~~required transactions shall provide the following functionality:

(i) At the same time that the requester receives the first responsive bid or offer, the swap execution facility shall communicate to the requester any firm bid or offer pertaining to the same instrument resting on ~~any of~~ the swap execution facility~~'s~~, whether such firm bid or offer is in an Order Book~~s~~, as defined in § 37.3(a)(3)~~;~~, or on the swap execution facility's markets, trading systems or platforms, in an executable form;

(ii) The swap execution facility shall provide the requester with the ability to execute against such firm resting bids or offers along with any responsive orders; and

(iii) The swap execution facility shall ensure that its trading protocols provide each of its market participants with equal priority in receiving requests for quotes and in transmitting and displaying for execution responsive orders.

(b) Time delay requirement for required transactions on an order book—

(1) Time delay requirement. A swap execution facility shall require that a broker or dealer who seeks to either execute against its customer's order or execute two of its customers' orders against each other through the swap execution facility's Order Book, following some form of pre-arrangement or pre-negotiation of such orders, be subject to at least a 15 second time delay between the entry of those two orders into the Order Book, such that one side of the potential transaction is disclosed and made available to other market participants before the second side of the potential transaction, whether for the broker's or dealer's own account or for a second customer, is submitted for execution.

(2) Adjustment of time delay requirement. A swap execution facility may adjust the time period of the 15 second time delay requirement described in paragraph (b)(1) of this section, based upon a swap's liquidity or other product-specific considerations; however, the time delay shall be set for a sufficient period of time so that an order is exposed to the market and other market participants have a meaningful opportunity to execute against such order.

(c) Execution methods for permitted transactions.

(1) Permitted transaction means any transaction not involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the Act.

(2) Execution methods. A swap execution facility may offer any method of execution for each ~~Permitted Transaction.~~permitted transaction.

§ 37.10 Process for a swap execution facility to make a swap available to trade.

(a)(1) Required submission. A swap execution facility that makes a ~~swap~~stand-alone swap or a package transaction available to trade in accordance with paragraph (b) of this section, shall submit to the Commission its determination with respect to such ~~swap~~stand-alone swap or package transaction as a rule, as that term is defined by § 40.1 of this chapter, pursuant to the procedures under part 40 of this chapter.

(i) Public Comment. The Commission shall provide a public comment period after each submission by a swap execution facility pursuant to this paragraph. The Commission shall publish a notice of the public comment period on the Commission Web site. Comments from the public shall be submitted as specified in that notice.

(2) Listing requirement. A swap execution facility that makes a ~~swap~~stand-alone swap or a package transaction available to trade must demonstrate that it lists or offers that ~~swap~~stand-alone swap or package transaction for trading on its trading system or platform.

(b) Factors to consider. To make a stand-alone swap or a package transaction available to trade, for purposes of section 2(h)(8) of the Act, a swap execution facility shall consider, as appropriate, the following factors with respect to such ~~swap:~~stand-alone swap or package transaction:

(1) Whether there are ready and willing buyers and sellers;

(2) The frequency or size of transactions;

(3) The trading volume;

(4) The number and types of market participants;

(5) The bid/ask spread; or

(6) The usual number of resting firm or indicative bids and offers.

(c) Applicability. Upon a determination that a stand-alone swap or a package transaction is available to trade on any swap execution facility or designated contract market pursuant to part 40 of this chapter, all other swap execution facilities and designated contract markets shall comply with the ~~requirements of~~Commission's regulations promulgated pursuant to section 2(h)(8)(A) of the Act in listing or offering such swap for trading.

(d) Removal—

(1) Determination. The Commission may issue an order to suspend the trade execution requirement in section 2(h)(8) of the Act for any stand-alone swap or package transaction that is ~~issue a determination that a swap is~~ no longer available to trade ~~upon determining that no~~ if none of the factors described in paragraph (b) of this section support a determination that the transaction is made available to trade. ~~swap execution facility or designated contract market lists such swap for trading.~~ The Commission's determination shall be based on either:

(i) Its annual review and assessment of each stand-alone swap or package transaction that has been made available to trade on any swap execution facility or designated contract market pursuant to part 40 of this chapter and that is among the lowest ten percent of the least actively traded on any swap execution facility or designated contract market; or

(ii) Its review and assessment upon notice of de-listing submissions from at least two swap execution facilities or designated contract markets pursuant to § 40.6 of this chapter.

(2) Public Comment. The Commission shall provide a public comment period for each determination that a stand-alone swap or a package transaction is no longer available to trade. The Commission shall publish a notice of the public comment period on the Commission Web site. Comments from the public shall be submitted as specified in that notice.

(3~~2~~) Delegation of Authority.

(i) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, the authority to issue a determination that a stand-alone swap or a package transaction is no longer available to trade.

(ii) The Director may submit to the Commission for its consideration any matter that has been delegated in this section. Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

§ 37.11 [Reserved].

§ 37.12 Trade execution compliance schedule.

(a) A ~~swap~~transaction involving a stand-alone swap or a package transaction shall be subject to the requirements of section 2(h)(8) of the Act upon the later of:

(1) The applicable deadline established under the compliance schedule provided under § 50.25(b) of this chapter; or

(2) Thirty days after the available-to-trade determination submission or certification for that ~~swap~~stand-alone swap or package transaction is, respectively, deemed approved under § 40.5 of this chapter or deemed certified under § 40.6 of this chapter.

(b) Nothing in this section shall prohibit any counterparty from complying voluntarily with the requirements of section 2(h)(8) of the Act sooner than as provided in paragraph (a) of this section.

§ 37.13 Re-execution of trades due to operational and clerical errors.

(a) *Definitions.* (1) *Accepted erroneous trade* means any trade executed on or subject to the rules of a swap execution facility that was accepted for clearing by a derivatives clearing organization that contains an operational or clerical error or omission made by the swap execution facility, the derivatives clearing organization, a counterparty to the trade or an agent of such counterparty.

(2) *Correcting trade* means any new correcting trade and any offsetting correcting trade.

(3) *Erroneous trade* means any accepted erroneous trade and any rejected erroneous trade.

(4) *New correcting trade* means a new pre-arranged trade executed on or subject to the rules of the swap execution facility with terms and conditions that match the terms and conditions of an erroneous trade, other than any operational or clerical error or omission and the time of execution, that is executed as a result of an erroneous trade.

(5) *Offsetting correcting trade* means a new pre-arranged trade executed on or subject to the rules of the swap execution facility that offsets an accepted erroneous trade carried on a derivatives clearing organization's books and records.

(6) *Rejected erroneous trade* means any trade executed on or subject to the rules of a swap execution facility that was rejected from clearing by a derivatives clearing organization as a result of an operational or clerical error or omission made by the swap execution facility, the derivatives clearing organization, a counterparty to the trade or an agent of such counterparty.

(b) *Execution methods for erroneous trades*. (1) Notwithstanding the requirements of §§ 37.9(a)(2) and 37.203 of this chapter:

(A) in the case of any rejected erroneous trade, a swap execution facility may permit the market participants that entered into such rejected erroneous trade to enter into a new correcting trade provided that such new correcting trade is submitted for clearing as quickly as technologically practicable after delivery of notice of the rejection by the derivatives clearing organization to such market participants, but, in any event, no later than one hour from the delivery of such notice [Condition 3]; and

(B) in the case of any accepted erroneous trade, the swap execution facility may, no later than three business days after the accepted erroneous trade was executed, permit the market participants that entered into such accepted erroneous trade to execute and submit for clearing [Condition 3]:

(i) an offsetting correcting trade; and

(ii) a new correcting trade.

(2) (A) If the swap execution facility is able to determine how to correct the operational or clerical error or omission in an erroneous trade, the swap execution facility will execute a new correcting trade (and, in the case of an accepted erroneous trade, an offsetting correcting trade) without obtaining consent from the market participants that entered into the erroneous trade. [Condition 4.]

(B) If the swap execution facility is unable to determine how to correct the operational or clerical error or omission in the erroneous trade, it shall seek guidance from the market participants that entered into the erroneous trade on how to address such operational or clerical error or omission; *provided, however*, that any such guidance may not be implemented without the consent of both such market participants. [Condition 4.]

(c) *Limitation on re-execution.* A correcting trade that is rejected from clearing by a derivatives clearing organization may not be re-executed in accordance with paragraph (b)(1) of this section and will be void *ab initio* with no liability incurred between the parties to such trade in respect of such trade. [Condition 5.]

(d) *Additional requirements for re-execution.* A swap execution facility may only permit the re-execution of an erroneous trade in accordance with paragraph (b)(1) of this section to the extent that such swap execution facility:

(1) has error trade rules consistent with this Part 37 that account for whether any cancellation or price adjustment will adversely impact market integrity, facilitate market manipulation or other illegitimate activity in contravention of one or more core principles or the swap execution facility's other obligations under the Act, the Commission's regulations or the

swap execution facility's rules [Condition 2];

(2) has rules (i) setting forth the conditions under which it will determine that an operational or clerical error or omission has occurred and the procedures it will follow to execute, or allow the execution of, a new correcting trade or offsetting correcting trade in accordance with this § 37.13, including addressing the relevant requirements of paragraph (b)(1) of this section; and

(ii) providing what the swap execution facility will do if it is unable to determine how to correct the operational or clerical error or omission in the erroneous trade, including addressing the relevant requirements of paragraph (b)(1) of this section [Condition 4]; and

(3) in making its determination whether to permit execution of a new correcting trade or offsetting correcting trade in accordance with paragraph (b)(1) of this § 37.13, makes an affirmative finding that the trade or some term therein resulted from an operational or clerical error or omission made by the swap execution facility, the derivatives clearing organization, a counterparty to the trade or an agent of such counterparty [Condition 6].

Subpart B—Compliance With Core Principles

§ 37.100 Core Principle 1—Compliance with core principles.

(a) In general. To be registered, and maintain registration, as a swap execution facility, the swap execution facility shall comply with—

(1) The core principles described in section 5h of the Act; and

(2) Any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5) of the Act.

(b) Reasonable discretion of a swap execution facility. Unless otherwise determined by the Commission by rule or regulation, a swap execution facility described in paragraph (a) of this section shall have reasonable discretion in establishing the manner in which the swap execution facility complies with the core principles described in section 5h of the Act.

Subpart C—Compliance With Rules

§ 37.200 Core Principle 2—Compliance with rules.

A swap execution facility shall:

(a) Establish and enforce compliance with any rule of the swap execution facility, including the terms and conditions of the swaps traded or processed on or through the swap execution facility and any limitation on access to the swap execution facility;

(b) Establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means to provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred;

(c) Establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades; ~~and~~

(d) Provide by its rules that when a swap dealer or major swap participant enters into or facilitates a swap that is subject to the mandatory clearing requirement of section 2(h) of the Act, the swap dealer or major swap participant shall be responsible for compliance with the mandatory trading requirement under section 2(h)(8) of the Act~~.~~; and

(e) Provide by its rules that any trade that is executed on or subject to the rules of the swap execution facility that is intended to be submitted to a derivatives clearing organization for clearing contemporaneously with execution that is rejected from clearing by such derivatives clearing organization is void *ab initio* with no liability incurred between the parties to such trade in respect of such trade.

§ 37.201 Operation of swap execution facility and compliance with rules.

(a) A swap execution facility shall establish rules governing the operation of the swap execution facility, including, but not limited to, rules specifying trading procedures to be followed by members and market participants when entering and executing orders traded or posted on the swap execution facility, including block trades, as defined in part 43 of this chapter, if offered.

(b) A swap execution facility shall establish and impartially enforce compliance with the rules of the swap execution facility, including, but not limited to—

(1) The terms and conditions of any swaps traded or processed on or through the swap execution facility;

(2) Access to the swap execution facility;

(3) Trade practice rules;

(4) Audit trail requirements;

(5) Disciplinary rules; and

(6) Mandatory trading requirements.

§ 37.202 Access requirements.

(a) Impartial access to markets and market services. A swap execution facility shall provide any eligible contract participant and any independent software vendor with impartial access to its market(s) and market services, including any indicative quote screens or any similar pricing data displays, provided that the facility has:

(1) Criteria governing such access that are impartial, transparent, and applied in a fair and nondiscriminatory manner;

(2) Procedures whereby eligible contract participants provide the swap execution facility with written or electronic confirmation of their status as eligible contract participants, as defined by the Act and Commission regulations, prior to obtaining access; and

(3) Comparable fee structures for eligible contract participants and independent software vendors receiving comparable access to, or services from, the swap execution facility.

(b) Jurisdiction. Prior to granting any eligible contract participant access to its facilities, a swap execution facility shall require that the eligible contract participant consent to its jurisdiction.

(c) Limitations on access. (1) A swap execution facility shall establish and impartially enforce rules governing any decision to allow, deny, suspend, or permanently bar eligible contract participants' access to the swap execution facility, including when such decisions are made as part of a disciplinary or emergency action taken by the swap execution facility.

(2) A swap execution facility shall not impose or require, nor shall it permit any eligible contract participant to impose or require, as a condition to accessing or transacting on the swap execution facility: (i) any mechanism, scheme, functionality, counterparty credit filter, or other arrangement related to swaps that are intended to be submitted to a derivatives clearing organization for clearing contemporaneously with execution that prevents eligible contract participants from interacting or trading with, or viewing the bids and offers (firm or indicative) displayed by any other eligible contract participant on that swap execution facility; or (ii) any agreement governing an eligible contract participant's obligations or liabilities in respect of any trade executed on or subject to the rules of a swap execution facility that is intended to be submitted to a derivatives clearing organization for clearing contemporaneously with execution and that is not accepted for clearing by such derivatives clearing organization.

(3) A swap execution facility shall not limit access to, or the ability to transact on, the swap execution facility to certain types of eligible contract participants in a discriminatory manner based on, for example, the manner in which they typically interact with the market, anticipated levels of trading activity or entity registration status.

§ 37.203 Rule enforcement program.

Appendix A

A swap execution facility shall establish and enforce trading, trade processing, and participation rules that will deter abuses and it shall have the capacity to detect, investigate, and enforce those rules.

(a) Abusive trading practices prohibited. A swap execution facility shall prohibit abusive trading practices on its markets by members and market participants. Swap execution facilities that permit intermediation shall prohibit customer-related abuses including, but not limited to, trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading. Specific trading practices that shall be prohibited include front-running, wash trading, pre-arranged trading (except for block trades permitted by part 43 of this chapter, correcting trades permitted by this part 37, or other types of transactions certified to or approved by the Commission pursuant to the procedures under part 40 of this chapter), fraudulent trading, money passes, and any other trading practices that a swap execution facility deems to be abusive. A swap execution facility shall also prohibit any other manipulative or disruptive trading practices prohibited by the Act or by the Commission pursuant to Commission regulation.

(b) Capacity to detect and investigate rule violations. A swap execution facility shall have arrangements and resources for effective enforcement of its rules. Such arrangements shall include the authority to collect information and documents on both a routine and non-routine basis, including the authority to examine books and records kept by the swap execution facility's members and by persons under investigation. A swap execution facility's arrangements and resources shall also facilitate the direct supervision of the market and the analysis of data collected to determine whether a rule violation has occurred.

(c) Compliance staff and resources. A swap execution facility shall establish and maintain sufficient compliance staff and resources to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. The swap execution facility's compliance staff shall also be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner, as set forth in § 37.203(f).

(d) Automated trade surveillance system. A swap execution facility shall maintain an automated trade surveillance system capable of detecting potential trade practice violations. The automated trade surveillance system shall load and process daily orders and trades no later than 24 hours after the completion of the trading day. The automated trade surveillance system shall have the capability to detect and flag specific trade execution patterns and trade anomalies; compute, retain, and compare trading statistics; compute trade gains, losses, and swap-equivalent positions; reconstruct the sequence of market activity; perform market analyses; and support system users to perform in-depth analyses and ad hoc queries of trade-related data.

(e) Real-time market monitoring. A swap execution facility shall conduct real-time market monitoring of all trading activity on its system(s) or platform(s) to identify disorderly trading and any market or system anomalies. A swap execution facility shall have the authority to adjust trade prices or cancel trades when necessary to mitigate market disrupting events caused by malfunctions in its system(s) or platform(s) or errors in orders submitted by members and market participants. Any trade price adjustments or trade cancellations shall be transparent to the market and subject to standards that are clear, fair, and publicly available.

(f) Investigations and investigation reports—

(1) Procedures. A swap execution facility shall establish and maintain procedures that require its compliance staff to conduct investigations of possible rule violations. An investigation shall be commenced upon the receipt of a request from Commission staff or upon the discovery or receipt of information by the swap execution facility that indicates a reasonable basis for finding that a violation may have occurred or will occur.

(2) Timeliness. Each compliance staff investigation shall be completed in a timely manner. Absent mitigating factors, a timely manner is no later than 12 months after the date that an investigation is opened. Mitigating factors that may reasonably justify an investigation taking longer than 12 months to complete include the complexity of the investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined and analyzed by compliance staff.

(3) Investigation reports when a reasonable basis exists for finding a violation. Compliance staff shall submit a written investigation report for disciplinary action in every instance in which compliance staff determines from surveillance or from an investigation that a reasonable basis exists for finding a rule violation. The investigation report shall include the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; compliance staff's analysis and conclusions; and a recommendation as to whether disciplinary action should be pursued.

(4) Investigation reports when no reasonable basis exists for finding a violation. If after conducting an investigation, compliance staff determines that no reasonable basis exists for finding a rule violation, it shall prepare a written report including the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; and compliance staff's analysis and conclusions.

(5) Warning letters. No more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling twelve month period.

(g) Additional sources for compliance. A swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.203.

§ 37.204 Regulatory services provided by a third party.

(a) Use of regulatory service provider permitted. A swap execution facility may choose to contract with a registered futures association or another registered entity, as such terms are defined under the Act, or the Financial Industry Regulatory Authority (collectively, "regulatory service providers"), for the provision of services to assist in complying with the Act and Commission regulations thereunder, as approved by the Commission. Any swap execution facility that chooses to contract with a regulatory service provider shall ensure that such provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and automated surveillance systems. A swap execution facility shall at all times remain responsible for the performance of any regulatory services received, for compliance with the swap execution facility's obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf.

(b) Duty to supervise regulatory service provider. A swap execution facility that elects to use the service of a regulatory service provider shall retain sufficient compliance staff to supervise the quality and effectiveness of the regulatory services provided on its behalf. Compliance staff of the swap execution facility shall hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern. A swap execution facility shall also conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf. Such reviews shall be documented carefully and made available to the Commission upon request.

(c) Regulatory decisions required from the swap execution facility. A swap execution facility that elects to use the service of a regulatory service provider shall retain exclusive authority in all substantive decisions made by its regulatory service provider, including, but not limited to, decisions involving the cancellation of trades, the issuance of disciplinary charges against members or market participants, and denials of access to the trading platform for disciplinary reasons. A swap execution facility shall document any instances where its actions differ from those recommended by its regulatory service provider, including the reasons for the course of action recommended by the regulatory service provider and the reasons why the swap execution facility chose a different course of action.

§ 37.205 Audit trail.

A swap execution facility shall establish procedures to capture and retain information that may be used in establishing whether rule violations have occurred.

(a) Audit trail required. A swap execution facility shall capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses. Such data shall be sufficient to reconstruct all indications of interest, requests for quotes, orders, and trades within a reasonable period of time and to provide evidence of any violations of the rules of the swap execution facility. An acceptable audit trail shall also permit the swap execution facility to track a customer order from the time of receipt through fill, allocation, or other disposition, and shall include both order and trade data.

(b) Elements of an acceptable audit trail program—

(1) Original source documents. A swap execution facility's audit trail shall include original source documents. Original source documents include unalterable, sequentially-identified records on which trade execution information is originally recorded, whether recorded manually or electronically. Records for customer orders (whether filled, unfilled, or cancelled, each of which shall be retained or electronically captured) shall reflect the terms of the order, an account identifier that relates back to the account(s) owner(s), the time of order entry, and the time of trade execution. Swap execution facilities shall require that all orders, indications of interest, and requests for quotes be immediately captured in the audit trail.

(2) Transaction history database. A swap execution facility's audit trail program shall include an electronic transaction history database. An adequate transaction history database includes a history of all indications of interest, requests for quotes, orders, and trades entered into a swap execution facility's trading system or platform, including all order modifications and cancellations. An adequate transaction history database also includes:

(i) All data that are input into the trade entry or matching system for the transaction to match and clear;

(ii) The customer type indicator code;

(iii) Timing and sequencing data adequate to reconstruct trading; and

(iv) Identification of each account to which fills are allocated.

(3) Electronic analysis capability. A swap execution facility's audit trail program shall include electronic analysis capability with respect to all audit trail data in the transaction history database. Such electronic analysis capability shall ensure that the swap execution

facility has the ability to reconstruct indications of interest, requests for quotes, orders, and trades, and identify possible trading violations with respect to both customer and market abuse.

(4) Safe storage capability. A swap execution facility's audit trail program shall include the capability to safely store all audit trail data retained in its transaction history database. Such safe storage capability shall include the capability to store all data in the database in a manner that protects it from unauthorized alteration, as well as from accidental erasure or other loss. Data shall be retained in accordance with the recordkeeping requirements of Core Principle 10 for swap execution facilities and the associated regulations in subpart K of this part.

(c) Enforcement of audit trail requirements—

(1) Annual audit trail and recordkeeping reviews. A swap execution facility shall enforce its audit trail and recordkeeping requirements through at least annual reviews of all members and persons and firms subject to the swap execution facility's recordkeeping rules to verify their compliance with the swap execution facility's audit trail and recordkeeping requirements. Such reviews shall include, but are not limited to, reviews of randomly selected samples of front-end audit trail data for order routing systems; a review of the process by which user identifications are assigned and user identification records are maintained; a review of usage patterns associated with user identifications to monitor for violations of user identification rules; and reviews of account numbers and customer type indicator codes in trade records to test for accuracy and improper use.

(2) Enforcement program required. A swap execution facility shall establish a program for effective enforcement of its audit trail and recordkeeping requirements. An effective program shall identify members and persons and firms subject to the swap execution facility's recordkeeping rules that have failed to maintain high levels of compliance with such requirements, and impose meaningful sanctions when deficiencies are found. Sanctions shall be sufficient to deter recidivist behavior. No more than one warning letter shall be issued to the same person or entity found to have committed the same violation of audit trail or recordkeeping requirements within a rolling twelve month period.

§ 37.206 Disciplinary procedures and sanctions.

A swap execution facility shall establish trading, trade processing, and participation rules that will deter abuses and have the capacity to enforce such rules through prompt and effective disciplinary action, including suspension or expulsion of members or market participants that violate the rules of the swap execution facility.

(a) Enforcement staff. A swap execution facility shall establish and maintain sufficient enforcement staff and resources to effectively and promptly prosecute possible rule violations within the disciplinary jurisdiction of the swap execution facility.

(b) Disciplinary panels. A swap execution facility shall establish one or more disciplinary panels that are authorized to fulfill their obligations under the rules of this subpart. Disciplinary panels shall meet the composition requirements of part 40 of this chapter, and shall not include any members of the swap execution facility's compliance staff or any person involved in adjudicating any other stage of the same proceeding.

(c) Hearings. A swap execution facility shall adopt rules that provide for the following minimum requirements for any hearing:

(1) The hearing shall be fair, shall be conducted before members of the disciplinary panel, and shall be promptly convened after reasonable notice to the respondent; and

(2) If the respondent has requested a hearing, a copy of the hearing shall be made and shall become a part of the record of the proceeding. The record shall not be required to be transcribed unless:
(i) The transcript is requested by Commission staff or the respondent;
(ii) The decision is appealed pursuant to the rules of the swap execution facility; or
(iii) The decision is reviewed by the Commission pursuant to section 8c of the Act or part 9 of this chapter. In all other instances, a summary record of a hearing is permitted.
(d) Decisions. Promptly following a hearing conducted in accordance with the rules of the swap execution facility, the disciplinary panel shall render a written decision based upon the weight of the evidence contained in the record of the proceeding and shall provide a copy to the respondent. The decision shall include:
(1) The notice of charges or a summary of the charges;
(2) The answer, if any, or a summary of the answer;
(3) A summary of the evidence produced at the hearing or, where appropriate, incorporation by reference of the investigation report;
(4) A statement of findings and conclusions with respect to each charge, and a complete explanation of the evidentiary and other basis for such findings and conclusions with respect to each charge;
(5) An indication of each specific rule that the respondent was found to have violated; and
(6) A declaration of all sanctions imposed against the respondent, including the basis for such sanctions and the effective date of such sanctions.
(e) Disciplinary sanctions. All disciplinary sanctions imposed by a swap execution facility or its disciplinary panels shall be commensurate with the violations committed and shall be clearly sufficient to deter recidivism or similar violations by other market participants. All disciplinary sanctions, including sanctions imposed pursuant to an accepted settlement offer, shall take into account the respondent's disciplinary history. In the event of demonstrated customer harm, any disciplinary sanction shall also include full customer restitution, except where the amount of restitution or to whom it should be provided cannot be reasonably determined.
(f) Warning letters. Where a rule violation is found to have occurred, no more than one warning letter may be issued per rolling twelve month period for the same violation.
(g) Additional sources for compliance. A swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.206.

Subpart D—Swaps Not Readily Susceptible to Manipulation

§ 37.300 Core Principle 3—Swaps not readily susceptible to manipulation.

The swap execution facility shall permit trading only in swaps that are not readily susceptible to manipulation.

§ 37.301 General requirements.

To demonstrate to the Commission compliance with the requirements of § 37.300, a swap execution facility shall, at the time it submits a new swap contract in advance to the Commission pursuant to part 40 of this chapter, provide the applicable information as set forth in Appendix C to part 38 of this chapter—Demonstration of Compliance That a Contract is not Readily Susceptible to Manipulation. A swap execution facility may also refer to the guidance and/or acceptable practices in Appendix B of this part.

Subpart E—Monitoring of Trading and Trade Processing

Appendix A

§ 37.400 Core Principle 4—Monitoring of trading and trade processing.

The swap execution facility shall:

(a) Establish and enforce rules or terms and conditions defining, or specifications detailing:

(1) Trading procedures to be used in entering and executing orders traded on or through the facilities of the swap execution facility; and

(2) Procedures for trade processing of swaps on or through the facilities of the swap execution facility; and

(b) Monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

§ 37.401 General requirements.

A swap execution facility shall:

(a) Collect and evaluate data on its market participants' market activity on an ongoing basis in order to detect and prevent manipulation, price distortions, and, where possible, disruptions of the physical-delivery or cash-settlement process;

(b) Monitor and evaluate general market data in order to detect and prevent manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand;

(c) Demonstrate an effective program for conducting real-time monitoring of trading for the purpose of detecting and resolving abnormalities; and

(d) Demonstrate the ability to comprehensively and accurately reconstruct daily trading activity for the purpose of detecting instances or threats of manipulation, price distortion, and disruptions.

§ 37.402 Additional requirements for physical-delivery swaps.

For physical-delivery swaps, the swap execution facility shall demonstrate that it:

(a) Monitors a swap's terms and conditions as they relate to the underlying commodity market; and

(b) Monitors the availability of the supply of the commodity specified by the delivery requirements of the swap.

§ 37.403 Additional requirements for cash-settled swaps.

(a) For cash-settled swaps, the swap execution facility shall demonstrate that it monitors the pricing of the reference price used to determine cash flows or settlement;

(b) For cash-settled swaps listed on the swap execution facility where the reference price is formulated and computed by the swap execution facility, the swap execution facility shall demonstrate that it monitors the continued appropriateness of its methodology for deriving that price; and

(c) For cash-settled swaps listed on the swap execution facility where the reference price relies on a third-party index or instrument, including an index or instrument traded on another venue, the swap execution facility shall demonstrate that it monitors the continued appropriateness of the index or instrument.

§ 37.404 Ability to obtain information.

(a) A swap execution facility shall demonstrate that it has access to sufficient information to assess whether trading in swaps listed on its market, in the index or instrument used as a reference price, or in the underlying commodity for its listed swaps is being used to affect prices on its market.

(b) A swap execution facility shall have rules that require its market participants to keep records of their trading, including records of their activity in the index or instrument used as a reference price, the underlying commodity, and related derivatives markets, and make such records available, upon request, to the swap execution facility or, if applicable, to its regulatory service provider, and the Commission.

§ 37.405 Risk controls for trading.
The swap execution facility shall establish and maintain risk control mechanisms to prevent and reduce the potential risk of market disruptions, including, but not limited to, market restrictions that pause or halt trading under market conditions prescribed by the swap execution facility.

§ 37.406 Trade reconstruction.
The swap execution facility shall have the ability to comprehensively and accurately reconstruct all trading on its facility. All audit-trail data and reconstructions shall be made available to the Commission in a form, manner, and time that is acceptable to the Commission.

§ 37.407 Regulatory service provider.
A swap execution facility shall comply with the regulations in this subpart through a dedicated regulatory department or by contracting with a regulatory service provider pursuant to § 37.204.

§ 37.408 Additional sources for compliance.
A swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.400.

Subpart F—Ability to Obtain Information

§ 37.500 Core Principle 5—Ability to obtain information.
The swap execution facility shall:
(a) Establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in section 5h of the Act;
(b) Provide the information to the Commission on request; and
(c) Have the capacity to carry out such international information-sharing agreements as the Commission may require.

§ 37.501 Establish and enforce rules.
A swap execution facility shall establish and enforce rules that will allow the swap execution facility to have the ability and authority to obtain sufficient information to allow it to fully perform its operational, risk management, governance, and regulatory functions and any requirements under this part, including the capacity to carry out international information-sharing agreements as the Commission may require.

§ 37.502 Collection of information.
A swap execution facility shall have rules that allow it to collect information on a routine basis, allow for the collection of non-routine data from its market participants, and allow for its examination of books and records kept by the market participants on its facility.

§ 37.503 Provide information to the Commission.
A swap execution facility shall provide information in its possession to the Commission upon request, in a form and manner that the Commission approves.

§ 37.504 Information-sharing agreements.
A swap execution facility shall share information with other regulatory organizations, data repositories, and third-party data reporting services as required by the Commission or as otherwise necessary and appropriate to fulfill its self-regulatory and reporting responsibilities. Appropriate information-sharing agreements can be established with such entities or the Commission can act in conjunction with the swap execution facility to carry out such information sharing.

Subpart G—Position Limits or Accountability

§ 37.600 Core Principle 6—Position limits or accountability.
(a) In general. To reduce the potential threat of market manipulation or congestion, especially during trading in the

delivery month, a swap execution facility that is a trading facility shall adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators.
(b) Position limits. For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a) of the Act, the swap execution facility shall:
(1) Set its position limitation at a level no higher than the Commission limitation; and
(2) Monitor positions established on or through the swap execution facility for compliance with the limit set by the Commission and the limit, if any, set by the swap execution facility.

§ 37.601 Additional sources for compliance.
Until such time that compliance is required under part 151 of this chapter, a swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.600.

Subpart H—Financial Integrity of Transactions

§ 37.700 Core Principle 7—Financial integrity of transactions.
The swap execution facility shall establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the swap execution facility, including the clearance and settlement of the swaps pursuant to section 2(h)(1) of the Act.

§ 37.701 Required clearing.
Transactions executed on or through the swap execution facility that are required to be cleared under section 2(h)(1)(A) of the Act or are voluntarily cleared by the counterparties shall be cleared through a Commission-registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration.

§ 37.702 General financial integrity.
A swap execution facility shall provide for the financial integrity of its transactions:
(a) By establishing minimum financial standards for its members, which shall, at a minimum, require that members qualify as an eligible contract participant as defined in section 1a(18) of the Act;
(b) For transactions cleared by a derivatives clearing organization:
(1) By ensuring that the swap execution facility has the capacity to route transactions to the derivatives clearing organization in a manner acceptable to the derivatives clearing organization for purposes of clearing; and
(2) By coordinating with each derivatives clearing organization to which it submits transactions for clearing, in the development of rules and procedures to facilitate prompt and efficient transaction processing in accordance with the requirements of § 39.12(b)(7) of this chapter.

§ 37.703 Monitoring for financial soundness.
A swap execution facility shall monitor its members to ensure that they continue to qualify as eligible contract participants as defined in section 1a(18) of the Act.

Subpart I—Emergency Authority

§ 37.800 Core Principle 8—Emergency authority.
The swap execution facility shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary and appropriate, including the authority to liquidate or transfer open positions in any swap or to suspend or curtail trading in a swap.

§ 37.801 Additional sources for compliance.
A swap execution facility may refer to the guidance and/or acceptable practices in Appendix

B of this part to demonstrate to the Commission compliance with the requirements of § 37.800.

Subpart J—Timely Publication of Trading Information

§ 37.900 Core Principle 9—Timely publication of trading information.

(a) In general. The swap execution facility shall make public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission.

(b) Capacity of swap execution facility. The swap execution facility shall be required to have the capacity to electronically capture and transmit trade information with respect to transactions executed on the facility.

§ 37.901 General requirements.

With respect to swaps traded on or through a swap execution facility, each swap execution facility shall:

(a) Report specified swap data as provided under part 43 and part 45 of this chapter; and

(b) Meet the requirements of part 16 of this chapter.

Subpart K—Recordkeeping and Reporting

§ 37.1000 Core Principle 10—Recordkeeping and reporting.

(a) In general. A swap execution facility shall:

(1) Maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of five years;

(2) Report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under the Act; and

(3) Keep any such records relating to swaps defined in section 1a(47)(A)(v) of the Act open to inspection and examination by the Securities and Exchange Commission.

(b) Requirements. The Commission shall adopt data collection and reporting requirements for swap execution facilities that are comparable to corresponding requirements for derivatives clearing organizations and swap data repositories.

§ 37.1001 Recordkeeping.

A swap execution facility shall maintain records of all activities relating to the business of the facility, in a form and manner acceptable to the Commission, for a period of at least five years. A swap execution facility shall maintain such records, including a complete audit trail for all swaps executed on or subject to the rules of the swap execution facility, investigatory files, and disciplinary files, in accordance with the requirements of § 1.31 and part 45 of this chapter.

Subpart L—Antitrust Considerations

§ 37.1100 Core Principle 11—Antitrust considerations.

Unless necessary or appropriate to achieve the purposes of the Act, the swap execution facility shall not:

(a) Adopt any rules or take any actions that result in any unreasonable restraint of trade; or

(b) Impose any material anticompetitive burden on trading or clearing.

§ 37.1101 Additional sources for compliance.

A swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.1100.

Subpart M—Conflicts of Interest

§ 37.1200 Core Principle 12—Conflicts of interest.

The swap execution facility shall:

(a) Establish and enforce rules to minimize conflicts of interest in its decision-making process; and

(b) Establish a process for resolving the conflicts of interest.

Subpart N—Financial Resources

§ 37.1300 Core Principle 13—Financial resources.

(a) In general. The swap execution facility shall have adequate financial, operational, and managerial resources to discharge each responsibility of the swap execution facility.

(b) Determination of resource adequacy. The financial resources of a swap execution facility shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the swap execution facility to cover the operating costs of the swap execution facility for a one-year period, as calculated on a rolling basis.

§ 37.1301 General requirements.

(a) A swap execution facility shall maintain financial resources sufficient to enable it to perform its functions in compliance with the core principles set forth in section 5h of the Act.

(b) An entity that operates as both a swap execution facility and a derivatives clearing organization shall also comply with the financial resource requirements of § 39.11 of this chapter.

(c) Financial resources shall be considered sufficient if their value is at least equal to a total amount that would enable the swap execution facility to cover its operating costs for a period of at least one year, calculated on a rolling basis.

§ 37.1302 Types of financial resources.

Financial resources available to satisfy the requirements of § 37.1301 may include:

(a) The swap execution facility's own capital, meaning its assets minus its liabilities calculated in accordance with U.S. generally accepted accounting principles; and

(b) Any other financial resource deemed acceptable by the Commission.

§ 37.1303 Computation of projected operating costs to meet financial resource requirement.

A swap execution facility shall, each fiscal quarter, make a reasonable calculation of its projected operating costs over a twelve-month period in order to determine the amount needed to meet the requirements of § 37.1301. The swap execution facility shall have reasonable discretion in determining the methodology used to compute such projected operating costs. The Commission may review the methodology and require changes as appropriate.

§ 37.1304 Valuation of financial resources.

No less than each fiscal quarter, a swap execution facility shall compute the current market value of each financial resource used to meet its obligations under § 37.1301. Reductions in value to reflect market and credit risk ("haircuts") shall be applied as appropriate.

§ 37.1305 Liquidity of financial resources.

The financial resources allocated by the swap execution facility to meet the requirements of § 37.1301 shall include unencumbered, liquid financial assets (i.e., cash and/or highly liquid securities) equal to at least six months' operating costs. If any portion of such financial resources is not sufficiently liquid, the swap execution facility may take into account a committed line of credit or similar facility for the purpose of meeting this requirement.

§ 37.1306 Reporting to the Commission.

(a) Each fiscal quarter, or at any time upon Commission request, a swap execution facility shall:

(1) Report to the Commission:

(i) The amount of financial resources necessary to meet the requirements of § 37.1301; and

(ii) The value of each financial resource available, computed in accordance with the requirements of § 37.1304;

(2) Provide the Commission with a financial statement, including the balance sheet, income statement, and statement of cash flows of the swap execution facility or of its parent company;

(b) The calculations required by paragraph (a) of this section shall be made as of the last business day of the swap execution facility's fiscal quarter.

(c) The swap execution facility shall provide the Commission with:

(1) Sufficient documentation explaining the methodology used to compute its financial requirements under § 37.1301;

(2) Sufficient documentation explaining the basis for its determinations regarding the valuation and liquidity requirements set forth in §§ 37.1304 and 37.1305; and

(3) Copies of any agreements establishing or amending a credit facility, insurance coverage, or other arrangement evidencing or otherwise supporting the swap execution facility's conclusions.

(d) The reports required by this section shall be filed not later than 40 calendar days after the end of the swap execution facility's first three fiscal quarters, and not later than 60 calendar days after the end of the swap execution facility's fourth fiscal quarter, or at such later time as the Commission may permit, in its discretion, upon request by the swap execution facility.

§ 37.1307 Delegation of authority.

(a) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, authority to:

(1) Determine whether a particular financial resource under § 37.1302 may be used to satisfy the requirements of § 37.1301;

(2) Review and make changes to the methodology used to compute projected operating costs under § 37.1303;

(3) Request reports, in addition to fiscal quarter reports, under § 37.1306(a); and

(4) Grant an extension of time to file fiscal quarter reports under § 37.1306(d).

(b) The Director may submit to the Commission for its consideration any matter that has been delegated in this section. Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

Subpart O—System Safeguards

§ 37.1400 Core Principle 14—System safeguards.

The swap execution facility shall:

(a) Establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems, that:

(1) Are reliable and secure; and

(2) Have adequate scalable capacity;

(b) Establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for:

(1) The timely recovery and resumption of operations; and

(2) The fulfillment of the responsibilities and obligations of the swap execution facility; and

(c) Periodically conduct tests to verify that the backup resources of the swap execution facility are sufficient to ensure continued:

(1) Order processing and trade matching;

(2) Price reporting;

(3) Market surveillance; and

(4) Maintenance of a comprehensive and accurate audit trail.

§ 37.1401 Requirements.

(a) A swap execution facility's program of risk analysis and oversight with respect to its operations and automated systems shall address each of the following categories of risk analysis and oversight:

(1) Information security;

(2) Business continuity-disaster recovery planning and resources;

(3) Capacity and performance planning;

(4) Systems operations;
(5) Systems development and quality assurance; and
(6) Physical security and environmental controls.

(b) A swap execution facility shall maintain a business continuity-disaster recovery plan and resources, emergency procedures, and backup facilities sufficient to enable timely recovery and resumption of its operations and resumption of its ongoing fulfillment of its responsibilities and obligations as a swap execution facility following any disruption of its operations. Such responsibilities and obligations include, without limitation, order processing and trade matching; transmission of matched orders to a designated clearing organization for clearing, where appropriate; price reporting; market surveillance; and maintenance of a comprehensive audit trail. The swap execution facility's business continuity-disaster recovery plan and resources generally should enable resumption of trading and clearing of swaps executed on the swap execution facility during the next business day following the disruption. Swap execution facilities determined by the Commission to be critical financial markets pursuant to Appendix E to part 40 of this chapter are subject to more stringent requirements in this regard, set forth in § 40.9 of this chapter.

(c) A swap execution facility that is not determined by the Commission to be a critical financial market satisfies the requirement to be able to resume its operations and resume its ongoing fulfillment of its responsibilities and obligations during the next business day following any disruption of its operations by maintaining either:

(1) Infrastructure and personnel resources of its own that are sufficient to ensure timely recovery and resumption of its operations and resumption of its ongoing fulfillment of its responsibilities and obligations as a swap execution facility following any disruption of its operations; or

(2) Contractual arrangements with other swap execution facilities or disaster recovery service providers, as appropriate, that are sufficient to ensure continued trading and clearing of swaps executed on the swap execution facility, and ongoing fulfillment of all of the swap execution facility's responsibilities and obligations with respect to such swaps, in the event that a disruption renders the swap execution facility temporarily or permanently unable to satisfy this requirement on its own behalf.

(d) A swap execution facility shall notify Commission staff promptly of all:

(1) Electronic trading halts and material system malfunctions;

(2) Cyber security incidents or targeted threats that actually or potentially jeopardize automated system operation, reliability, security, or capacity; and

(3) Activations of the swap execution facility's business continuity-disaster recovery plan.

(e) A swap execution facility shall provide Commission staff timely advance notice of all material:

(1) Planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems; and

(2) Planned changes to the swap execution facility's program of risk analysis and oversight.

(f) A swap execution facility shall provide to the Commission, upon request, current copies of its business continuity-disaster recovery plan and other emergency procedures, its assessments of its operational risks, and other documents requested by Commission staff for the purpose of maintaining a current profile of the swap execution facility's automated systems.

(g) A swap execution facility shall conduct regular, periodic, objective testing and review of its automated systems to ensure that they are reliable, secure, and have adequate scalable capacity. A swap execution facility shall also conduct regular, periodic testing and review of its business continuity-disaster recovery capabilities. Pursuant to Core Principle 10 under section 5h of the Act (Recordkeeping and Reporting) and §§ 37.1000 through 37.1001, the swap execution facility shall keep records of all such tests, and make all test results available to the Commission upon request.

(h) Part 40 of this chapter governs the obligations of those registered entities that the Commission has determined to be critical financial markets, with respect to maintenance and geographic dispersal of disaster recovery resources sufficient to meet a same-day recovery time objective in the event of a wide-scale disruption. Section 40.9 establishes the requirements for core principle compliance in that respect.

Subpart P—Designation of Chief Compliance Officer

§ 37.1500 Core Principle 15—Designation of chief compliance officer.

(a) In general. Each swap execution facility shall designate an individual to serve as a chief compliance officer.

(b) Duties. The chief compliance officer shall:

(1) Report directly to the board or to the senior officer of the facility;

(2) Review compliance with the core principles in this subsection;

(3) In consultation with the board of the facility, a body performing a function similar to that of a board, or the senior officer of the facility, resolve any conflicts of interest that may arise;

(4) Be responsible for establishing and administering the policies and procedures required to be established pursuant to this section;

(5) Ensure compliance with the Act and the rules and regulations issued under the Act, including rules prescribed by the Commission pursuant to section 5h of the Act; and

(6) Establish procedures for the remediation of noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or through validated complaints.

(c) Requirements for procedures. In establishing procedures under paragraph (b)(6) of this section, the chief compliance officer shall design the procedures to establish the handling, management response, remediation, retesting, and closing of noncompliance issues.

(d) Annual reports—

(1) In general. In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of:

(i) The compliance of the swap execution facility with the Act; and

(ii) The policies and procedures, including the code of ethics and conflict of interest policies, of the swap execution facility.

(2) Requirements. The chief compliance officer shall:

(i) Submit each report described in paragraph (d)(1) of this section with the appropriate financial report of the swap execution facility that is required to be submitted to the Commission pursuant to section 5h of the Act; and

(ii) Include in the report a certification that, under penalty of law, the report is accurate and complete.

§ 37.1501 Chief compliance officer.

(a) Definition of board of directors. For purposes of this part, the term "board of directors" means the board of directors of a swap execution facility, or for those swap execution facilities whose organizational structure does not include a board of directors, a body performing a function similar to a board of directors.

(b) Designation and qualifications of chief compliance officer—

(1) Chief compliance officer required. Each swap execution facility shall establish the position of chief compliance officer and designate an individual to serve in that capacity.

(i) The position of chief compliance officer shall carry with it the authority and resources to develop and enforce policies and procedures necessary to fulfill the duties set forth for chief compliance officers in the Act and Commission regulations.

(ii) The chief compliance officer shall have supervisory authority over all staff acting at the direction of the chief compliance officer.

(2) Qualifications of chief compliance officer. The individual designated to serve as chief compliance officer shall have the background and skills appropriate for fulfilling the responsibilities of the position. No individual disqualified from registration pursuant to sections 8a(2) or 8a(3) of the Act may serve as a chief compliance officer.

(c) Appointment, supervision, and removal of chief compliance office—

(1) Appointment and compensation of chief compliance officer.

(i) A swap execution facility's chief compliance officer shall be appointed by its board of directors or senior officer. A swap execution facility shall notify the Commission within two business days of appointing any new chief compliance officer, whether interim or permanent.

(ii) The board of directors or the senior officer shall approve the compensation of the chief compliance officer.

(iii) The chief compliance officer shall meet with the board of directors at least annually and the regulatory oversight committee at least quarterly.

(iv) The chief compliance officer shall provide any information regarding the swap execution facility's self-regulatory program that is requested by the board of directors or the regulatory oversight committee.

(2) Supervision of chief compliance officer. A swap execution facility's chief compliance officer shall report directly to the board of directors or to the senior officer of the swap execution facility, at the swap execution facility's discretion.

(3) Removal of chief compliance officer.

(i) Removal of a swap execution facility's chief compliance officer shall require the approval of a majority of the swap execution facility's board of directors. If the swap execution facility does not have a board of directors, then the chief compliance officer may be removed by the senior officer of the swap execution facility.

(ii) The swap execution facility shall notify the Commission of such removal within two business days.

(d) Duties of chief compliance officer. The chief compliance officer's duties shall include, but are not limited to, the following:

(1) Overseeing and reviewing the swap execution facility's compliance with section 5h of the Act and any related rules adopted by the Commission;

(2) In consultation with the board of directors, a body performing a function similar to the board of directors, or the senior officer of the swap execution facility, resolving any conflicts of interest that may arise, including:

(i) Conflicts between business considerations and compliance requirements;

(ii) Conflicts between business considerations and the requirement that the swap execution facility provide fair, open, and impartial access as set forth in § 37.202; and;

(iii) Conflicts between a swap execution facility's management and members of the board of directors;

(3) Establishing and administering written policies and procedures reasonably designed to prevent violations of the Act and the rules of the Commission;

(4) Taking reasonable steps to ensure compliance with the Act and the rules of the Commission;

(5) Establishing procedures for the remediation of noncompliance issues identified by the chief compliance officer through a compliance office review, look-back, internal or external audit finding, self-reported error, or validated complaint;

(6) Establishing and following appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues;
(7) Establishing and administering a compliance manual designed to promote compliance with the applicable laws, rules, and regulations and a written code of ethics designed to prevent ethical violations and to promote honesty and ethical conduct;
(8) Supervising the swap execution facility's self-regulatory program with respect to trade practice surveillance; market surveillance; real-time market monitoring; compliance with audit trail requirements; enforcement and disciplinary proceedings; audits, examinations, and other regulatory responsibilities with respect to members and market participants (including ensuring compliance with, if applicable, financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and
(9) Supervising the effectiveness and sufficiency of any regulatory services provided to the swap execution facility by a regulatory service provider in accordance with § 37.204.
(e) Preparation of annual compliance report. The chief compliance officer shall, not less than annually, prepare and sign an annual compliance report that, at a minimum, contains the following information covering the time period since the date on which the swap execution facility became registered with the Commission or since the end of the period covered by a previously filed annual compliance report, as applicable:
(1) A description of the swap execution facility's written policies and procedures, including the code of ethics and conflict of interest policies;
(2) A review of applicable Commission regulations and each subsection and core principle of section 5h of the Act, that, with respect to each:
(i) Identifies the policies and procedures that are designed to ensure compliance with each subsection and core principle, including each duty specified in section 5h(f)(15)(B) of the Act;
(ii) Provides a self-assessment as to the effectiveness of these policies and procedures; and
(iii) Discusses areas for improvement and recommends potential or prospective changes or improvements to its compliance program and resources;
(3) A list of any material changes to compliance policies and procedures since the last annual compliance report;
(4) A description of the financial, managerial, and operational resources set aside for compliance with respect to the Act and Commission regulations, including a description of the swap execution facility's self-regulatory program's staffing and structure, a catalogue of investigations and disciplinary actions taken since the last annual compliance report, and a review of the performance of disciplinary committees and panels;
(5) A description of any material compliance matters, including noncompliance issues identified through a compliance office review, look-back, internal or external audit finding, self-reported error, or validated complaint, and an explanation of how they were resolved; and
(6) A certification by the chief compliance officer that, to the best of his or her knowledge and reasonable belief, and under penalty of law, the annual compliance report is accurate and complete.
(f) Submission of annual compliance report.
(1) Prior to submission to the Commission, the chief compliance officer shall provide the annual compliance report to the board of directors of the swap execution facility for its review. If the swap execution facility does not have a board of directors, then the annual compliance report shall be provided to the senior officer for his or her review. Members of the board of directors and the senior officer shall not require the chief compliance officer to make any changes to the report. Submission

of the report to the board of directors or the senior officer, and any subsequent discussion of the report, shall be recorded in board minutes or a similar written record, as evidence of compliance with this requirement.

(2) The annual compliance report shall be submitted electronically to the Commission not later than 60 calendar days after the end of the swap execution facility's fiscal year, concurrently with the filing of the fourth fiscal quarter financial report pursuant to § 37.1306.

(3) Promptly upon discovery of any material error or omission made in a previously filed annual compliance report, the chief compliance officer shall file an amendment with the Commission to correct the material error or omission. An amendment shall contain the certification required under paragraph (e)(6) of this section.

(4) A swap execution facility may request from the Commission an extension of time to file its annual compliance report based on substantial, undue hardship. Extensions of the filing deadline may be granted at the discretion of the Commission.

(g) Recordkeeping.

(1) The swap execution facility shall maintain:

(i) A copy of the written policies and procedures, including the code of ethics and conflicts of interest policies adopted in furtherance of compliance with the Act and Commission regulations;

(ii) Copies of all materials created in furtherance of the chief compliance officer's duties listed in paragraphs (d)(8) and (d)(9) of this section, including records of any investigations or disciplinary actions taken by the swap execution facility;

(iii) Copies of all materials, including written reports provided to the board of directors or senior officer in connection with the review of the annual compliance report under paragraph (f)(1) of this section and the board minutes or a similar written record that documents the review of the annual compliance report by the board of directors or senior officer; and

(iv) Any records relevant to the swap execution facility's annual compliance report, including, but not limited to, work papers and other documents that form the basis of the report, and memoranda, correspondence, other documents, and records that are

(A) Created, sent, or received in connection with the annual compliance report and

(B) Contain conclusions, opinions, analyses, or financial data related to the annual compliance report.

(2) The swap execution facility shall maintain records in accordance with § 1.31 and part 45 of this chapter.

(h) Delegation of authority. The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, authority to grant or deny a swap execution facility's request for an extension of time to file its annual compliance report under paragraph (f)(4) of this section.

MAT Rules for DCMs

§ 38.11 Trade execution compliance schedule.

(a) A ~~swap~~ transaction involving a stand-alone swap or a package transaction as defined in § 37.9 of this chapter shall be subject to the requirements of section 2(h)(8) of the Act upon the later of:

(1) The applicable deadline established under the compliance schedule provided under § 50.25(b) of this chapter; or

(2) Thirty days after the available-to-trade determination submission or certification for that ~~swap~~stand-alone swap or package transaction as defined in § 37.9 of this chapter is, respectively, deemed approved under § 40.5 of this chapter or deemed certified under § 40.6 of this chapter.

(b) Nothing in this section shall prohibit any counterparty from complying voluntarily with the requirements of section 2(h)(8) of the Act sooner than as provided in paragraph (a) of this section.

§ 38.12 Process for a designated contract market to make a swap available to trade.

(a)(1) Required submission. A designated contract market that makes a ~~swap~~stand-alone swap or a package transaction as defined in § 37.9 of this chapter available to trade in accordance with paragraph (b) of this section, shall submit to the Commission its determination with respect to such swap as a rule, as that term is defined by § 40.1 of this chapter, pursuant to the procedures under part 40 of this chapter.

(i) Public Comment. The Commission shall provide a public comment period after each submission by a designated contract market pursuant to this paragraph. The Commission shall publish a notice of the public comment period on the Commission Web site. Comments from the public shall be submitted as specified in that notice.

(2) Listing requirement. A designated contract market that makes a ~~swap~~stand-alone swap or a package transaction as defined in § 37.9 of this chapter available to trade must demonstrate that it lists or offers that ~~swap~~stand-alone swap or package transaction for trading on its trading system or platform.

(b) Factors to consider. To make a stand-alone swap or a package transaction as defined in § 37.9 of this chapter available to trade, for purposes of section 2(h)(8) of the Act, a designated contract market shall consider, as appropriate, the following factors with respect to such ~~swap:~~stand-alone swap or package transaction:

(1) Whether there are ready and willing buyers and sellers;

(2) The frequency or size of transactions;

(3) The trading volume;

(4) The number and types of market participants;

(5) The bid/ask spread; or

(6) The usual number of resting firm or indicative bids and offers.

(c) Applicability.

(1) Upon a determination that a stand-alone swap or package transaction as defined in § 37.9 of this chapter is available to trade on any designated contract market or swap execution facility pursuant to part 40 of this chapter, all other designated contract markets and swap execution facilities shall comply with the ~~requirements of~~Commission's regulations promulgated pursuant to section 2(h)(8)(A) of the Act in listing or offering such swap for trading.

(d) Removal—

(1) Determination. The Commission may issue an order to suspend the trade execution requirement in section 2(h)(8) of the Act for any~~a determination that a~~ stand-alone swap or package transaction as defined in § 37.9 of this chapter that is no longer available to trade ~~upon determining that no~~ if none of the factors described in paragraph (b) of this section support a determination that the transaction is made available to trade.~~swap execution facility or designated contract market lists such swap for trading.~~ The Commission's determination shall be based on either:

(i) Its annual review and assessment of each stand-alone swap or package transaction that has been made available to trade on any designated contract market pursuant to part 40 of this chapter and that is among the lowest ten percent of the least actively traded on any swap execution facility or designated contract market; or

(ii) Its review and assessment upon notice of de-listing submissions from at least two designated contract markets or swap execution facilities pursuant to § 40.6 of this chapter.

(2) Delegation of Authority.

(i) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, the authority to issue a determination that a stand-alone swap or a package transaction as defined in

§ 37.9 of this chapter is no longer available to trade.

(ii) Public Comment. The Commission shall provide a public comment period for each determination that a stand-alone swap or a package transaction is no longer available to trade. The Commission shall publish a notice of the public comment period on the Commission Web site. Comments from the public shall be submitted as specified in that notice.

(iii) The Director may submit to the Commission for its consideration any matter that has been delegated in this section. Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

Part 38 – Designated Contract Markets, Subpart C – Compliance With Rules

§ 38.150 Core Principle 2.

(a) *In general*. The board of trade shall establish, monitor, and enforce compliance with the rules of the contract market, including:

(1) Access requirements;

~~(2)~~ The terms and conditions of any contracts to be traded on the contract market; ~~and~~

(2)

(3) Rules prohibiting abusive trade practices on the contract market; and

~~(3)~~(4) Rules providing that any trade that is executed on or subject to the rules of the contract market that is intended to be submitted to a derivatives clearing organization for clearing contemporaneously with execution that is rejected from clearing by such derivatives clearing organization is void *ab initio* with no liability incurred between the parties to such trade in respect of such trade.

(b) *Capacity of contract market*. The board of trade shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market.

(c) *Requirement of rules*. The rules of the contract market shall provide the board of trade with the ability and authority to obtain any necessary information to perform any function described in this section, including the capacity to carry out such international information-sharing agreements, as the Commission may require.

STP Rules

§ 1.73 Clearing futures commission merchant risk management.

(a) Each futures commission merchant that is a clearing member of a derivatives clearing organization shall:

(1) Establish risk-based limits in the proprietary account and in each customer account based on position size, order size, margin requirements, or similar factors;

(2) Screen orders for compliance with the risk-based limits in accordance with the following:

(i) When a clearing futures commission merchant provides electronic market access or accepts orders for automated execution, it shall use automated means to screen orders for compliance with the limits;

(ii) When a clearing futures commission merchant accepts orders for non-automated execution, it shall establish and maintain systems of risk controls reasonably designed to ensure compliance with the limits;

(iii) When a clearing futures commission merchant accepts transactions that were executed bilaterally and then submitted for clearing, it shall establish and maintain systems of risk management controls reasonably designed to ensure compliance with the limits;

(iv) When a firm executes an order on behalf of a customer but gives it up to another firm for clearing,

(A) The clearing futures commission merchant shall establish risk-based limits for the customer, and enter into an agreement in advance with the executing firm that requires the executing firm to screen orders for compliance with those limits in accordance with paragraph (a)(2)(i) or (ii) as applicable; and

(B) The clearing futures commission merchant shall establish and maintain systems of risk management controls reasonably designed to ensure compliance with the limits.

(v) When an account manager bunches orders on behalf of multiple customers for execution as a block and post-trade allocation to individual accounts for clearing:

(A) The futures commission merchant that initially clears the block shall establish risk-based limits for the block account and screen the order in accordance with paragraph (a)(2)(i) or (ii) as applicable;

(B) The futures commission merchants that clear the allocated trades on behalf of customers shall establish risk-based limits for each customer and enter into an agreement in advance with the account manager that requires the account manager to screen orders for compliance with those limits; and

(C) The futures commission merchants that clear the allocated trades on behalf of customers shall establish and maintain systems of risk management controls reasonably designed to ensure compliance with the limits.

(vi) (A) When a futures commission merchant that is a clearing member of a derivatives clearing organization screens an order in accordance with paragraph (a)(2)(i) or (ii) as applicable and such order falls within the futures commission merchant's pre-execution risk-based limits, then the order shall be deemed accepted for clearing by the futures commission merchant and thereby subject to a guarantee by such futures commission merchant upon execution; and

(B) A futures commission merchant that is a clearing member of a derivatives clearing organization may not reject a trade screened in accordance with paragraph (a)(2)(i) or (ii), as applicable, that falls within the futures commission merchant's pre-execution risk-based limits.

(3) Monitor for adherence to the risk-based limits intra-day and overnight;

(4) Conduct stress tests under extreme but plausible conditions of all positions in the proprietary account and in each customer account that could pose material risk to the futures commission merchant at least once per week;

(5) Evaluate its ability to meet initial margin requirements at least once per week;

(6) Evaluate its ability to meet variation margin requirements in cash at least once per week;

(7) Evaluate its ability to liquidate, in an orderly manner, the positions in the proprietary and customer accounts and estimate the cost of the liquidation at least once per quarter; and

(8) Test all lines of credit at least once per year.

(b) Each futures commission merchant that is a clearing member of a derivatives clearing organization shall:

(1) Establish written procedures to comply with this regulation; and

(2) Keep full, complete, and systematic records documenting its compliance with this regulation.

(3) All records required to be maintained pursuant to these regulations shall be maintained in accordance with Commission Regulation 1.31 (17 CFR 1.31) and shall be made available promptly upon request to representatives of the Commission and to representatives of applicable prudential regulators.

§ 1.74 Futures commission merchant acceptance for clearing.

(a) Each futures commission merchant that is a clearing member of a derivatives clearing organization shall coordinate with each derivatives clearing organization on which it clears to establish systems that enable the futures commission merchant, or the derivatives clearing organization acting on its behalf, to accept or reject each trade submitted to the derivatives clearing organization for clearing by or for the futures commission merchant or a customer of the futures commission merchant as quickly as would be. technologically practicable if fully automated systems were used and in any event within 60 seconds after submission to the futures commission merchant for acceptance; and

(b) Each futures commission merchant that is a clearing member of a derivatives clearing organization shall accept or reject each trade submitted by or for it or its customers as quickly as would be technologically practicable if fully automated systems were used and in any event within 60 seconds after submission to the futures commission merchant for acceptance; a clearing futures commission merchant may meet this requirement by:

(1) Establishing systems to pre-screen orders for compliance with criteria specified by the clearing futures commission merchant;

(2) Establishing systems that authorize a derivatives clearing organization to accept or reject on its behalf trades that meet, or fail to meet, criteria specified by the clearing futures commission merchant; or

(3) Establishing systems that enable the clearing futures commission merchant to communicate to the derivatives clearing organization acceptance or rejection of each trade as quickly as would be technologically practicable if fully automated systems were used.

§ 39.12 Participant and product eligibility.

(a) Participant eligibility. A derivatives clearing organization shall establish appropriate admission and continuing participation requirements for clearing members of the derivatives clearing organization that are objective, publicly disclosed, and risk-based.

(1) Fair and open access for participation. The participation requirements shall permit fair and open access;

(i) A derivatives clearing organization shall not adopt restrictive clearing member standards if less restrictive requirements that achieve the same objective and that would not materially increase risk to the derivatives clearing organization or clearing members could be adopted;

(ii) A derivatives clearing organization shall allow all market participants who satisfy participation requirements to become clearing members;

(iii) A derivatives clearing organization shall not exclude or limit clearing membership of certain types of market participants unless the derivatives clearing organization can demonstrate that the restriction is necessary to address credit risk or deficiencies in the participants' operational capabilities that would prevent them from fulfilling their obligations as clearing members.

(iv) A derivatives clearing organization shall not require that clearing members be swap dealers.

(v) A derivatives clearing organization shall not require that clearing members maintain a swap portfolio of any particular size, or that clearing members meet a swap transaction volume threshold.

(vi) No derivatives clearing organization shall require as a condition of accepting a swap for clearing that a futures commission merchant enter into an arrangement with a customer that:

(A) Discloses to the futures commission merchant or any swap dealer or major swap participant the identity of a customer's original executing counterparty;

(B) Limits the number of counterparties with whom a customer may enter into trades;

(C) Restricts the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the futures commission merchant;

(D) Impairs a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or

(E) Prevents compliance with the time frames set forth in § 1.74(b), § 23.610(b), or § 39.12(b)(7) of this chapter.

(2) Financial resources.

(i) The participation requirements shall require clearing members to have access to sufficient financial resources to meet obligations arising from participation in the derivatives clearing organization in extreme but plausible market conditions. A derivatives clearing organization may permit such financial resources to include, without limitation, a clearing member's capital, a guarantee from the clearing member's parent, or a credit facility funding arrangement. For purposes of this paragraph, "capital" means adjusted net capital as defined in § 1.17 of this chapter, for futures commission merchants, and net capital as defined in § 240.15c3–1 of this title, for broker-dealers, or any similar risk adjusted capital calculation for all other clearing members.

(ii) The participation requirements shall set forth capital requirements that are based on objective, transparent, and commonly accepted standards that appropriately match capital to risk. Capital requirements shall be scalable to the risks posed by clearing members.

(iii) A derivatives clearing organization shall not set a minimum capital requirement of more than $50 million for any person that seeks to become a clearing member in order to clear swaps.

(3) Operational requirements. The participation requirements shall require clearing members to have adequate operational capacity to meet obligations arising from participation in the derivatives clearing organization. The requirements shall include, but are not limited to: the ability to process expected volumes and values of transactions cleared by a clearing member within required time frames, including at peak times and on peak days; the ability to fulfill collateral, payment, and delivery obligations imposed by the derivatives clearing organization; and the ability to participate in default management activities under the rules of the derivatives clearing organization and in accordance with § 39.16 of this part.

(4) Monitoring. A derivatives clearing organization shall establish and implement procedures to verify, on an ongoing basis, the compliance of each clearing member with each participation requirement of the derivatives clearing organization.

(5) Reporting.

(i) A derivatives clearing organization shall require all clearing members, including non-futures commission merchants, to provide to the derivatives clearing organization periodic financial reports that contain any financial information that the derivatives clearing organization determines is necessary to assess whether participation requirements are being met on an ongoing basis.

(A) A derivatives clearing organization shall require clearing members that are futures commission merchants to provide the financial reports that are specified in § 1.10 of this chapter to the derivatives clearing organization.

(B) A derivatives clearing organization shall require clearing members that are not futures commission merchants to make the periodic financial reports provided pursuant to paragraph (a)(5)(i) of this section available to the Commission upon the Commission's request or, in lieu of imposing this requirement, a derivatives clearing organization may provide such financial reports directly to the Commission upon the Commission's request.

(ii) A derivatives clearing organization shall adopt rules that require clearing members to provide to the derivatives clearing organization, in a timely manner, information that concerns any financial or business developments that may materially affect the clearing members' ability to continue to comply with participation requirements.

(6) Enforcement. A derivatives clearing organization shall have the ability to enforce compliance with its participation requirements and shall establish procedures for the suspension and orderly removal of clearing members that no longer meet the requirements.

(b) Product eligibility.

(1) A derivatives clearing organization shall establish appropriate requirements for determining the eligibility of agreements, contracts, or

transactions submitted to the derivatives clearing organization for clearing, taking into account the derivatives clearing organization's ability to manage the risks associated with such agreements, contracts, or transactions. Factors to be considered in determining product eligibility include, but are not limited to:

(i) Trading volume;

(ii) Liquidity;

(iii) Availability of reliable prices;

(iv) Ability of market participants to use portfolio compression with respect to a particular swap product;

(v) Ability of the derivatives clearing organization and clearing members to gain access to the relevant market for purposes of creating, liquidating, transferring, auctioning, and/or allocating positions;

(vi) Ability of the derivatives clearing organization to measure risk for purposes of setting margin requirements; and

(vii) Operational capacity of the derivatives clearing organization and clearing members to address any unusual risk characteristics of a product.

(2) A derivatives clearing organization shall adopt rules providing that all swaps with the same terms and conditions, as defined by product specifications established under derivatives clearing organization rules, submitted to the derivatives clearing organization for clearing are economically equivalent within the derivatives clearing organization and may be offset with each other within the derivatives clearing organization.

(3) A derivatives clearing organization shall provide for non-discriminatory clearing of a swap executed bilaterally or on or subject to the rules of an unaffiliated swap execution facility or designated contract market.

(4) A derivatives clearing organization shall not require that one of the original executing parties be a clearing member in order for a product to be eligible for clearing.

(5) A derivatives clearing organization shall select product unit sizes and other terms and conditions that maximize liquidity, facilitate transparency in pricing, promote open access, and allow for effective risk management. To the extent appropriate to further these objectives, a derivatives clearing organization shall select product units for clearing purposes that are smaller than the product units in which trades submitted for clearing were executed.

(6) A derivatives clearing organization that clears swaps shall have rules providing that, upon acceptance of a swap by the derivatives clearing organization for clearing:

(i) The original swap is extinguished;

(ii) The original swap is replaced by an equal and opposite swap between the derivatives clearing organization and each clearing member acting as principal for a house trade or acting as agent for a customer trade;

(iii) All terms of a cleared swap must conform to product specifications established under derivatives clearing organization rules; and

(iv) If a swap is cleared by a clearing member on behalf of a customer, all terms of the swap, as carried in the customer account on the books of the clearing member, must conform to the terms of the cleared swap established under the derivatives clearing organization's rules.

(7) Time frame for clearing.

(i) Coordination with markets and clearing members.

(A) Each derivatives clearing organization shall coordinate with each designated contract market and swap execution facility that lists for trading a product that is cleared by the derivatives clearing organization in developing rules and procedures to facilitate prompt, efficient, and accurate processing of all transactions submitted to the derivatives clearing organization for clearing.

(B) Each derivatives clearing organization shall coordinate with each clearing member that is a futures commission merchant, swap dealer, or major swap participant to establish systems that enable the clearing member, or the derivatives clearing organization acting on its behalf, to accept or reject each trade submitted to the derivatives clearing organization for clearing by or for the clearing member or a customer of the clearing member as quickly as would be technologically practicable if fully automated systems were used and in any event within 10 seconds after submission to the derivatives clearing organization for clearing.

(ii) Transactions executed competitively on or subject to the rules of a designated contract market or swap execution facility. A derivatives clearing organization shall have rules that provide that the derivatives clearing organization will accept or reject for clearing as quickly after execution as would be technologically practicable if fully automated systems were used and in any event within 10 seconds after submission to the derivatives clearing organization for clearing, all contracts that are listed for clearing by the derivatives clearing organization and are executed competitively on or subject to the rules of a designated contract market or a swap execution facility. The derivatives clearing organization shall accept all trades:

(A) For which the executing parties have clearing arrangements in place with clearing members of the derivatives clearing organization;

(B) For which the executing parties identify the derivatives clearing organization as the intended clearinghouse; and

(C) That satisfy the criteria of the derivatives clearing organization, including but not limited to applicable risk filters; provided that such criteria are non-discriminatory across trading venues and are applied as quickly as would be technologically practicable if fully automated systems were used.

(D) Any trade that is executed on or subject to the rules of a swap execution facility that is intended to be submitted to a derivatives clearing organization for clearing contemporaneously with execution that is rejected from clearing by such derivatives clearing organization is void *ab initio* with no liability incurred between the parties to such trade in respect of such trade.

(iii) Swaps not executed on or subject to the rules of a designated contract market or a swap execution facility or executed non-competitively on or subject to the rules of a designated contract market or a swap execution facility. A derivatives clearing organization shall have rules that provide that the derivatives clearing organization will accept or reject for clearing as quickly after submission to the derivatives clearing organization as would be technologically practicable if fully automated systems were used, and in any event within 10 seconds after submission to the derivatives clearing organization for clearing, all swaps that are listed for clearing by the derivatives clearing organization and are not executed on or subject to the rules of a designated contract market or a swap execution facility or executed non-competitively on or subject to the rules of a designated contract market or a swap execution facility. The derivatives clearing organization shall accept all trades:

(A) That are submitted by the parties to the derivatives clearing organization, in accordance with § 23.506 of this chapter;

(B) For which the executing parties have clearing arrangements in place with clearing members of the derivatives clearing organization;

(C) For which the executing parties identify the derivatives clearing organization as the intended clearinghouse; and

(D) That satisfy the criteria of the derivatives clearing organization, including but not limited to applicable risk filters; provided that such criteria are non-discriminatory across trading venues and are applied as quickly as would be technologically practicable if fully automated systems were used.

(8) Confirmation. A derivatives clearing organization shall provide each clearing member carrying a cleared swap with a definitive written record of the terms of the transaction which shall legally supersede any previous agreement and serve as a confirmation of the swap. The confirmation of all terms of the transaction shall take place at the same time as the swap is accepted for clearing.

Part 43 – Real-Time Public Reporting Rules

Appendix A

§ 43.2 Definitions

As used in this part:

[prior definitions remain unchanged]

Block trade means a publicly reportable swap transaction that:

(1) Involves a swap that is listed on a registered swap execution facility or designated contract market and that is either:~~;~~
(i) Executed ~~Occurs~~ away from the ~~registered swap execution facility's or~~ designated contract market's trading system or platform and is executed pursuant to the ~~registered swap execution facility's or~~ designated contract market's rules and procedures; or
(ii) Executed on or away from the registered swap execution facility's trading system or platform and is executed as a permitted transaction in accordance with § 37.9(c)(2) and pursuant to the registered swap execution facility's rules and procedures;

(2) Has a notional or principal amount at or above the appropriate minimum block size applicable to such swap; and

(3) Is reported subject to the rules and procedures of the registered swap execution facility or designated contract market and the rules described in this part, including the appropriate time delay requirements set forth in § 43.5 of this part.

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Office of the
Secretariat

PAC 16

Jacob Ma-Weaver
Cable Car Capital LLC
1449 Washington St #6
San Francisco, CA 94109
jacob@cablecarcapital.com
(415)857-1965

Melissa Jurgens, Secretary of the Commission
U.S. Commodity Futures Trading Commission
Office of the Secretariat
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

July 9, 2014

Via Email and USPS

Regulation 13.2 Petition for Public Rulemaking

Dear Secretary Jurgens and Colleagues:

Cable Car Capital LLC ("Cable Car") is an investment adviser registered with the State of California. Cable Car's investment program implements a concentrated, hedged value investment strategy in separately managed accounts. The strategy is not currently effected using commodity interests and Cable Car is not currently registered as a Commodity Trading Advisor ("CTA"). Cable Car intends to make limited use of commodity interests in the future and will register as a CTA, if required.

Cable Car respectfully requests an addition/amendment to section 4.6 of Title 17 of the Code of Federal Regulations, or such other regulation as the Commission may deem appropriate, as specified below. Through the rulemaking process, Cable Car wishes to clarify, for itself and other similarly situated advisers, the applicability of what is currently a self-certifying registration exemption contained in section 4m(3) of the CEA. In particular, the proposed rule would explicitly grant relief from registration as a CTA to investment advisers who are not engaged primarily in trading commodity interests and, due to their small size, are registered with state regulatory authorities rather than the Securities and Exchange Commission.

Pursuant to several conversations and correspondence from December 5, 2013 through July 8, 2014 with Barbara Gold and Israel Goodman in the Division of Swap Dealer and Intermediary Oversight, Cable Car has withdrawn a request for a staff letter from the Commission in favor of this petition.

The proposed amendment to section 4.6 follows, with changes highlighted in **bold and underlined**:

> §4.6 Exclusion for certain otherwise regulated persons from the definition of the term "commodity trading advisor."

U20150629200A

(a) Subject to compliance with the provisions of this section, the following persons, and any principal or employee thereof, shall be excluded from the definition of the term "commodity trading advisor:"

(1) An insurance company subject to regulation by any State, or any wholly-owned subsidiary or employee thereof;*Provided, however,* That its commodity interest advisory activities are solely incidental to the conduct of the insurance business of the insurance company as such; and

(2) A person who is excluded from the definition of the term "commodity pool operator" by §4.5; *Provided, however,*That:

(i) Its commodity interest advisory activities are solely incidental to its operation of those trading vehicles for which §4.5 provides relief; and

(ii) Where necessary, prior to providing any commodity interest trading advice to any such trading vehicle the person files a notice of eligibility as specified in §4.5 to claim the relief available under that section.

(3) A swap dealer registered with the Commission as such pursuant to the Act or excluded or exempt from registration under the Act or the Commission's regulations; *Provided, however,* That the commodity interest and swap advisory activities of the swap dealer are solely incidental to the conduct of its business as a swap dealer.

(4) As provided for in section 4m(3) of the Act, a commodity trading advisor that is registered as an investment adviser under the Investment Advisers Act of 1940 or with the applicable regulatory agency of any State, and whose business does not consist primarily of acting as a commodity trading advisor, and that does not act as a commodity trading advisor to any commodity pool that is engaged primarily in trading commodity interests; *Provided, however,* That it shall not hold itself out to the public as being engaged primarily, or proposing to engage primarily, in the business of advising on commodity interests or investing, reinvesting, owning, holding, or trading in commodity interests, respectively.

(b) Any person who has claimed an exclusion under this §4.6 must submit to such special calls as the Commission may make to require the person to demonstrate compliance with the provisions of paragraph (a) of this section.

(c) An exclusion claimed under this §4.6 shall cease to be effective upon any change which would render the person claiming the exclusion ineligible under paragraph (a) of this section.

The proposed text follows nearly verbatim from section 4m(3). The exemption would continue to be self-executing as drafted; however, the Commission may also wish to consider whether the statutory definition of "engaged primarily" warrants additional regulatory clarification. Cable Car further submits that the proposed text could alternatively be inserted elsewhere in the title, e.g. as item (11) to section 4.14.

As the proposed rule is largely interpretative in nature and would not change the existing self-certifying exemption process, it may also be eligible for an exception to the public notice and comment requirements as described in section 13.5(b).

The remainder of this petition is adapted from Cable Car's December 6, 2013 letter to the Division of Swap Dealer and Intermediary Oversight. It includes information on the nature of Cable Car's interest and a detailed legal and public policy rationale for the proposal, as allowed under regulation 13.2.

The representations concerning Cable Car's business activities are true and complete to the best of my knowledge as of the date of this petition.

Thank you for your consideration. Please do not hesitate to contact me at the address or telephone number above if you should require any additional information.

Sincerely,

Jacob Ma-Weaver, CFA
Managing Member, Cable Car Capital LLC

Nature of Interest

Although not engaged primarily in trading commodity interests, Cable Car may be considered a CTA because, in the ordinary course of providing investment advice with respect to securities, it has the discretionary authority under its advisory agreements to direct customer accounts to buy or sell futures contracts, options on futures, retail off-exchange foreign exchange, or swaps. Not all of Cable Car's clients are qualifying entities eligible for the exemption in section 4.14(8), and this petition is intended to address similarly situated separate account managers who serve retail clients instead of or in addition to qualifying entities. Cable Car's intended commodity interest activities are incidental to its primary focus on corporate securities, arising out of the desire to hedge risks introduced by those investments. For example, Cable Car wishes to utilize foreign exchange futures to most cost-effectively hedge currency risk on international equities held in client portfolios. Commodity interests regulated by the Commission are often the only practical means of offsetting undesired exposures to price fluctuations introduced by investments in corporate securities. Certain security futures may also be useful as a lower-cost means of facilitating securities lending transactions. It is Cable Car's belief that its clients will be harmed if it is unable to hedge risks and reduce transaction costs using commodity interests.

At this time, none of Cable Car's customer accounts hold or transact in commodity interests. Commodity interests would represent a *de minimis* portion of Cable Car's intended investment activities, as measured by both transaction volume and value. None of Cable Car's clients is a commodity pool; however, by way of illustration, each client account would contain commodity interests below the <5% initial margin and <100% notional tests for section 4.13(a)(3) pool-level exemption from CPO registration.

Were its regulatory assets high enough to warrant registration with the SEC, Cable Car would rely on the exemption from registration as a CTA contained in section 4m(3), since it is not engaged primarily as a CTA and does not advise any commodity pools. Since the exemption is self-executing, there would be no need for this petition. Unfortunately, section 4m(3) was drafted with reference to SEC[1] registration, as opposed to investment adviser registration generally with the SEC or one or more of the States. The distinction was most likely not deliberate, as reasoned below. The proposed amendment harmonizes the language with that exempting certain other registered investment advisers in section 4.14(8).[2]

Arguments in Support – Legal Considerations

CFTC Staff Letters

Upon information and belief, the Commission has never directly addressed the question of whether state-registered investment advisers may rely on the exemption in section 4m(3). Accordingly, there are

[1] Section 4m(3) reads: "Paragraph (1) shall not apply to any commodity trading advisor that is registered with the Securities and Exchange Commission as an investment adviser whose business does not consist primarily of acting as a commodity trading advisor, as defined in section 1a of this title, and that does not act as a commodity trading advisor to any commodity pool that is engaged primarily in trading commodity interests."

[2] Section 4.14(8) refers to an investment adviser that is: "...registered as an investment adviser under the Investment Advisers Act of 1940 or with the applicable securities regulatory agency of any State, or it is exempt from such registration, or it is excluded from the definition of the term "investment adviser" pursuant to the provisions of sections 202(a)(2) and 202(a)(11) of the Investment Advisers Act of 1940."

no prior CFTC opinions, whether supportive or adverse, nor any precondition or prerequisite imposed by the Commission on persons in a similar situation. There are only two prior CFTC Letters that have commented on section 4m(3) in other contexts, CFTC Letter No. 05-13[3], and CFTC Letter No. 09-27[4].

Legislative History

Prior to 1996, investment advisers were regulated by both the states and the SEC and required to register with both.

In 1996, Congress passed the National Securities Markets Improvement Act of 1996 ("NSMIA"). The NSMIA split responsibility for investment adviser registration among the SEC and the states. The law recognized the inability of the SEC to inspect all 22,500 registered investment advisers at the time, and it established a threshold of $25 million under management for SEC registration, designed to distinguish national businesses from investment advisers operating primarily in a localized area. Senate Report No. 293 of the 104th Congress[5] reasoned:

> "Recognizing the limited resources of both the Commission and the states, the Committee believes that eliminating overlapping regulatory responsibilities will allow the regulators to make the best use of their scarce resources to protect clients of investment advisers. The states should play an important and logical role in regulating small investment advisers whose activities are likely to be concentrated in their home state. Large advisers, with national businesses, should be registered with the Commission and be subject to national rules."

The NSMIA nevertheless recognized that its prohibition on small advisers registering with the SEC might not be one-size-fits-all. A 2003 SEC rulemaking decision[6] exempting Internet-based advisers explained:

> "The $25 million threshold was designed to distinguish investment advisers with a national presence from those that are essentially local businesses. Congress recognized, however, that some investment advisers should be regulated at the federal level even though they have less than $25 million of assets under management, and gave the Commission the authority in section 203A(c) of the Advisers Act to exempt investment advisers, by rule or order, from the prohibition on Commission registration in cases in which the prohibition otherwise would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes" of section 203A."

[3] This letter addressed the ability of an adviser to claim exemption under multiple sections of the Act.

[4] A footnote to Letter No. 09-27 indicates that the original request asked that the Commission to consider the situation of "A" and unidentified other advisers "registered with the SEC or the securities regulatory authority of one of the States". The Commission held in its Interpretative Letter that "A" may be able to rely on a section 4m(3) exemption, but restricted its response to "A" in accordance with Regulation 140.99. Through the rulemaking process, the Commission now has an opportunity to address the broader question of whether the remedy offered to "A" should apply to similarly situated advisers registered with one of the States rather than the SEC.

[5] http://www.gpo.gov/fdsys/pkg/CRPT-104srpt293/pdf/CRPT-104srpt293.pdf

[6] Release No. IA-2091 http://www.sec.gov/rules/final/ia-2091.htm

Cable Car is registered in California because it does not qualify for any section 203A exemptions from the prohibition on SEC registration, discussed later.

Section 4m(3) was added to the CEA by the Commodity Futures Modernization Act (CFMA) of 2000[7] as part of a broader package of deregulatory reforms. The Act was passed as a rider to the Consolidated Appropriations Act of 2001 during the lame-duck session of Congress at the end of the Clinton administration.

In 2010, the Dodd-Frank Act included a provision increasing the threshold for SEC registration from $25 million to $100 million and requiring "mid-sized advisers" managing between $25-100 million to deregister from the SEC and re-register with the States. As with the NSMIA before it, the Dodd-Frank Act sought to address an overburdened SEC staff and delegate more of the responsibility for inspecting investment advisers to the States.

Applicability

Clearly, Congress, acting in 2000, could not have intended to withhold the relief available in section 4m(3) from mid-sized advisers managing more than the then-operative $25 million SEC registration threshold but less than the $100 million minimum subsequently established. At the time of the CFMA's passage, the minimum level of regulatory assets required to register with the SEC was $25 million. The Dodd-Frank Act, in turn, did not explicitly contemplate the effect of increasing this threshold on investment advisers relying on a section 4m(3) exemption from registration as a CTA.

Congressional intent suggests that at least mid-sized advisers registered with one or more of the States should be able to rely on the section 4m(3) exemption. As there is no regulatory distinction under current law between mid-sized advisers and smaller state-registered advisers, if state-registered mid-sized advisers should be able to rely on the exemption, then all state-registered advisers should be eligible by extension.

SEC Registration

The operative question with respect to the phrasing of section 4m(3) is as follows: for registered investment advisers with *de minimis* commodity interest activities, did Congress intend to impose an additional regulatory burden, i.e. registration as a CTA with additional recordkeeping, disclosure, and compliance obligations, on the smallest advisers that it did not impose on mid- and large-sized advisers? As detailed above, in dividing regulatory responsibilities among the states and the SEC, Congress had two aims, (i) to reduce the number of advisers overseen by the SEC so that more resources could be devoted to oversight, and (ii) to ensure that SEC regulation was limited to national businesses. Neither of these aims is consistent with an attempt to impose additional regulatory requirements on smaller advisers.

The states and the SEC share responsibility for regulating investment advisers because state investment adviser statutes broadly mirror the Investment Advisers Act of 1940 ("Advisers Act"). It is beyond the

[7] H.R. 5660 II.B.251.4j.(d)

scope of this petition to recite every difference between state and federal law; however, under the principle of preemption, more restrictive federal law should in any case govern the activities of investment advisers registered with state securities authorities. For example, state-registered investment advisers remain subject to the anti-fraud provisions in the Advisers Act. Cable Car voluntarily complies with SEC regulations not explicitly codified in California law, such as Regulation S-P governing the provision of an annual privacy notice to clients. Correspondingly, "Although state investment adviser statutes do not apply to SEC-registered advisers, other state laws, including other state securities laws, do apply."[8]

Importantly, registration under the SEC's aegis does not imply a greater degree of oversight, as would be expected if Congress had intended SEC registration as a higher bar warranting additional exemptive relief, such as that contemplated by section 4m(3). Substantive regulatory differences at the state level are, in point of fact, frequently more stringent than those codified in the Advisers Act. Indeed, one of the motivations for delegating increased responsibility to the states in both NSMIA and Dodd-Frank was the inadequacy of the SEC inspection regime. State-registered advisers may be subject to unannounced examination from multiple state securities authorities, and, unlike the SEC, state regulators impose minimum net worth and capital requirements on registered advisers. Form ADV is required of both state-registered and SEC-registered investment advisers, with additional disclosures requested of state-registered advisers on Part 1B and Part 2A Item 19. Since the creation of the Investment Adviser Registration Depository, the difference in practice between state registration and SEC registration has been largely reduced to completing these disclosures and checking a box on the online application form.

Since state-registered investment advisers are subject to the same or more restrictive oversight as an SEC-registered investment adviser, they should be able to rely on the same exemption from additional regulation by the CFTC.

Section 203A

Furthermore, were it not for other circumstances entirely unrelated to its commodity interest activities, Cable Car and similarly situated firms would be able to register with the SEC. As noted above, Congress intended to limit SEC registration to national businesses. Section 203A exempts advisers required to register in 15 or more states from the prohibition on SEC registration, even if their regulatory assets are less than $100 million. The threshold was previously 30 states. The increasing ease of doing business over long distances has rendered the concept of a primarily local investment adviser somewhat obsolete. Cable Car notes that although it has not yet reached the 15-state threshold, it maintains a public website and has clients in multiple states and countries. It is not uncommon for investment advisers with assets below the threshold for SEC registration to make their services available nationally, within the original purview of the SEC.

Section 203A also contains an exemption for advisers whose home state is Wyoming, since Wyoming does not conduct its own inspections. Were an adviser based in Wyoming, it would be required to

[8] "Regulation of Investment Advisers by the U.S. Securities and Exchange Commission," March 2013 staff paper, http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf

register with the SEC. In other words, an adviser could rely on section 4m(3) exemption from registration as a CTA as an entirely identical business operating in Wyoming instead of one of the other 49 states.

If the ability of multi-state advisers and Wyoming advisers with less than $100 million of assets to register with the SEC entitled these advisers to section 4m(3) relief from registration as a CTA, but this relief were not available to state-registered investment advisers, then those state-registered advisers would unfairly be subject to additional regulatory requirements not required of similar businesses. The prohibition on SEC registration is qualified by the requirement that it not be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of section 203A."[9] Assuming, *arguendo*, that the SEC's section 203A exemptions are *not* unfair to state-registered advisers, then by implication state-registered advisers must be entitled to the same relief extended to those SEC-registered advisers by virtue of their ability to register with the SEC. The proposed rule clarifies this point.

Arguments in Support – Public Policy Considerations

Irrespective of any legal principle that may require fair and equitable treatment of similarly situated industry participants, fair treatment of state-registered investment advisers vis-à-vis SEC-registered investment advisers is good public policy. Treating small, newly formed advisers fairly levels the playing field and promotes healthy competition in the marketplace. Treating advisers with primary places of business in different, or more, states differently for the purpose of a national registration exemption would be unfair on its face. Moreover, other than for the expediency of dividing regulatory authority between the SEC and the states, there is no justification for discrimination among advisers on the basis of assets under management. Imposing the additional burden of CTA registration on an adviser because it is too small to qualify for SEC registration violates basic principles of fairness by imposing additional regulatory burdens on the market participants least able to bear them. It contravenes the general trend of regulatory development in recent years to place the burden of additional regulatory responsibilities on the largest, systemically most important entities. Small state-registered investment advisers do not pose systemic risks to the financial system.

In addition, lack of relief is especially burdensome for small advisers, serving as a barrier to entry that limits the ability of newer firms to compete in the marketplace. Registration with the NFA is a material additional expense for an investment adviser, significantly more expensive than investment adviser registration. It requires non-refundable application fees for a firm and its associated persons of at least $285, and ongoing annual NFA membership fees of $750 (or $2,500 to allow for retail off-exchange foreign exchange activities). For advisers managing less than $25 million (or $100 million) both these fees and the related legal costs, which may be orders of magnitude higher, are significant.

Another public policy consideration, which supports the existence of the section 4m(3) exemption in the first place, is that the disclosures required of CTAs could potentially have unintended consequences for registered investment advisers with *de minimis* commodity interest activities. Adding additional disclosure requirements regarding commodity interests that are not a significant portion of an adviser's

[9] 15 U.S.C. 80b-3a(c), as cited in SEC Release No. IA-2091 above.

business could deflect attention from the already extensive disclosures provided about an adviser's investment program on Form ADV. Although these enhanced disclosures are desirable for entities acting primarily as CTAs, they run the risk of obfuscating the securities-related disclosures and confusing less sophisticated clients who are subscribing to an investment program not focused on commodity interests. Also, it may be difficult or impossible for an investment adviser to separate the performance of its limited, hedging-related commodity interest activities for the purpose of disclosing the performance of a commodity interest trading program.

Lastly, the Commission should consider the high likelihood that state-registered investment advisers are already relying on the self-certifying exemption in section 4m(3). Cable Car was advised by outside counsel that it could rely on the exemption as a state-registered adviser; this petition was prompted by a more conservative position taken by Cable Car's prime broker. The diversity of opinion suggests that other investment advisers could benefit from clarity, such as that suggested by the proposed rule. As reasoned above, mid-sized advisers are particularly likely to be affected, as some may have been relying on section 4m(3) prior to Dodd-Frank and could have continued to rely on the exemption after switching to state registration.

Thank you for your consideration.

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Office of the
Secretariat

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Reed Smith LLP
10 South Wacker Drive
Chicago, IL 60606-7507
+1 312 207 1000
Fax +1 312 207 6400
reedsmith.com

Patricia Dondanville
Direct Phone: +1 312 207 3911
Email: pdondanville@reedsmith.com

July 12, 2012

VIA MESSENGER
Mr. David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4)

Dear Mr. Stawick:

Enclosed please find a copy of the Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4), filed today pursuant to CFTC Regulation 13.2 on behalf of the following Petitioners:

American Public Power Association
Large Public Power Council
American Public Gas Association
Transmission Access Policy Study Group
Bonneville Power Administration

Very truly yours,

Patricia Dondanville PLK
Patricia Dondanville

PD:esh
Enclosure

U20120293300A

APPA American Public Power Association
PublicPower.org

American Public Gas Association

TAPS

BPA 75 YEARS SERVING THE NORTHWEST

July 12, 2012

Via Email and Messenger Delivery

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4)

Dear Mr. Stawick:

The American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), the American Public Gas Association ("APGA"), the Transmission Access Policy Study Group ("TAPS") and the Bonneville Power Administration ("BPA")(collectively, the "Petitioners") respectfully petition the Commodity Futures Trading Commission (the "Commission" or the "CFTC") under CFTC Regulation 13.2 to amend CFTC Regulation 1.3(ggg)(4),[1] which implements the *de minimis* exception to the definition of "swap dealer." The Petitioners specifically request that the rule amendment exclude from the "special entity sub-threshold," which appears in Regulation 1.3(ggg)(4)(i), "Utility Operations-Related Swaps" to which the Petitioners and other "Utility Special Entities" are, or may in the future be, counterparties. The definitions of "Utility Operations-Related Swap" and "Utility Special Entity" are included directly in the text of the proposed rule amendment, and narrowly circumscribe the scope of the proposed rule amendment.

[1] 77 Fed. Reg. 30596, at 30744.

Such a rule amendment is permitted by Section 1a(49)(D) of the Commodity Exchange Act ("CEA") as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"),[2] and is specifically contemplated by CFTC Regulation 1.3(ggg)(4)(v).[3] The rule amendment is necessary in order to preserve uninterrupted and cost-effective access to the customized, nonfinancial commodity swaps that Petitioners and other Utility Special Entities use to hedge or mitigate commercial risks arising from their utility facilities, operations and public service obligations.

The information required by CFTC Regulation 13.2 follows:

I. THE TEXT OF THE PROPOSED RULE AMENDMENT (Additional language is underlined and italicized)

PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

***

Section 1.3 Definitions.

***

(ggg) Swap Dealer.

***

(4) *De minimis* exception. (i) Except as provided in paragraph (ggg)(4)(vi) of this section, a person that is not currently registered as a swap dealer shall be deemed not to be a swap dealer as a result of its swap dealing activity involving counterparties, so long as the swap positions connected with those dealing activities into which the person – or any other entity controlling, controlled by or under common control with the person – enters over the course of the immediately preceding 12 months (or following the effective date of final rules implementing Section 1a(47) of the Act, 7 U.S.C. 1a(47), if that period is less than 12 months) have an aggregate gross notional amount of no more than $3 billion, subject to a phase in level of an aggregate gross notional amount of no more than $8 billion applied in accordance with paragraph (ggg)(4)(ii) of this section, and an aggregate gross notional amount of no more than $25 million *(the "special entity sub-threshold")* with regard to swaps in which the counterparty is a "special entity" (as that term is defined in Section 4s(h)(2)(C) of the Act, 7 U.S.C. 6s(h)(2)(C), and §23.401(c) of this chapter)*; provided that such $25 million special entity sub-threshold shall* ***not*** *apply with regard to "utility operations related swaps" to which the counterparty is a "utility special entity." For purposes of this paragraph, (A) a "utility special entity" means a government "special entity" (as described in clause (i) or (ii) of Section 4s(h)(2)(C) of the Act or in clause (1) or (2) of §23.401(c) of this chapter) that owns or operates electric or natural gas facilities or electric or natural gas operations (or anticipated facilities or operations), supplies natural gas and/or electric energy to other*

[2] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[3] 77 Fed. Reg. 30744-30745.

utility special entities, has public service obligations (or anticipated public service obligations) under Federal, State or local law or regulation to deliver electric energy and/or natural gas service to utility customers, or is a Federal power marketing agency as defined in Section 3 of the Federal Power Act (16 U.S.C. 796(19)), and (B) a "utility operations-related swap" shall mean any swap that a utility special entity enters into "to hedge or mitigate commercial risks" (as such phrase is used in Section 2(h)(7)(A)(ii) of the Act) intrinsically related to the electric or natural gas facilities that the utility special entity owns or operates or its electric or natural gas operations (or anticipated facilities or operations), or to the utility special entity's supply of natural gas and/or electric energy to other utility special entities or to its public service obligations (or anticipated public service obligations) to deliver electric energy or natural gas service to utility customers. For the avoidance of doubt, "intrinsically related" shall include all transactions related to (i) the generation or production, purchase or sale, and transmission or transportation of electric energy or natural gas, or the supply of natural gas and/or electric energy to other utility special entities, or delivery of electric energy or natural gas service to utility customers, (ii) all fuel supply for the utility special entity's electric facilities or operations, (iii) compliance with electric system reliability obligations applicable to the utility special entity, its electric facilities or operations, (iv) compliance with energy, energy efficiency, conservation or renewable energy or environmental statutes, regulations or government orders applicable to the utility special entity, its facilities or operations, or (v) any other electric or natural gas utility operations-related swap to which the utility special entity is a party. Utility operations-related swaps shall ***not*** *include a swap based or derived on, or referencing, commodities in the interest rates, credit, equity or currency asset classes, or a product type or category in the "other commodity" asset class that is based or derived on, or referencing, metals, or agricultural commodities or crude oil or gasoline commodities of any grade not used as fuel for electric generation.* For purposes of this paragraph, if the stated notional amount of a swap is leveraged or enhanced by the structure of the swap, the calculation shall be based on the effective notional amount of the swap rather than on the stated notional amount.

II. THE PETITIONERS

APPA is the national association that represents the interests of approximately 2000 government-owned electric utilities in the United States. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. Government-owned electric utilities provide over 15% of all KWh sales to retail electric customers.

LPPC is an organization representing 26 of the largest government-owned electric utilities in the nation. LPPC members own and operate over 86,000 megawatts of generation capacity and nearly 35,000 circuit miles of high voltage transmission lines, representing nearly 90% of the transmission investment owned by non-Federal government-owned electric utilities in the United States.

TAPS is an association of transmission dependent electric utilities located in more than 30 states. All of TAPS member electric utilities except one are government-owned electric utilities.

APGA is the national association that represents government-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and over 720 of these systems are APGA members. Government-owned natural gas distribution systems are not-for-profit entities owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other government agencies that have natural gas distribution facilities.

Some government-owned utilities are both electric utilities and natural gas distribution utilities, and are therefore members of both APPA and APGA. The purpose of a government-owned electric utility or natural gas distribution system is to provide reliable, safe and affordable electric energy and/or natural gas service to the community it serves.

BPA is a self-financed, non-profit Federal agency created in 1937 by Congress that primarily markets electric power from 31 federally owned and operated projects, and supplies over one-third of the electricity used in the Pacific Northwest. BPA also owns and operates approximately 75 percent of the high-voltage transmission in the Pacific Northwest. BPA's primary statutory responsibility is to market its Federal system power at cost-based rates to its "preference customers."[4] BPA also funds one of the largest wildlife protection and restoration programs in the world.

III. NATURE OF THE PETITIONERS' INTEREST

APPA, LPPC, TAPS and APGA represent thousands of government-owned electric and natural gas utilities throughout the United States, all of which are "special entities" as that term is defined in Section 4s(h)(2)(C) of the Commodity Exchange Act, as amended by the Dodd-Frank Act, and §23.401(c) of the Commission's regulations. BPA and the other Federal power agencies are "special entities" as well.[5] The Petitioners

[4] BPA has 130 preference customers made up of electric utilities which are not subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC"), including Indian tribes, electric cooperatives, state and municipally chartered electric utilities, and other Federal agencies located in the Pacific Northwest.

[5] According to the Energy Information Administration, there are nine Federal electric utilities in the United States, which are part of several agencies of the United States Government (see, http://www.eia.gov/cneaf/electricity/page/prim2/toc2.html): the Army Corps of Engineers; the Bureau of Indian Affairs and the Bureau of Reclamation in the Department of the Interior, the International Boundary and Water Commission in the Department of State , the Power Marketing Administrations in the Department of Energy (BPA, Western Area Power Administration, Southwestern Area Power Administration, and Southeastern Area Power Administration), and the Tennessee Valley Authority (TVA). In addition, three Federal agencies operate electric generating facilities: TVA, the largest Federal power producer; the U.S. Army Corps of Engineers; and the U.S. Bureau of Reclamation.

respectfully seek the rule amendment for the benefit of all "Utility Special Entities" that currently, or may in the future, enter into Utility Operations-Related Swaps with counterparties that are not registered with the Commission as "swap dealers."

"Utility Special Entities," as defined in the proposed rule amendment, are a narrow category of special entities distinguishable by their electric energy and/or natural gas utility facilities, operations and public service obligations. None of the Utility Special Entities is a "financial entity;" all are nonfinancial entities and "commercial end users" as such term is used by Congress and regulatory policy makers. "Utility Operations-Related Swaps," as defined in the proposed rule amendment, are a narrow category of "swaps"[6] in the nonfinancial or "other commodity" asset class. Such swaps are, by definition, of product types intrinsically related to the commercial risks associated with utility facilities, operations and public service obligations, and are used to hedge or mitigate such commercial risks. Such customized nonfinancial commodity swaps are typically not available on exchanges or electronic trading platforms, due to the myriad non-numeric operational conditions, requirements and permutations embedded in such swaps.

The Petitioners commented on the Commission's proposed rules further defining "swap dealer" raising concerns that **both** the general *de minimis* threshold and the "special entity sub-threshold" needed to be raised significantly. See comments filed by NFP Electric End User Coalition, including APPA and LPPC with assistance from TAPS, in the Commission's "Entity Definitions" docket, a link to which appears at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27917&SearchText=

[6] This term has not yet been defined by the Commission to the extent required to provide regulatory clarity to Petitioners and others in the utility industry. The Petitioners and others in the utility industry await publication in the Federal Register of rules further defining "swap," along with the Commission's response to public comments on any further questions asked by the Commission in the most recent statutory interpretations relevant to the definition of "swap," the Commission's response to comments solicited on the nonfinancial commodity "trade option" Interim Final Rule, the CFTC/FERC jurisdictional Memoranda of Understanding called for by Section 720 of the Dodd-Frank Act, the "tariffed transaction exemption(s)" and "between FPA 201(f) transaction exemption" called for in new CEA Sections 4(c)(6), and other final rules, interpretations and exemptions. See the comment letter filed by the Electric Trade Associations in the "Product Definitions" or "Definition of 'Swap'" docket at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47934&SearchText=Wasson, and other comment letters, applications and petitions filed by the Petitioners and others in the utility industry.

There is no need to wait to consider the proposed rule amendment for the effective date of the Commission's final rules further defining the term "swap." The proposed rule amendment, as drafted, will only be applicable to those utility operations-related transactions which are ultimately subject to the Commission's jurisdiction as "swaps," and would therefore be considered part of an entity's "swap dealing activity," and counted against either the general *de minimis* threshold or the special entity sub-threshold. In this manner, the proposed rule amendment is similar to all the Commission's regulations that include the term "swap," including the Entity Definition rules themselves. None of these regulations can be fully understood or applied to Petitioners' and other market participants' businesses until the Commission's final rules further defining "swap" and other foundational terms that include the term "swap" are effective for relevant asset classes and product types.

rural at 18-19, supporting the comments filed by the Edison Electric Institute and the Electric Power Supply Association in the same docket requesting significantly higher thresholds for ***both*** the general *de minimis* threshold and the special entity sub-threshold than were proposed by the Commission, a link to which appears at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27918&SearchText=

The Commission acknowledges the Petitioners' comments in numerous places in the Adopting Release for the Entity Definitions rules (the "Adopting Release"). See, for example, 77 Fed. Reg. 30627 and 30707. In the final rules, however, the Commission raised the general *de minimis* threshold by a factor of 80 during the phase in period (and by a factor of 30 thereafter) - from $100 million to $8 billion during the phase in period (and $3 billion thereafter). In contrast, the Commission left the special entity sub-threshold unchanged at $25 million. The Petitioners' concern about the competitive disadvantage represented by the discrepancy between the two thresholds in the final rules is the reason for this Petition.

A. Utility Special Entities Require Customized Utility Operations-Related Swaps.

Utility Special Entities depend on nonfinancial commodity transactions, trade options and "swaps," as well as the futures markets, to hedge commercial risks that arise from their utility facilities, operations and public service obligations. Together, these nonfinancial commodity markets play a central role in government-owned utilities securing electric energy, fuel for generation and natural gas supplies for delivery to consumers at reasonable and stable prices. Specifically, many government-owned utilities purchase firm electric energy, fuel and gas supplies in the physical delivery markets (in the "cash" or "spot" or "forward" markets) at prevailing and fluctuating market prices, and enter into bilateral, financially–settled nonfinancial commodity swaps with customized terms to hedge the unique operational risks to which each Utility Special Entity is subject.

The Utility Special Entities use Utility Operations-Related Swaps to ensure reliability of utility service and to reduce utility customers' exposure to future commodity price fluctuations and to stabilize utility rates. In hedging, mitigating or managing the commercial risks of its utility facilities operations or public service obligations, the Utility Special Entity are engaged in commercial risk management activities that are no different from the operations-related hedging of an investor-owned utility or an electric cooperative located in the same geographic region.

B. The "Market" for Each Particular Utility Operations-Related Swap is Illiquid.

Utility Special Entities enter into these bilateral customized swaps in illiquid regional or local "markets."[7] Some counterparties available to transact with Utility Special Entities

[7] The word "markets" is used in quotations in this context, as Utility Operations-Related Swaps do not occur with anywhere near the frequency or uniformity that financial "swaps" occur, or that agricultural,

Continued on following page

will be major financial institutions or other financial entities, such as hedge funds, that may or may not transact in other swap asset classes or product types. Other available counterparties will be nonfinancial counterparties, those which are not "financial entities" as such term is defined in CEA Section 2(h)(7)(C).

Each Utility Special Entity actively seeks out available swap counterparties in order to hedge its unique, ongoing and dynamically-changing commercial risks.[8] Commercial risk management policies in the energy industry typically require diversification of suppliers and swap counterparties, limited concentration of supplier/vendor/counterparty credit risk, and other commercial risk management metrics to prudently manage the commercial risks of bilateral contracting processes.

Each regional geographic market has a somewhat different group of financial entity and nonfinancial counterparties available to enter into customized Utility Operations-Related Swaps. An available counterparty may own or operate commercial businesses related to the particular nonfinancial commodity that underlies the Utility Operations-Related Swap. It may be a neighboring utility or electric cooperative, the owner of a merchant electric generation facility located in the area, or a natural gas or coal company with production assets in the region.

For example, a large natural gas utility or the owner of a large merchant electric generation station in western Alabama might be available as a nonfinancial counterparty for swaps referencing an Alabama delivery point. But that same entity would not necessarily offer the type of customized Utility Operations-Related Swap required by a Utility Special Entity located in Oregon. Or, a natural gas producer or coal producer with production assets in Wyoming might offer Utility Operations-Related Swaps required by a California-based or Oregon-based Utility Special Entity. But the same counterparty would not necessarily enter into a similar Utility Operations-Related Swap referencing a nonfinancial commodity delivered in the Southeast. Nor would it

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metals, global oil or other product types of "swaps" in the "other commodity" asset class occur. Utility Operations-Related Swaps are, in some cases, negotiated over a period of days, weeks or months. Some may be documented based on a master agreement template, with many pages of specialized operational, credit and other risk management provisions included by the bilateral counterparties as schedules. Transacting under standardized master agreement templates (with bilaterally negotiated schedules and transaction documents) should not be confused with a conclusion or an assumption that there is a trading "market" for Utility Operations-Related Swaps having, standardized or "market" terms.

[8] Utility Special Entities may also be called upon from time to time by other utilities located in the same geographic region, by or in coordination with electric reliability organizations, to act as counterparties in Utility Operations-Related Swaps for electric system reliability purposes. Such swaps should not be considered "swap dealing activity" by the utility counterparty or counterparties to such swaps. Otherwise, the Utility Special Entities may not be able to participate in such swaps for reliability purposes without causing the counterparty to exceed the Special Entity Sub-Threshold, which may compromise the reliability of the interconnected electric system.

necessarily offer a Utility Operations-Relatec Swap referencing electric energy in any regional market.

C. Utility Special Entities Need All Available Utility Operations-Related Swap Counterparties.

Due to the limited number of counterparties for any particular Utility Operations-Related Swap in any particular region, each available financial or nonfinancial swap counterparty, whether or not a registered "swap dealer," brings important market liquidity or supplier/counterparty diversity for a Utility Special Entity. Multiple available counterparties create price competition for the customized swaps that a Utility Special Entity requires to cost-effectively hedge or mitigate unique commercial risks.[9]

Based on an informal survey of some of the larger Utility Special Entities, a substantial percentage of the counterparties that are currently available to enter into Utility Operations-Related Swaps with such Utility Special Entities are nonfinancial entities engaged in the electric, natural gas, coal or another aspect of the energy industry in the same geographic area as the specific Utility Special Entity.

Wall Street financial institutions and other financial entities tend to offer such swaps only where there is standardization of transaction terms and liquid trading markets: at trading hubs where the financial entity's swaps can be promptly and effectively hedged to maintain a "balanced book." Nonfinancial entities with assets or operations located in the geographic region may, as a result, face parallel commercial risks and can use the Utility Operations-Related Swap to manage some portion or aspect of the commercial risks inherent in its own physical assets, liabilities and commercial obligations.[10]

Because the Utility Special Entity is hedging a commercial risk, its focus is to align the Utility Operations-Related Swap as closely as possible with the underlying and unique commercial risk being hedged, rather than to settle for a more standardized, shorter-

[9] In the Adopting Release, the Commission cites comments made by Petitioners' representatives and other energy industry market participants at the Commission Roundtable and meetings on these important points. See 77 Fed. Reg. at 30707-30708. Although a Utility Special Entity may be able to seek out a CFTC-registered Wall Street "swap dealer" or another financial entity, such as a hedge fund, to provide such a customized Utility Operations-Related Swap, if the "swap dealer" does not have assets in the region or is not otherwise active in the particular regional nonfinancial commodity swap market, the pricing and customization of the Utility Operations-Related Swap it offers are unlikely to be competitive.

[10] The nonfinancial counterparty may itself be entering into a Utility Operations-Related Swap "for the purpose of hedging physical positions," as that phrase appears in CFTC Regulation 1.3(ggg)(6)(iii) and about which the Commission is seeking further comment in the Adopting Release. That regulation is identified as an "interim final rule," and therefore presumably is still subject to further Commission rulemaking before the rules defining "swap dealer" are, indeed, final. See 77 Fed Reg. 30612. See also footnote 6 with reference to the Commission's anticipated further rulemakings on the definition of "swap" and nonfinancial commodity "trade options."

term, and therefore less "perfect" (and consequently less cost-effective) hedge for such commercial risk.[11]

D. Utility Operations-Related Swaps Often Have Large Notional Amounts.

Many Utility Operations-Related Swaps have longer terms than may be typical in other swap asset classes or product types, as a result of the long-term commercial risks being hedged – risks arising from long-term utility service obligations, construction projects, generation outage or availability projections, or long term fuel needs. Consequently, the notional amount of such swaps can be quite large. In addition, due to the volatile nature of the market prices of these nonfinancial commodities, the notional amounts can fluctuate dramatically over the term of a Utility Operations-Related Swap. The prices of electric energy, fuel and natural gas are among the most volatile of traded commodities, especially prices for illiquid delivery points, subject to regional supply and demand factors such as weather, and with customized operational conditions and terms.

A single one-year 100 MW swap or a single three-year 10,000 mmBtu/day swap may have a notional value of $25 million.[12] A nonfinancial entity would, therefore, be available to enter into only one such swap with Utility Special Entity counterparties in any rolling twelve-month period. Otherwise, the nonfinancial entity risks exceeding the special entity sub-threshold, and would be required to register with the Commission as a "swap dealer."

E. Utility Special Entities are At a Competitive Disadvantage to Similarly-Situated Market Participants due to the Special Entity Sub-Threshold.

If the Commission denies the proposed rule amendment, Utility Special Entities could still look to CFTC-registered swap dealers for these types of swaps, or could use less customized, more expensive commercial risk management solutions that might be

[11] We have discussed the Special Entity Sub-Threshold issue with energy trade associations and with large nonfinancial entities that currently act as regular counterparties to Utility Special Entities in these types of swaps. A number of these entities have indicated to Petitioners that they share our concern about the sub-threshold, and that they are prepared to file comments in support of this Petition. See footnote 16.

[12] These examples are based on available quotes for 100 MWs of 7x24 electric energy for calendar year 2013 at Mid-C, PJM West and SP-15 for "Firm LD" power, and on Henry Hub calendar strip prices for natural gas. Each of these examples is for a relatively liquid delivery point, and for swaps that are not customized as are many Utility Operations-Related Swaps. To put these examples (and the $25 million Sub-Threshold) in context, the Los Angeles Department of Water and Power owns or operates 6000 MWs of electric generation, and the New York Powe· Authority owns or operates 7400 MWs of electric generation. JEA, formerly the Jacksonville Electric Authority, hedges approximately 13.8 million mmBtus of natural gas in an average year as part of its fuel procurement process for electric operations, based on the past 5 years actual hedging activity. If each of these Utility Special Entities was limited to one $25 million hedge per year with each non-"swap dealer" counterparty, it would dramatically limit the ability of these Utility Special Entities to hedge or mitigate commercial risks arising from everyday utility operations.

available on an exchange. Or Utility Special Entities could simply forego using nonfinancial commodity swaps for commercial risk management purposes entirely. At the same time, the available counterparties for Utility Operations-Related Swaps could enter into up to $8 Billion notional in swaps, or even $8 Billion in Utility Operations-Related Swaps, with counterparties ***other than*** Utility Special Entities, including neighboring investor-owned utilities and electric cooperatives. As a direct result of the Special Entity Sub-Threshold, Utility Special Entities are denied a level playing field in the competition for available counterparties for these commercial risk hedging swaps. Utility Special Entities are denied comparable, cost-effective access to such commercial risk management tools that will instead be offered to neighboring investor-owned utilities and electric cooperatives by otherwise available market participants.[13]

In today's regional markets, a Utility Special Entity is equally as likely as an investor-owned utility in the same region to be an attractive counterparty for an entity that chooses to "deal" in Utility Operations-Related Swaps, whether the entity is a nonfinancial company hedging its own commercial risks (or "hedging a physical position" as such phrase is more narrowly defined in the CFTC's definition of "swap dealer"), trading for profit (speculating), or engaging in a regular business of dealing in such swaps. The "playing field" between the Utility Special Entity and the investor-owned utility, electric cooperative or any other counterparty is currently "level."

Moreover, in today's regional markets, if a market participant (such as the Alabama merchant generator or the Wyoming natural gas or coal producer referenced above) is considering establishing a new entrant "swap dealing" business in specific regional product types of Utility Operations-Related Swaps, it will similarly consider the Utility Special Entity as a potential counterparty with the same ability to transact as any other potential counterparty. The Utility Special Entity benefits from any new or additional price competition.

Once the CFTC's Entity Definition rules are effective, as a result of the significant disparity between the general *de minimis* threshold and the special entity sub-threshold, the Alabama-based merchant generator or the Wyoming-based natural gas or coal producer, or any other market participant not intending to register as a "swap dealer," will substantially limit its swap dealing activity in Utility Operations-Related Swaps with Utility Special Entities. Indeed, in regions like California and the Southeast United

[13] An unintended consequence of the $25 million Special Entity Sub-Threshold applied to Utility Operations-Related Swaps will be to limit the Utility Special Entities' available counterparties and force Utility Special Entities to engage in Utility Operations-Related Swaps with financial institutions and other entities that are registered with the CFTC. This would concentrate, not disperse, risk to the United States financial system. For financial institutions, such activity may or may not be an activity in which such financial institutions or their "banking entity" affiliates are permitted to engage once the regulations implementing the Volcker Rule and other provisions of the Dodd-Frank Act rulemakings are finalized. Such Utility Operations-Related Swaps with "swap dealer" counterparties may also require the posting of margin by Utility Special Entities (depending on the applicable regulators' final rules on capital and margin).

States, where there are geographic concentrations of Utility Special Entities, a non-"swap dealer" counterparty may only be able to execute one such Utility Operations-Related Swap with one such Utility Special entity in a 12-month period without the risk of exceeding the $25 million sub-threshold. The entity will set up its swap dealing activity business, its business processes, its documentation and its compliance programs to transact with counterparties ***other than*** the Utility Special Entities, including neighboring investor-owned utilities and electric cooperatives.[14] The unworkably low, and comparatively disadvartageous, Special Entity Sub-Threshold threatens the Utility Special Entities' uninterrupted access to these important and cost-effective commercial risk management tools.

IV. SUPPORTING ARGUMENTS

For the following reasons, the Commission should approve the proposed rule amendment as soon as possible:

A. The Commission has the Authority to Approve the Rule Amendment.

Section 1a(49)(D) of the Commodity Exchange Act ("CEA") as amended by the Dodd-Frank Act, and new CFTC Regulation 1.3(ggg)(4)(v) authorize the Commission to change or modify the requirements of the *de minimis* exception to the "swap dealer" definition by rule or regulation, without engaging in further joint rulemaking or joint interpretative guidance with the Securities and Exchange Commission. The Adopting Release acknowledges this. See footnote 464 at 77 Fed. Reg. 30634, and related text.

Section 1a(49)(D) provides as follows:

...(D) *DE MINIMIS* EXCEPTION – The Commission shall exempt from designation as a swap dealer an entity that engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to making of this determination to exempt."

As the Commission notes on page 30702 of the Adopting Release, "... CEA Section 1a(49)(D) directs the CFTC to promulgate regulations to establish factors with respect to the making of the determination to apply the *de minimis* exceptions to the definition of the term "swap dealer."

[14] The Adopting Release notes that the statute's *de minimis* exception intended to increase competition within markets for swaps by encouraging new entrants, thereby decreasing costs for commercial end users and decreasing systemic risks by lessening concentration of dealing activity among a few major financial market participants. See 77 Fed. Reg. 30629. Ironically the special entity sub-threshold acts directly contrary to this stated statutory and regulatory objective. For Utility Special Entities hedging commercial risks, the sub-threshold will serve to discourage new entrants and concentrate the Utility Special Entity's counterparty credit risk. The proposed rule amendment would restore this competitive, and less risky, market structure.

New CFTC Regulation 1.3(ggg)(4)(v) provides as follows:

"...(v) Future adjustments to scope of the de minimum exception. The Commission may by rule or regulation change the requirements of the *de minimis* exception described in paragraphs (ggg)(4)(i) through (iv) of this section.

Clearly the Commission has the authority to approve the proposed rule amendment.

B. The Factors Set Forth the Proposed Rule Amendment are Distinctly and Uniquely Applicable to Utility Operations-Related Swaps and to Utility Special Entities.

The proposed rule amendment will have no affect on the *de minimis* exception to the "security-based swap dealer" definition. Nor will the proposed rule amendment have any affect on the *de minimis* exception to the Commission's "swap dealer" definition as it applies in general to special entities (including Utility Special Entities) engaging in financial swaps or nonfinancial" other commodity" swaps, other than those product types critical to hedging or mitigating commercial risks in the utility industry.

The factors set forth in the proposed rule amendment are not applicable to security-based swap dealers or to their counterparties. Counterparties to security-based swaps do not need such security-based swaps to "hedge or mitigate commercial risks", as is the case with commercial end users' need for nonfinancial commodity swaps to hedge or mitigate commercial risks. Congress specifically recognized the importance of protecting "commercial end users" access to nonfinancial commodity swaps when it emphasized that the Dodd-Frank Act's focus on financial market stability and price and market transparency should not be achieved without also preserving commercial end users' access to swaps used to hedge or mitigate commercial risks.[15]

The factors that argue in favor of the Commission approving the proposed rule amendment are also inapplicable to entities involved in agricultural or metal commodities transactions and swaps. Such entities are simply not subject to public service obligation comparable to those that apply to utilities that require Utility Operations-Related Swaps to hedge commercial risks associated with utility facilities, operations and public service obligations. Utilities (including Utility Special Entities) have public service obligations under Federal, state and local laws and regulations, and utility reliability obligations, that other industries simply do not share. Congress recognized these important obligations throughout the Dodd-Frank Act as deserving of the Commission's regulatory deference. See Section 720 of the Dodd-Frank Act calling for FERC/CFTC memoranda of understanding, new CEA Section 2(a)(1)(I) regarding jurisdiction of the various energy regulatory agencies, and new CEA Section 4(c)(6) directing the Commission to consider public interest waivers of its jurisdiction.

[15] *See* 156 Cong Rec. H5238 (the "Dodd-Lincoln letter").

The Commission clearly has the authority to approve the proposed rule amendment. The factors that argue in favor of the proposed rule amendment, and limit its affect, reflect the unique and the different characteristics of these types of "swaps" and these market participants, and recognize the differing applicable laws and regulations, and statutory and regulatory policies The Commission should approve the proposed rule amendment and do so as soon as possible.

C. Nothing in the Dodd-Frank Act or the CEA Requires the Special Entity Sub-Threshold.

The proposed rule amendment is narrowly tailored to achieve both the statutory goals and Congressional intent underlying the Dodd-Frank Act, and to leave in place the supplemental investor protection objectives of the Commission in including the Special Entity Sub-Threshold in the "swap dealer" definition.

In the Dodd-Frank Act, Congress imposed on registered "swap dealers" heightened business conduct standards when advising, offering or entering into swaps with "special entities." Nothing in the Dodd-Frank Act imposes or requires the Commission to impose business conduct standards on entities that are not required to register as "swap dealers." Nothing in the Dodd-Frank Act requires the Commission to impose an exponentially smaller *de minimis* sub-threshold for counterparties that are not registered "swap dealers" and that enter into swaps to which "special entities" are counterparties. The Adopting Release acknowledges as much, characterizing the lower threshold as "*consistent with* the fact that Title VII's requirements applicable to swap dealers . . . provide heightened protection to these types of entities." 77 Fed. Reg. at 30630 (*emphasis added*).

The Adopting Release cites the Dodd-Frank Act provisions that impose on *registered* swap dealers and major swap participants (those market professionals whose activities are directly regulated by the Commission) heightened business conduct standards and documentation requirements for interacting with "special entities." The Adopting Release then extrapolates without explanation as to why it is consistent for the Commission to extend its regulatory reach beyond the market professionals registered as "swap dealers," whose conduct the statute intends it to regulate, to impose restrictions on the activities of entities that are not swap dealers, and whose *de minimis* "swap dealing activities" do not require such registration. The Special Entity Sub-Threshold is a clear regulatory overreach by the Commission, and should be modified where such regulatory overreach negatively affects the ability of yet another group of entities that are not "swap dealing" – the "Utility Special Entities" – to hedge or mitigate the commercial risks of their nonfinancial, public service enterprises.

The Adopting Release gives examples of situations where the special entity "lacked the requisite sophistication and experience to independently evaluate *the risks of the investment* and exposed the [special entity] to a heightened risk of catastrophic loss ultimately led to a complete loss of their investments." See footnote 425 and text

accompanying at 77 Fed. Reg. 30630 (*emphasis added).* In the examples, the special entities were acting outside the scope of their core operations as investors in financial derivatives, interacting with financial institution or "financial entity" market professionals, using cash reserves or other cash assets of the special entity to invest (for profit or loss) in financial derivatives instruments. By contrast, the Utility Special Entities use Utility Operations-Related Swaps to hedge the commercial risks of their core utility operations, not to invest for profit.

D. The Proposed Rule Amendment is Consistent with Both Congressional Intent of the Dodd-Frank Act and Will have No Affect on the Commission's Investor Protection Policy Objectives.

The investor protection objectives of the Dodd-Frank Act, and the Commission's own "consistent" and supplemental investor protection objectives as expressed in the Adopting Release, would not be affected or compromised by the proposed rule amendment. As is clear from the proposed definition of "Utility Operations-Related Swap," the Utility Special Entity enters into such a nonfinancial commodity swap to hedge commercial risks that arise from its utility facilities, operations and public service obligations.

The proposed rule amendment is drafted narrowly to respect the Commission's investor protection policies but to achieve the distinct, but equally important, Congressional intent of the Dodd-Frank Act: to preserve cost-effective (and comparative, competitively equal) access to nonfinancial commodity swaps that Utility Special Entities use "to hedge or mitigate commercial risks."

The proposed rule amendment does not amend either the general *de minimis* threshold for swap dealing activity. The general *de minimis* threshold would continue to apply to Utility Operations-Related Swaps to which Utility Special Entities are counterparties. Nor does the proposed rule amendment change the "special entity sub-threshold" for swaps in asset classes or product types other than Utility Operations-Related Swaps to which Utility Special Entities are counterparties.

In defining the term "Special Entity" in Section 4s(h)(2)(C) of the Dodd-Frank Act and establishing the heightened business conduct standards for registered "swap dealers," Congress did not intend for the Commission expand its regulatory oversight beyond oversight of regulated "swap dealers" to place restrictions on entities that are not required to register as "swap dealers." In establishing the Special Entity Sub-Threshold and then not substantially raising it when it raised the general de minimis threshold, Ihte Commission restricted Utility Special Entities' competitive abilities, and severely restricted Utility Special Entities' access to the nonfinancial commodity swaps needed to cost-effectively hedge or mitigate commercial risks.

V. PROCESS AND TIMELINE FOR PETITION

The Petitioners respectfully request the Commission to act as soon as possible on the proposed rule amendment -- to remove continuing regulatory uncertainty for the Utility Special Entities and counterparties that would, but for the Special Entity Sub-Threshold, be available to enter into Utility Operations-Related Transactions with Utility Special Entities. As the Commission's new "swap" regulations are proposed, become final and implementation begins, market participants are evaluating whether and how to participate in the new market structure for "swaps." At the same time, Utility Special Entities have continuing utility public service obligations to provide affordable, reliable utility service to their customers, and consequently have both short-term and long-term commercial risks to hedge.

As the effective dates and compliance dates approach for the new "swap" regulatory regime, market participants are beginning to turn their attention away from current activities in nonfinancial commodities and commodity swaps in general. The challenges of the new regulatory requirements applicable to "swaps," including challenges for systems, staffing, compliance, documentation and reporting are overwhelming, even for the largest financial institutions and financial markets professionals, especially given the tight and interrelated compliance timelines.

The added challenge of determining whether to register as a "swap dealer" for one or more asset classes or product types of "swaps" are even more daunting for a nonfinancial entity, whose primary and ongoing business is not trading or investing or dealing in the financial markets, but drilling for natural gas, mining coal, or generating, transmitting and/or delivering electric energy or natural gas to consumers.[16]

[16] A number of the nonfinancial entities with whom the Petitioners (or the trade association Petitioners' members) transact in Utility Operations-Related Swaps have told us that they are currently evaluating their nonfinancial commodity "swap" activities in light of the final Entity Definitions rules, the Interim Final Rule in Section 1.3(ggg)(6)(iii), and the statutory guidance provided in the Adopting Release and elsewhere in the CFTC's regulations, interpretations and precedents. Such nonfinancial entities are also awaiting the CFTC's final rules defining the term "swap," which is the foundational rulemaking which will enable the energy industry to understand the scope of the CFTC's jurisdiction over our industry's transactions. As of July 10, 2012, for the electric and natural gas utility industry, the challenges are compounded by the continuing uncertainty as to what is and isn't a "swap," a "nonfinancial commodity forward" transaction, a nonfinancial commodity forward with embedded optionality, or a "trade option." See footnote 6 above. Once the rules defining "swap" are final with respect to our industry's transactions, each nonfinancial entity will then (and can only then) analyze which of its activities will fall within the definition of "swap," and therefore would or could be "swap dealing," which of its activities will be excluded as "hedging a physical position" (depending on the outcome of that final rulemaking), or fit within other safe harbors under the interpretive guidance provided by the Commission. Then and only then can the nonfinancial entity decide, as a business matter, whether to continue all or any of its swap dealing activities, and whether to register as a "swap dealer" or to register for a limited designation as a "swap dealer" for certain asset classes and product types (that may or may not include particular Utility Operations-Related Swaps). Alternatively, only then can such a nonfinancial entity alternatively decide to wind down any swap activities which the Commission might consider to be "swap dealing activities." Nothing requires a nonfinancial entity (whose primary business is not to engage in financial markets transactions like "swaps") to continue its past or current business strategies. If a particular nonfinancial

Continued on following page

If a market participant decides to continue some amount of "swap dealing activity" in Utility Operations-Related Swaps, it will carefully evaluate and then establish compliance procedures to monitor the two *de minimis* thesholds. In doing so, it will certainly hesitate or delay incurring the expense of setting up specially calibrated systems, compliance processes and staff training in order to engage in one or two such swaps with Utility Special Entities within a 12-month period. A nonfinancial counterparty that does not choose to register as a "swap dealer" will instead understandably focus on modifying its business processes and documents to engage in swaps with counterparties other than Utility Special Entities, under the general *de minimis* exception threshold.

We request that the Commission promptly publish the proposed rule amendment for comment in the Federal Register, without waiting for the effective date of the Entity Definitions rules. We recommend a public comment period of no longer than 20 days, and respectfully request publication of the Commission's final approval or grounds for denying the rule amendment within 10 days thereafter.[17] The Petitioners request that the amended rule be retroactive and prospective for all Utility Operations-Related Swaps to which a Utility Special Entity is a counterparty entered into after the effective date of the Entity Definition rules.

VI. CONCLUSION

The Petitioners respectfully petition the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 1(ggg)(4), which implements the *de minimis* exception to the definition of "swap dealer," as described above.

Continued from previous page
entity decides to continue some level of swap dealing activity, it may decide not to continue such activity as a registered "swap dealer." At last decision point, once the new Dodd-Frank Act rules are effective and as compliance dates approach, these entities will restrict their swap dealing activity to stay well below the two very different *de minimis* exception thresholds in the CFTC's swap dealer definition.

[17] The proposed rule amendment relieves a competitive restriction on Utility Special Entities, and modifies the special entity sub-threshold to the *de minimis* exception to the definition of "swap dealer." The Commission and interested persons in the electric and natural gas industry have been on notice of the Utility Special Entities' concerns since early May 2012. As a result, the proposed rule amendment is entitled to the earlier effective date permitted by CFTC Regulation 13.6.

SIGNATURE PAGE – SPECIAL ENTITY SUB-THRESHOLD PETITION

Please contact any of the individuals below or Patricia Dondanville, Reed Smith LLP, 10 South Wacker Drive, 40th Floor, Chicago Illinois 60606, telephone (312) 207-3911, or e-mail pdondanville@reedsmith.com, if you have questions regarding this Petition.

Respectfully submitted,

AMERICAN PUBLIC POWER ASSOCIATION

Susan N Kelly

Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel
1875 Connecticut Avenue, N.W.
Suite 1200
Washington, D.C. 20009-5715
Tel: (202) 467-2933
E-mail: skelly@publicpower.org

LARGE PUBLIC POWER COUNCIL

Noreen Roche-Carter
Chair, Tax and Finance Task Force
c/o Sacramento Municipal Utility District
6201 S Street
Sacramento, CA 95817-1899
Tel: (916) 732-6509
E-mail: nrochec@smud.org

TRANSMISSION ACCESS POLICY STUDY GROUP

John Twitty
Executive Director
4203 East Woodland Street
Springfield, MO 65809
Tel: (414) 838-8576
E-mail: 835consulting@gmail.com

AMERICAN PUBLIC GAS ASSOCIATION

David Schryver
Executive Vice President
201 Massachusetts Avenue, NE
Suite C-4
Washington, DC 20002
Tel: (202) 464-0835
E-mail: dschryver@apga.org

BONNEVILLE POWER ADMINISTRATION

Virginia K. Schaeffer
Attorney
Office of the General Counsel – LC-7
P.O. Box 3621
Portland, Oregon 98208-3621
Tel: (503)230-4030
Email: vkschaeffer@bpa.gov

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Virginia K. Schaeffer
Attorney
Office of the General Counsel – LC-7
P.O. Box 3621
Portland, Oregon 98208-3621
Tel: (503)230-4030
Email: vkschaeffer@bpa.gov

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6201 S Street
Sacramento, CA 95817-1899
Tel: (916) 732-6509
E-mail: nrochec@smud.org

AMERICAN PUBLIC GAS ASSOCIATION

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Executive Vice President
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Washington, DC 20002
Tel: (202) 464-0835
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____

David Schryver
Executive Vice President
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Suite C-4
Washington, DC 20002
Tel: (202) 464-0835
E-mail: dschryver@apga.org

cc: Honorable Gary Gensler, Chairman
Honorable Bart Chilton, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Mark Wetjen, Commissioner
Office of the CFTC General Counsel

Received
CFTC
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Office of the
Secretariat

MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

PC 17

August 30, 2012

Via Electronic Mail

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Rule 4.10(d)(1) & Request for Interim Relief

Dear Mr. Stawick:

Managed Funds Association ("MFA")[1] respectfully petitions the Commodity Futures Trading Commission (the "Commission" or "CFTC") under CFTC Rule 13.2 to amend CFTC Rule 4.10(d)(1) to provide for an explicit exclusion from the definition of commodity "pool" for certain internally owned entities, including compensation entities, operated for the benefit of private fund advisors' principals and key employees, thereby excluding the operators of such entities from registration as a commodity pool operator ("CPO") with respect to such entities.

Currently, many private fund advisors rely on the exemption from CPO registration under Rule 4.13(a)(4) with respect to internally owned entities, discussed in detail below, that invest either directly in commodity interests or indirectly through investment vehicles that are themselves commodity pools. Recently, the Commission issued final rules rescinding Rule 4.13(a)(4), effective for all entities currently claiming this exemption on December 31, 2012.[2] This rescission, coupled with the expansion of the scope of the definition of "commodity interest" to include swaps by the Dodd Frank Wall Street Reform and Consumer

[1] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[2] Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 11252, 11280 (Feb. 24, 2012).

Protection Act ("Dodd-Frank")[3] will result in numerous private fund advisors' internally owned entities being deemed commodity pools and require the operators of such entities to register as commodity pool operators. The proposal to include in CFTC Rule 4.10(a) a new definition of "commodity interests" will, when adopted, result in the inclusion of swaps in the trading threshold and net notional value tests in Rule 4.13(a)(3), thereby reducing the availability of this exclusion for private fund advisors that use swaps in their internally owned entities, including compensation entities.[4] The unavailability of the exemptions from CPO registration in 4.13(a)(3) and 4.13(a)(4) will require a number of private fund advisors operating internally owned entities to register as commodity pool operators and comply with CFTC regulatory requirements and NFA rules with respect to such entities, which does not seem appropriate or warranted considering the small class of financially sophisticated participants in such advisors' internally owned entities and the purposes for which these entities are formed and operated.

Because of the upcoming effective date of the rescission of CFTC Rule 4.13(a)(4) for MFA members currently claiming this exemption, we request that the CFTC amend Rule 4.10(d)(1) as soon as possible to exclude from the definition of "pool" a limited class of employee investment entities, and, pending adoption of such amendment, to grant temporary relief from CPO and CTA registration requirements with respect to such internally owned entities in the form of an interim no-action letter or exemption.[5] The information required by CFTC Rule 13.2 follows:

I. *Text of Proposed Rule Amendments [proposed additions are underlined]*

Part 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

4.10 Definitions.

* * *

(d)(1) *Pool* means any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests; provided, however, that enterprise participations which are offered and sold in an offering that qualifies for exemption from the registration requirement of the Securities Act of 1933 pursuant to Section 4(a)(2) of that Act or pursuant to Regulation S,

[3] Pub. L. 111-203 (2010).

[4] *See* CFTC Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions -- CPO/CTA: Amendments to Compliance Obligations (providing that for purposes of calculating "commodity interest" exposure, swaps will be included on December 31, 2012), *available at:* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/faq_cpocta.pdf.

[5] There is precedent for the Commission issuing temporary relief pending the adoption of a new CPO registration exemption. In 2003, as part of the Commission's proposal to adopt the rule 4.13(a)(3) and (a)(4) CPO registration exemptions, the Commission confirmed the issuance of temporary no-action relief pending the adoption of a final rule. 68 Federal Register 12622, at 12631, Section IV (CFTC, March 17, 2003). The Commission also issued temporary interim CPO registration relief pending the adoption of the rule 4.5 CPO exclusion. 67 Federal Register 68785, at 68788-89, Section III (CFTC, November 13, 2002).

17 CFR 230.901 *et seq*., and in which each participant at the time of initial investment is a "qualified eligible person," as that term is defined in §4.7(a)(2)(viii)(A) of this chapter, shall not be deemed to be a pool.

* * *

II. Nature of MFA's Interest

MFA's members include certain hedge fund advisors and investment managers, as well as traditional CPOs, that have a number of proprietary, internally owned entities (together "Employee Funds") operated pursuant to various terms. However, a common feature of these Employee Funds is that they are owned by a narrow class of persons that excludes the general investing public. Generally, these Employee Funds are an integral part of a private fund advisor's means of compensating its key employees or operate as a means of investing the proprietary capital of the advisor's principals or allowing a firm's principals to seed a potential new strategy that is not yet being offered to outside investors. Participation in these entities is limited to financially sophisticated key employees (including former employees), principals of the advisor, close family members of such participants and estate planning entities of such participants. Interests in the Employee Funds are not offered to the public and are non-transferable, except by gift or bequest to close family members, or by operation of a legal separation or divorce. The managers of the Employee Funds do not receive any compensation from the Employee Fund for their services. The types of Employee Funds operated by MFA members generally fall into three categories.

(1) The first category consists of Employee Funds that are either exempt from registration as an investment company under the Investment Company Act of 1940 (the "Company Act") pursuant to Sections 3(c)(1) or 3(c)(7) thereof,[6] or if such exemption is unavailable, as an "employees' security

[6] Company Act Section 3(c) provides: "Notwithstanding subsection a, none of the following persons is an investment company within the meaning of this title.

> (1) Any issuer whose outstanding securities are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities. Such issuer shall be deemed to be an investment company for purposes of the limitations set forth in subparagraphs (A)(i) and (B)(i) of section 12(d)(1) governing the purchase or other acquisition by such issuer of any security issued by any registered investment company and the sale of any security issued by any registered open-end investment company to any such issuer. For purposes of this paragraph:
>
> (A) Beneficial ownership by a company shall be deemed to be beneficial ownership by one person, except that, if the company owns 10 per centum or more of the outstanding voting securities of the issuer and is or, but for the exception provided for in this paragraph or paragraph (7), would be an investment company, the beneficial ownership shall be deemed to be that of the holders of such company's outstanding securities (other than short-term paper).
>
> (B) Beneficial ownership by any person who acquires securities or interests in securities of an issuer described in the first sentence of this paragraph shall be deemed to be beneficial ownership by the person from whom such transfer was made, pursuant to such rules and regulations as the Commission shall

company" ("ESC") within the meaning of Section 2(a)(13) of the

prescribe as necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title, where the transfer was caused by legal separation, divorce, death, or other involuntary event.

...

(7)(A) Any issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, and which is not making and does not intend to make a public offering of such securities. Securities that are owned by persons who received the securities from a qualified purchaser as a gift or bequest, or in a case in which the transfer was caused by legal separation, divorce, death, or other involuntary event, shall be deemed to be owned by a qualified purchaser, subject to such rules, regulations, and orders as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(B) Notwithstanding subparagraph (A), an issuer is within the exception provided by this paragraph if—

(i) in addition to qualified purchasers, outstanding securities of that issuer are beneficially owned by not more than 100 persons who are not qualified purchasers, if - (I) such persons acquired any portion of the securities of such issuer on or before September 1, 1996; and (II) at the time at which such persons initially acquired the securities of such issuer, the issuer was excepted by paragraph (1); and

(ii) prior to availing itself of the exception provided by this paragraph— (I) such issuer has disclosed to each beneficial owner, as determined under paragraph (1), that future investors will be limited to qualified purchasers, and that ownership in such issuer is no longer limited to not more than 100 persons; and (II) concurrently with or after such disclosure, such issuer has provided each beneficial owner, as determined under paragraph (1), with a reasonable opportunity to redeem any part or all of their interests in the issuer, notwithstanding any agreement to the contrary between the issuer and such persons, for that person's proportionate share of the issuer's net assets.

(C) Each person that elects to redeem under subparagraph (B)(ii)(II) shall receive an amount in cash equal to that person's proportionate share of the issuer's net assets, unless the issuer elects to provide such person with the option of receiving, and such person agrees to receive, all or a portion of such person's share in assets of the issuer. If the issuer elects to provide such persons with such an opportunity, disclosure concerning such opportunity shall be made in the disclosure required by subparagraph (B)(ii)(I).

(D) An issuer that is excepted under this paragraph shall nonetheless be deemed to be an investment company for purposes of the limitations set forth in subparagraphs (A)(i) and (B)(i) of section 12(d)(1) relating to the purchase or other acquisition by such issuer of any security issued by any registered investment company and the sale of any security issued by any registered open-end investment company to any such issuer.

(E) For purposes of determining compliance with this paragraph and paragraph (1), an issuer that is otherwise excepted under this paragraph and an issuer that is otherwise excepted under paragraph (1) shall not be treated by the Commission as being a single issuer for purposes of determining whether the outstanding securities of the issuer excepted under paragraph (1) are beneficially owned by not more than 100 persons or whether the outstanding securities of the issuer excepted under this paragraph are owned by persons that are not qualified purchasers. Nothing in this subparagraph shall be construed to establish that a person is a bona fide qualified purchaser for purposes of this paragraph or a bona fide beneficial owner for purposes of paragraph (1)."

Company Act.[7] ESCs are subject to a certain amount of Company Act regulation, but customarily receive exemptions from many burdensome provisions of the Company Act pursuant to sections 6(b) and 6(e) thereof.[8]

(2) A second category of Employee Fund consists of entities (generally limited liability companies) in which Eligible Employees[9] of a private fund advisor are members and through which the Eligible Employees participate in the income of the advisor by virtue of the Employee Fund's ownership, or profits share, interest in the advisor. These Employee Funds may also invest in products advised by the advisor including, in certain cases, where the advisor's products are commodity pools. These Employee Funds may have a management entity that, for liability insulation reasons, is separate from the advisor entity.

[7] Company Act Section 2(a)(13) provides: "Employees' securities company" means any investment company or similar issuer all of the outstanding securities of which (other than short-term paper) are beneficially owned (A) by the employees or persons on retainer of a single employer or of two or more employers each of which is an affiliated company of the other, (B) by former employees of such employer or employers, (C) by members of the immediate family of such employees, persons on retainer, or former employees, (D) by any two or more of the foregoing classes of persons, or (E) by such employer or employers together with any one or more of the foregoing classes of persons.

[8] The Company Act subjects registered investment companies ("RICs") to an extensive and complex array of regulation. For example, the Company Act (i) requires RICs to be formed in the United States as corporations or business trusts governed by boards of directors that have a majority of independent directors, (ii) provides the SEC the authority to require RICs to file information, documents and periodic reports with the SEC and to determine the contents of a RIC's reports and disclosure to shareholders, (iii) regulates RICs relationships with service providers such as custodians and auditors, (iv) subjects RICs to minimum capital requirements and credit limits, and (v) imposes investment diversification requirements and substantive investment and trading restrictions on RICs, such as limitations on the use of leverage. Furthermore, investment advisers to RICs are subject to a number of legal restrictions, such as limitations on (i) transactions between the RIC and the adviser and its affiliated funds, (ii) dual employment of the adviser, and (iii) the terms of advisory contracts. Sections 6(b) and 6(e) of the Company Act authorizes the SEC to exempt ESCs from all or certain of the provisions of the Company Act. In order to qualify for an exemption, an entity's securities may generally only be held by the persons listed in Company Act Section 2(a)(13) and the entity must apply to the SEC for such an exemption. The SEC typically grants orders exempting ESCs from all of the provisions of the Company Act except: Section 9 (persons disqualified to serve as an employee, officer, advisory board member, investment adviser or depositor); Section 17 (transactions with certain affiliated persons and underwriters), other than certain provisions of paragraphs (a) (principal transactions with affiliates), (d) (joint transactions with affiliates), (f) (custody of securities), (g) (bonding of officers and employees) and (j) (code of ethics); Section 30 (periodic and other reports including reports of affiliated persons), other than certain provisions of paragraphs (a), (b), (e) (which together require a manager to distribute certain shareholder reports and audited financial statements and to maintain certain records) and (h) (Section 16 liability for specified persons); and Sections 36 through 53 (governing SEC rulemaking, investigation and enforcement powers). *See e.g.*, DRW Venture partners LP, Company Act Release Nos. 25404 (Jan. 29, 2002) and 25353 (Jan. 2, 2002). This relief has become generally standard, and many applications contain nearly identical requests. *See* Robert H. Rosenblum, Investment Company Determination Under the 1940 Act: Exemptions and Exceptions, 849-850 (American Bar Association 2003); *See e.g.*, Jefferies Employees Special Opportunities Partners, LLC, Company Act Release No. 30007 (Mar. 29, 2012).

[9] *See supra* p. 6 text.

(3) The third category of Employee Fund are those entities owned and operated exclusively for the benefit of an advisor's owners, and occasionally, high level, financially sophisticated employees or close family members of such participants through gifts or estate planning vehicles. These Employee Funds often serve as diversification vehicles for advisor principals heavily invested in the products managed by the advisory entity or as an investment option for such principals' individual estate planning or as a limited liability vehicle through which a firm may test a new strategy prior to it being available to outside investors.

In many cases, an Employee Fund (generally a fund of funds) may be the only pool for which an advisor may have a CPO registration obligation.

Interests in these Employee Funds are offered without registration in reliance on Section 4(a)(2) of the Securities Act of 1933 (the "Securities Act"),[10] including Regulation D[11] thereunder, and are sold without a sales charge solely to employees and related persons that meet certain eligibility requirements ("Eligible Investors"). Eligible Investors in these Employee Funds typically consist of: (a) Eligible Employees (as defined below); (b) partnerships, corporations or other entities all of the voting power of which is controlled by an Eligible Employee; (c) the advisor; and (d) trusts of which (i) the trustees, grantors and/or beneficiaries are Eligible Employees, (ii) the beneficiaries are immediate family members of Eligible Employees (spouses, children, siblings, parents, spouses of children, and grandchildren), including self-directed retirement plan vehicles (including individual retirement accounts) and (iii) the beneficiaries are charitable organizations within the meaning of Section 501(c)(3) of the Internal Revenue Code. An "Eligible Employee" is typically an individual who at the time of an offer for an interest in the Employee Fund is (a) a professional or key administrative employee of

[10] Securities Act Section 4(a) provides: "The following provisions of section 5 shall not apply to … (2) transactions by an issuer not involving any public offering."

[11] Rule 506 of Regulation D provides: "(a) *Exemption.* Offers and sales of securities by an issuer that satisfy the conditions in paragraph (b) of this section shall be deemed to be transactions not involving any public offering within the meaning of section 4(2) of the Act.

(b) *Conditions to be met*· (1) *General conditions.* To qualify for an exemption under this section, offers and sales must satisfy all the terms and conditions of §§230.501 and 230.502.

(2) *Specific conditions* · (i) *Limitation on number of purchasers.* There are no more than or the issuer reasonably believes that there are no more than 35 purchasers of securities from the issuer in any offering under this section.

(ii) *Nature of purchasers.* Each purchaser who is not an accredited investor either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description.

the advisor or an affiliate, or a former professional employee of the advisor or an affiliate or (b) an employee of the advisor or an affiliate who: (i) will be involved in managing the finances or the day-to-day affairs of the Employee Fund or in locating, structuring or administering the investments made by the Employee Fund and has such knowledge and experience in financial and business matters that he or she will be capable of evaluating the merits and risks of the proposed investments. Both Eligible Investors and Eligible Employees would be "qualified eligible persons," as that term is defined in CFTC Rule 4.7(a)(2)(viii)(A).

Because the Employee Funds either invest directly in commodity interests, including swaps, or in other investment funds that invest in commodity interests, the rescission of CFTC Rule 4.13(a)(4) and likely unavailability of Rule 4.13(a)(3) to Employee Funds that use swaps (or are funds of funds) will result in many Employee Funds being deemed commodity pools that are required to be operated by a registered CPO and comply with the CFTC's regulations and relevant rules of the National Futures Association ("NFA"). Such regulations and rules are incompatible with the business purpose of the Employee Funds, may be economically burdensome and are unwarranted considering the participants in and general purposes of these Employee Funds. Employee Funds are designed to operate flexibly and may engage in activities that are generally not permitted, or are impractical, for a commodity pool subject to the CFTC and NFA regulation. For example, Employee Funds operated exclusively for the benefit of an advisor's principals may make loans to the advisor or its investors, who, being the advisor's principals, are the advisor's affiliates or may permit notional investments with the advisor's principals, as business partners, specifically agreeing to take each other's credit risk. These transactions would not be permitted under NFA Rule 2-45.

III. Supporting Arguments

The term "pool" was not originally defined in the Commodity Exchange Act (the "CEA"), but instead was defined by the Commission based on language taken from the definition of CPO in old Section 1a(4) of the CEA (renumbered as Section 1a(10) of the CEA).[12] Congress intended this definition, and the corresponding CPO registration requirement in Section 4m(1), to primarily address consumer protection concerns.[13] Accordingly, the Part 4 regulations themselves were designed to "expose and thus help circumscribe" the abuse of investors by unregulated pool operators.[14] The Commission has noted that Congress intended to eliminate abusive market practices by regulating "unscrupulous operators who had enticed unsuspecting traders into the markets with, far too often, substantial loss of funds" and that the operation of certain entities is simply not the type of activity that Congress and the Commission intended to

[12] CFTC Interpretive Letter No. 99-45 (Sept. 15, 1999); CFTC Interpretive Letter No. 00-98 (May 22, 2000). Effective July 16, 2011, Dodd-Frank added a definition of "commodity pool" to the CEA that was based on the Commission's existing definition of "pool" in Rule 4.10(d) and the definition of "commodity interest" in Rule 1.3, but expanded the definition of commodity pool to include entities operated for the purpose of trading securities futures products, swaps, certain leveraged or dealer-financed retail foreign exchange or commodity contracts.

[13] Proposed Comprehensive Scheme for Regulation, 42 Fed. Reg. 9266 (Feb. 15, 1977) (These provisions were "designed to protect unsophisticated traders from undesirable managerial and trading practices of pool operators.").

[14] Proposed Comprehensive Scheme for Regulation, 42 Fed. Reg. 9266 (Feb. 15, 1977).

regulate in adopting the CPO and pool definitions.[15] Employee Funds do not present the consumer protection concerns the definition of pool and CPO were meant to address and their operation is not the type of activity that Congress and the Commission intended to regulate.

Recognizing that the definition of CPO was broad, Congress gave the Commission the discretion to exempt persons from the provisions of Part 4 of the CFTC regulations where there is "no substantial public interest served by such registration."[16] When Dodd-Frank amended the CEA to add a definition of "commodity pool," Congress also gave the Commission the authority to exclude entities from the definition of commodity pool.[17] The Commission has used this discretion over the years to issue a number of interpretive letters that have concluded that entities similar to the Employee Funds were not "pools" within the meaning and intent of CFTC Rule 4.10(d)(1) and that the operation of these entities was not the type of activity that Congress and the Commission intended to regulate.[18] The common focus of these letters is on the nature of, and relationship between, the participants in each pool. The participants in these pools were generally financially sophisticated investment industry professionals with close personal or business relationships, and such participants' close family members and their estate planning vehicles. The operation of an investment fund for such participants does not raise the sort of consumer protection concerns the Part 4 regulations were intended to address.

Similarly, these Employee Funds also do not raise consumer protection concerns because the participants in such Employee Funds are generally investment industry professionals each of whom are, at the time of initial investment in the Employee Fund, a "qualified eligible person," as that term is defined in CFTC Rule 4.7(a)(2)(viii)(A). Furthermore, the purpose of the Employee Funds is to operate as an integral part of a private advisor's employee compensation program or as a means to invest the proprietary capital of the principals of the advisor. The types of issues raised by "unscrupulous operators" enticing "unsuspecting traders into the markets" are simply not raised by Employee Funds established to reward and retain key employees or to invest the proprietary capital of a private advisor's principals. The operators of the Employee Funds do not receive compensation from the Employee Funds for their services, the Employee Funds are not offered to the public and there are transfer restrictions on the interests of the Employee Funds to ensure the interests stay within the narrow class of participants for whom the Employee Funds are designed. The standard established by CFTC Rule 4.7(a)(2)(viii)(A) ensures that access to the Employee Funds will be available only to a narrow class of knowledgeable employees that are well versed in each private fund advisor's business and industry. The Commission has previously granted no-action relief from CPO registration in

[15] CFTC Interpretive Letter No. 00-98 (May 22, 2000).

[16] Id.; *Cf.* CFTC Rule 4.12(a).

[17] 7 U.S.C § 1a(10)(B).

[18] *See e.g.*, CFTC Interpretive Letter No. 94-26 (Mar. 11, 1994); CFTC Interpretive Letter No. 96-11 (Jan. 18, 1996); CFTC Interpretive Letter No. 97-50 (Jun. 23, 1997); CFTC Interpretive Letter No. 99-45 (Sept. 15, 1999) *See also* CFTC No-Action Letter No. 97-77 (Sept. 16, 1997).

circumstances where a pool's participants would likely not meet the narrow standard set forth in CFTC Rule 4.7(a)(2)(viii)(A) proposed by MFA.[19]

The upcoming rescission of CFTC Rule 4.13(a)(4) with respect to MFA members prompted MFA to seek this amendment to CFTC Rule 4.10(d)(1). Rule 4.13(a)(4) provided an exemption from CPO registration based solely on a pool participant's purported sophistication, by reference to all of the categories in Rule 4.7(a)(2). However, the requested amendment to Rule 4.10(d)(1) provides an appropriately narrow exclusion from the definition of "pool" based on Rule 4.7(a)(2)(viii) and is tailored to address private fund advisors' internally owned entities by limiting the participants in the Employee Funds to knowledgeable employees, their close family members and their respective estate planning vehicles.

MFA notes that the exclusion of the Employee Funds from the definition of "pool" would not excuse the Employee Funds, their operators, advisors and the participants from other applicable requirements of the CEA or the Commission's regulations.[20] The Employee Funds, their operators, advisors and the participants, as persons, would remain subject to the antifraud provisions of the CEA, the reporting requirements set forth in Parts 15, 18 and 19 of the CFTC regulations and the new swap rules adopted by the Commission pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

MFA respectfully petitions the Commission to amend Rule 4.10(d)(1) as described above. MFA also requests that pending the Commission's consideration of MFA's rulemaking petition, the Commission grant temporary interim relief from CPO and CTA registration requirements in the form of an interim no-action letter or exemption with respect to internally owned vehicles as described in this letter. If you have any questions, please contact the undersigned or Jennifer Han, Associate General Counsel, at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing
Director, General Counsel

cc:

The Hon. Gary Gensler, CFTC Chairman
The Hon. Scott O'Malia, CFTC Commissioner
The Hon. Jill E. Sommers, CFTC Commissioner
The Hon. Bart Chilton, CFTC Commissioner

[19] CFTC No-Action Letter No. 97-77 (Sept. 16, 1997).

[20] CFTC Interpretive Letter No. 00-98 (May 22, 2000).

The Hon. Mark P. Wetjen, CFTC Commissioner
Mr. Gary Barnett, CFTC Director, Division of Swap Dealer and Intermediary Oversight
Mr. Christopher Cummings, Division of Swap Dealer and Intermediary Oversight
Mrs. Barbara Gold, Division of Swap Dealer and Intermediary Oversight

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APPA American Public Power Association
PublicPower.org

LPPC

American Public Gas Association

TAPS

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July 12, 2012

Via Email and Messenger Delivery

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4)

Dear Mr. Stawick:

The American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), the American Public Gas Association ("APGA"), the Transmission Access Policy Study Group ("TAPS") and the Bonneville Power Administration ("BPA")(collectively, the "Petitioners") respectfully petition the Commodity Futures Trading Commission (the "Commission" or the "CFTC") under CFTC Regulation 13.2 to amend CFTC Regulation 1.3(ggg)(4),[1] which implements the *de minimis* exception to the definition of "swap dealer." The Petitioners specifically request that the rule amendment exclude from the "special entity sub-threshold," which appears in Regulation 1.3(ggg)(4)(i), "Utility Operations-Related Swaps" to which the Petitioners and other "Utility Special Entities" are, or may in the future be, counterparties. The definitions of "Utility Operations-Related Swap" and "Utility Special Entity" are included directly in the text of the proposed rule amendment, and narrowly circumscribe the scope of the proposed rule amendment.

[1] 77 Fed. Reg. 30596, at 30744.

Such a rule amendment is permitted by Section 1a(49)(D) of the Commodity Exchange Act ("CEA") as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"),[2] and is specifically contemplated by CFTC Regulation 1.3(ggg)(4)(v).[3] The rule amendment is necessary in order to preserve uninterrupted and cost-effective access to the customized, nonfinancial commodity swaps that Petitioners and other Utility Special Entities use to hedge or mitigate commercial risks arising from their utility facilities, operations and public service obligations.

The information required by CFTC Regulation 13.2 follows:

I. THE TEXT OF THE PROPOSED RULE AMENDMENT (Additional language is underlined and italicized)

PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT
***

Section 1.3 Definitions.
***

(ggg) Swap Dealer.
***

(4) *De minimis* exception. (i) Except as provided in paragraph (ggg)(4)(vi) of this section, a person that is not currently registered as a swap dealer shall be deemed not to be a swap dealer as a result of its swap dealing activity involving counterparties, so long as the swap positions connected with those dealing activities into which the person – or any other entity controlling, controlled by or under common control with the person – enters over the course of the immediately preceding 12 months (or following the effective date of final rules implementing Section 1a(47) of the Act, 7 U.S.C. 1a(47), if that period is less than 12 months) have an aggregate gross notional amount of no more than $3 billion, subject to a phase in level of an aggregate gross notional amount of no more than $8 billion applied in accordance with paragraph (ggg)(4)(ii) of this section, and an aggregate gross notional amount of no more than $25 million *(the "special entity sub-threshold")* with regard to swaps in which the counterparty is a "special entity" (as that term is defined in Section 4s(h)(2)(C) of the Act, 7 U.S.C. 6s(h)(2)(C), and §23.401(c) of this chapter)*; provided that such $25 million special entity sub-threshold shall* ***not*** *apply with regard to "utility operations related swaps" to which the counterparty is a "utility special entity." For purposes of this paragraph, (A) a "utility special entity" means a government "special entity" (as described in clause (i) or (ii) of Section 4s(h)(2)(C) of the Act or in clause (1) or (2) of §23.401(c) of this chapter) that owns or operates electric or natural gas facilities or electric or natural gas operations (or anticipated facilities or operations), supplies natural gas and/or electric energy to other*

[2] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[3] 77 Fed. Reg. 30744-30745.

utility special entities, has public service obligations (or anticipated public service obligations) under Federal, State or local law or regulation to deliver electric energy and/or natural gas service to utility customers, or is a Federal power marketing agency as defined in Section 3 of the Federal Power Act (16 U.S.C. 796(19)), and (B) a "utility operations-related swap" shall mean any swap that a utility special entity enters into "to hedge or mitigate commercial risks" (as such phrase is used in Section 2(h)(7)(A)(ii) of the Act) intrinsically related to the electric or natural gas facilities that the utility special entity owns or operates or its electric or natural gas operations (or anticipated facilities or operations), or to the utility special entity's supply of natural gas and/or electric energy to other utility special entities or to its public service obligations (or anticipated public service obligations) to deliver electric energy or natural gas service to utility customers. For the avoidance of doubt, "intrinsically related" shall include all transactions related to (i) the generation or production, purchase or sale, and transmission or transportation of electric energy or natural gas, or the supply of natural gas and/or electric energy to other utility special entities, or delivery of electric energy or natural gas service to utility customers, (ii) all fuel supply for the utility special entity's electric facilities or operations, (iii) compliance with electric system reliability obligations applicable to the utility special entity, its electric facilities or operations, (iv) compliance with energy, energy efficiency, conservation or renewable energy or environmental statutes, regulations or government orders applicable to the utility special entity, its facilities or operations, or (v) any other electric or natural gas utility operations-related swap to which the utility special entity is a party. Utility operations-related swaps shall ***not*** *include a swap based or derived on, or referencing, commodities in the interest rates, credit, equity or currency asset classes, or a product type or category in the "other commodity" asset class that is based or derived on, or referencing, metals, or agricultural commodities or crude oil or gasoline commodities of any grade not used as fuel for electric generation*. For purposes of this paragraph, if the stated notional amount of a swap is leveraged or enhanced by the structure of the swap, the calculation shall be based on the effective notional amount of the swap rather than on the stated notional amount.

II. THE PETITIONERS

APPA is the national association that represents the interests of approximately 2000 government-owned electric utilities in the United States. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. Government-owned electric utilities provide over 15% of all KWh sales to retail electric customers.

LPPC is an organization representing 26 of the largest government-owned electric utilities in the nation. LPPC members own and operate over 86,000 megawatts of generation capacity and nearly 35,000 circuit miles of high voltage transmission lines, representing nearly 90% of the transmission investment owned by non-Federal government-owned electric utilities in the United States.

TAPS is an association of transmission dependent electric utilities located in more than 30 states. All of TAPS member electric utilities except one are government-owned electric utilities.

APGA is the national association that represents government-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and over 720 of these systems are APGA members. Government-owned natural gas distribution systems are not-for-profit entities owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other government agencies that have natural gas distribution facilities.

Some government-owned utilities are both electric utilities and natural gas distribution utilities, and are therefore members of both APPA and APGA. The purpose of a government-owned electric utility or natural gas distribution system is to provide reliable, safe and affordable electric energy and/or natural gas service to the community it serves.

BPA is a self-financed, non-profit Federal agency created in 1937 by Congress that primarily markets electric power from 31 federally owned and operated projects, and supplies over one-third of the electricity used in the Pacific Northwest. BPA also owns and operates approximately 75 percent of the high-voltage transmission in the Pacific Northwest. BPA's primary statutory responsibility is to market its Federal system power at cost-based rates to its "preference customers."[4] BPA also funds one of the largest wildlife protection and restoration programs in the world.

III. NATURE OF THE PETITIONERS' INTEREST

APPA, LPPC, TAPS and APGA represent thousands of government-owned electric and natural gas utilities throughout the United States, all of which are "special entities" as that term is defined in Section 4s(h)(2)(C) of the Commodity Exchange Act, as amended by the Dodd-Frank Act, and §23.401(c) of the Commission's regulations. BPA and the other Federal power agencies are "special entities" as well.[5] The Petitioners

[4] BPA has 130 preference customers made up of electric utilities which are not subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC"), including Indian tribes, electric cooperatives, state and municipally chartered electric utilities, and other Federal agencies located in the Pacific Northwest.

[5] According to the Energy Information Administration, there are nine Federal electric utilities in the United States, which are part of several agencies of the United States Government (see, http://www.eia.gov/cneaf/electricity/page/prim2/toc2.html): the Army Corps of Engineers; the Bureau of Indian Affairs and the Bureau of Reclamation in the Department of the Interior, the International Boundary and Water Commission in the Department of State, the Power Marketing Administrations in the Department of Energy (BPA, Western Area Power Administration, Southwestern Area Power Administration, and Southeastern Area Power Administration), and the Tennessee Valley Authority (TVA). In addition, three Federal agencies operate electric generating facilities: TVA, the largest Federal power producer; the U.S. Army Corps of Engineers; and the U.S. Bureau of Reclamation.

respectfully seek the rule amendment for the benefit of all "Utility Special Entities" that currently, or may in the future, enter into Utility Operations-Related Swaps with counterparties that are not registered with the Commission as "swap dealers."

"Utility Special Entities," as defined in the proposed rule amendment, are a narrow category of special entities distinguishable by their electric energy and/or natural gas utility facilities, operations and public service obligations. None of the Utility Special Entities is a "financial entity;" all are nonfinancial entities and "commercial end users" as such term is used by Congress and regulatory policy makers. "Utility Operations-Related Swaps," as defined in the proposed rule amendment, are a narrow category of "swaps"[6] in the nonfinancial or "other commodity" asset class. Such swaps are, by definition, of product types intrinsically related to the commercial risks associated with utility facilities, operations and public service obligations, and are used to hedge or mitigate such commercial risks. Such customized nonfinancial commodity swaps are typically not available on exchanges or electronic trading platforms, due to the myriad non-numeric operational conditions, requirements and permutations embedded in such swaps.

The Petitioners commented on the Commission's proposed rules further defining "swap dealer" raising concerns that **both** the general *de minimis* threshold and the "special entity sub-threshold" needed to be raised significantly. *See* comments filed by NFP Electric End User Coalition, including APPA and LPPC with assistance from TAPS, in the Commission's "Entity Definitions" docket, a link to which appears at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27917&SearchText=

[6] This term has not yet been defined by the Commission to the extent required to provide regulatory clarity to Petitioners and others in the utility industry. The Petitioners and others in the utility industry await publication in the Federal Register of rules further defining "swap," along with the Commission's response to public comments on any further questions asked by the Commission in the most recent statutory interpretations relevant to the definition of "swap," the Commission's response to comments solicited on the nonfinancial commodity "trade option" Interim Final Rule, the CFTC/FERC jurisdictional Memoranda of Understanding called for by Section 720 of the Dodd-Frank Act, the "tariffed transaction exemption(s)" and "between FPA 201(f) transaction exemption" called for in new CEA Sections 4(c)(6), and other final rules, interpretations and exemptions. *See* the comment letter filed by the Electric Trade Associations in the "Product Definitions" or "Definition of 'Swap'" docket at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47934&SearchText=Wasson, and other comment letters, applications and petitions filed by the Petitioners and others in the utility industry.

There is no need to wait to consider the proposed rule amendment for the effective date of the Commission's final rules further defining the term "swap." The proposed rule amendment, as drafted, will only be applicable to those utility operations-related transactions which are ultimately subject to the Commission's jurisdiction as "swaps," and would therefore be considered part of an entity's "swap dealing activity," and counted against either the general *de minimis* threshold or the special entity sub-threshold. In this manner, the proposed rule amendment is similar to all the Commission's regulations that include the term "swap," including the Entity Definition rules themselves. None of these regulations can be fully understood or applied to Petitioners' and other market participants' businesses until the Commission's final rules further defining "swap" and other foundational terms that include the term "swap" are effective for relevant asset classes and product types.

rural at 18-19, supporting the comments filed by the Edison Electric Institute and the Electric Power Supply Association in the same docket requesting significantly higher thresholds for ***both*** the general *de minimis* threshold and the special entity sub-threshold than were proposed by the Commission, a link to which appears at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27918&SearchText=

The Commission acknowledges the Petitioners' comments in numerous places in the Adopting Release for the Entity Definitions rules (the "Adopting Release"). *See*, for example, 77 Fed. Reg. 30627 and 30707. In the final rules, however, the Commission raised the general *de minimis* threshold by a factor of 80 during the phase in period (and by a factor of 30 thereafter) - from $100 million to $8 billion during the phase in period (and $3 billion thereafter). In contrast, the Commission left the special entity sub-threshold unchanged at $25 million. The Petitioners' concern about the competitive disadvantage represented by the discrepancy between the two thresholds in the final rules is the reason for this Petition.

A. Utility Special Entities Require Customized Utility Operations-Related Swaps.

Utility Special Entities depend on nonfinancial commodity transactions, trade options and "swaps," as well as the futures markets, to hedge commercial risks that arise from their utility facilities, operations and public service obligations. Together, these nonfinancial commodity markets play a central role in government-owned utilities securing electric energy, fuel for generation and natural gas supplies for delivery to consumers at reasonable and stable prices. Specifically, many government-owned utilities purchase firm electric energy, fuel and gas supplies in the physical delivery markets (in the "cash" or "spot" or "forward" markets) at prevailing and fluctuating market prices, and enter into bilateral, financially–settled nonfinancial commodity swaps with customized terms to hedge the unique operational risks to which each Utility Special Entity is subject.

The Utility Special Entities use Utility Operations-Related Swaps to ensure reliability of utility service and to reduce utility customers' exposure to future commodity price fluctuations and to stabilize utility rates. In hedging, mitigating or managing the commercial risks of its utility facilities operations or public service obligations, the Utility Special Entity are engaged in commercial risk management activities that are no different from the operations-related hedging of an investor-owned utility or an electric cooperative located in the same geographic region.

B. The "Market" for Each Particular Utility Operations-Related Swap is Illiquid.

Utility Special Entities enter into these bilateral customized swaps in illiquid regional or local "markets."[7] Some counterparties available to transact with Utility Special Entities

[7] The word "markets" is used in quotations in this context, as Utility Operations-Related Swaps do not occur with anywhere near the frequency or uniformity that financial "swaps" occur, or that agricultural,

Continued on following page

will be major financial institutions or other financial entities, such as hedge funds, that may or may not transact in other swap asset classes or product types. Other available counterparties will be nonfinancial counterparties, those which are not "financial entities" as such term is defined in CEA Section 2(h)(7)(C).

Each Utility Special Entity actively seeks out available swap counterparties in order to hedge its unique, ongoing and dynamically-changing commercial risks.[8] Commercial risk management policies in the energy industry typically require diversification of suppliers and swap counterparties, limited concentration of supplier/vendor/counterparty credit risk, and other commercial risk management metrics to prudently manage the commercial risks of bilateral contracting processes.

Each regional geographic market has a somewhat different group of financial entity and nonfinancial counterparties available to enter into customized Utility Operations-Related Swaps. An available counterparty may own or operate commercial businesses related to the particular nonfinancial commodity that underlies the Utility Operations-Related Swap. It may be a neighboring utility or electric cooperative, the owner of a merchant electric generation facility located in the area, or a natural gas or coal company with production assets in the region.

For example, a large natural gas utility or the owner of a large merchant electric generation station in western Alabama might be available as a nonfinancial counterparty for swaps referencing an Alabama delivery point. But that same entity would not necessarily offer the type of customized Utility Operations-Related Swap required by a Utility Special Entity located in Oregon. Or, a natural gas producer or coal producer with production assets in Wyoming might offer Utility Operations-Related Swaps required by a California-based or Oregon-based Utility Special Entity. But the same counterparty would not necessarily enter into a similar Utility Operations-Related Swap referencing a nonfinancial commodity delivered in the Southeast. Nor would it

Continued from previous page

metals, global oil or other product types of "swaps" in the "other commodity" asset class occur. Utility Operations-Related Swaps are, in some cases, negotiated over a period of days, weeks or months. Some may be documented based on a master agreement template, with many pages of specialized operational, credit and other risk management provisions included by the bilateral counterparties as schedules. Transacting under standardized master agreement templates (with bilaterally negotiated schedules and transaction documents) should not be confused with a conclusion or an assumption that there is a trading "market" for Utility Operations-Related Swaps having, standardized or "market" terms.

[8] Utility Special Entities may also be called upon from time to time by other utilities located in the same geographic region, by or in coordination with electric reliability organizations, to act as counterparties in Utility Operations-Related Swaps for electric system reliability purposes. Such swaps should not be considered "swap dealing activity" by the utility counterparty or counterparties to such swaps. Otherwise, the Utility Special Entities may not be able to participate in such swaps for reliability purposes without causing the counterparty to exceed the Special Entity Sub-Threshold, which may compromise the reliability of the interconnected electric system.

necessarily offer a Utility Operations-Related Swap referencing electric energy in any regional market.

C. Utility Special Entities Need All Available Utility Operations-Related Swap Counterparties.

Due to the limited number of counterparties for any particular Utility Operations-Related Swap in any particular region, each available financial or nonfinancial swap counterparty, whether or not a registered "swap dealer," brings important market liquidity or supplier/counterparty diversity for a Utility Special Entity. Multiple available counterparties create price competition for the customized swaps that a Utility Special Entity requires to cost-effectively hedge or mitigate unique commercial risks.[9]

Based on an informal survey of some of the larger Utility Special Entities, a substantial percentage of the counterparties that are currently available to enter into Utility Operations-Related Swaps with such Utility Special Entities are nonfinancial entities engaged in the electric, natural gas, coal or another aspect of the energy industry in the same geographic area as the specific Utility Special Entity.

Wall Street financial institutions and other financial entities tend to offer such swaps only where there is standardization of transaction terms and liquid trading markets: at trading hubs where the financial entity's swaps can be promptly and effectively hedged to maintain a "balanced book." Nonfinancial entities with assets or operations located in the geographic region may, as a result, face parallel commercial risks and can use the Utility Operations-Related Swap to manage some portion or aspect of the commercial risks inherent in its own physical assets, liabilities and commercial obligations.[10]

Because the Utility Special Entity is hedging a commercial risk, its focus is to align the Utility Operations-Related Swap as closely as possible with the underlying and unique commercial risk being hedged, rather than to settle for a more standardized, shorter-

[9] In the Adopting Release, the Commission cites comments made by Petitioners' representatives and other energy industry market participants at the Commission Roundtable and meetings on these important points. See 77 Fed. Reg. at 30707-30708. Although a Utility Special Entity may be able to seek out a CFTC-registered Wall Street "swap dealer" or another financial entity, such as a hedge fund, to provide such a customized Utility Operations-Related Swap, if the "swap dealer" does not have assets in the region or is not otherwise active in the particular regional nonfinancial commodity swap market, the pricing and customization of the Utility Operations-Related Swap it offers are unlikely to be competitive.

[10] The nonfinancial counterparty may itself be entering into a Utility Operations-Related Swap "for the purpose of hedging physical positions," as that phrase appears in CFTC Regulation 1.3(ggg)(6)(iii) and about which the Commission is seeking further comment in the Adopting Release. That regulation is identified as an "interim final rule," and therefore presumably is still subject to further Commission rulemaking before the rules defining "swap dealer" are, indeed, final. See 77 Fed Reg. 30612. See also footnote 6 with reference to the Commission's anticipated further rulemakings on the definition of "swap" and nonfinancial commodity "trade options."

term, and therefore less "perfect" (and consequently less cost-effective) hedge for such commercial risk.[11]

D. Utility Operations-Related Swaps Often Have Large Notional Amounts.

Many Utility Operations-Related Swaps have longer terms than may be typical in other swap asset classes or product types, as a result of the long-term commercial risks being hedged – risks arising from long-term utility service obligations, construction projects, generation outage or availability projections, or long term fuel needs. Consequently, the notional amount of such swaps can be quite large. In addition, due to the volatile nature of the market prices of these nonfinancial commodities, the notional amounts can fluctuate dramatically over the term of a Utility Operations-Related Swap. The prices of electric energy, fuel and natural gas are among the most volatile of traded commodities, especially prices for illiquid delivery points, subject to regional supply and demand factors such as weather, and with customized operational conditions and terms.

A single one-year 100 MW swap or a single three-year 10,000 mmBtu/day swap may have a notional value of $25 million.[12] A nonfinancial entity would, therefore, be available to enter into only one such swap with Utility Special Entity counterparties in any rolling twelve-month period. Otherwise, the nonfinancial entity risks exceeding the special entity sub-threshold, and would be required to register with the Commission as a "swap dealer."

E. Utility Special Entities are At a Competitive Disadvantage to Similarly-Situated Market Participants due to the Special Entity Sub-Threshold.

If the Commission denies the proposed rule amendment, Utility Special Entities could still look to CFTC-registered swap dealers for these types of swaps, or could use less customized, more expensive commercial risk management solutions that might be

[11] We have discussed the Special Entity Sub-Threshold issue with energy trade associations and with large nonfinancial entities that currently act as regular counterparties to Utility Special Entities in these types of swaps. A number of these entities have indicated to Petitioners that they share our concern about the sub-threshold, and that they are prepared to file comments in support of this Petition. See footnote 16.

[12] These examples are based on available quotes for 100 MWs of 7x24 electric energy for calendar year 2013 at Mid-C, PJM West and SP-15 for "Firm LD" power, and on Henry Hub calendar strip prices for natural gas. Each of these examples is for a relatively liquid delivery point, and for swaps that are not customized as are many Utility Operations-Related Swaps. To put these examples (and the $25 million Sub-Threshold) in context, the Los Angeles Department of Water and Power owns or operates 6000 MWs of electric generation, and the New York Power Authority owns or operates 7400 MWs of electric generation. JEA, formerly the Jacksonville Electric Authority, hedges approximately 13.8 million mmBtus of natural gas in an average year as part of its fuel procurement process for electric operations, based on the past 5 years actual hedging activity. If each of these Utility Special Entities was limited to one $25 million hedge per year with each non-"swap dealer" counterparty, it would dramatically limit the ability of these Utility Special Entities to hedge or mitigate commercial risks arising from everyday utility operations.

available on an exchange. Or Utility Special Entities could simply forego using nonfinancial commodity swaps for commercial risk management purposes entirely. At the same time, the available counterparties for Utility Operations-Related Swaps could enter into up to $8 Billion notional in swaps, or even $8 Billion in Utility Operations-Related Swaps, with counterparties ***other than*** Utility Special Entities, including neighboring investor-owned utilities and electric cooperatives. As a direct result of the Special Entity Sub-Threshold, Utility Special Entities are denied a level playing field in the competition for available counterparties for these commercial risk hedging swaps. Utility Special Entities are denied comparable, cost-effective access to such commercial risk management tools that will instead be offered to neighboring investor-owned utilities and electric cooperatives by otherwise available market participants.[13]

In today's regional markets, a Utility Special Entity is equally as likely as an investor-owned utility in the same region to be an attractive counterparty for an entity that chooses to "deal" in Utility Operations-Related Swaps, whether the entity is a nonfinancial company hedging its own commercial risks (or "hedging a physical position" as such phrase is more narrowly defined in the CFTC's definition of "swap dealer"), trading for profit (speculating), or engaging in a regular business of dealing in such swaps. The "playing field" between the Utility Special Entity and the investor-owned utility, electric cooperative or any other counterparty is currently "level."

Moreover, in today's regional markets, if a market participant (such as the Alabama merchant generator or the Wyoming natural gas or coal producer referenced above) is considering establishing a new entrant "swap dealing" business in specific regional product types of Utility Operations-Related Swaps, it will similarly consider the Utility Special Entity as a potential counterparty with the same ability to transact as any other potential counterparty. The Utility Special Entity benefits from any new or additional price competition.

Once the CFTC's Entity Definition rules are effective, as a result of the significant disparity between the general *de minimis* threshold and the special entity sub-threshold, the Alabama-based merchant generator or the Wyoming-based natural gas or coal producer, or any other market participant not intending to register as a "swap dealer," will substantially limit its swap dealing activity in Utility Operations-Related Swaps with Utility Special Entities. Indeed, in regions like California and the Southeast United

[13] An unintended consequence of the $25 million Special Entity Sub-Threshold applied to Utility Operations-Related Swaps will be to limit the Utility Special Entities' available counterparties and force Utility Special Entities to engage in Utility Operations-Related Swaps with financial institutions and other entities that are registered with the CFTC. This would concentrate, not disperse, risk to the United States financial system. For financial institutions, such activity may or may not be an activity in which such financial institutions or their "banking entity" affiliates are permitted to engage once the regulations implementing the Volcker Rule and other provisions of the Dodd-Frank Act rulemakings are finalized. Such Utility Operations-Related Swaps with "swap dealer" counterparties may also require the posting of margin by Utility Special Entities (depending on the applicable regulators' final rules on capital and margin).

States, where there are geographic concentrations of Utility Special Entities, a non-"swap dealer" counterparty may only be able to execute one such Utility Operations-Related Swap with one such Utility Special entity in a 12-month period without the risk of exceeding the $25 million sub-threshold. The entity will set up its swap dealing activity business, its business processes, its documentation and its compliance programs to transact with counterparties ***other than*** the Utility Special Entities, including neighboring investor-owned utilities and electric cooperatives. [14] The unworkably low, and comparatively disadvantageous, Special Entity Sub-Threshold threatens the Utility Special Entities' uninterrupted access to these important and cost-effective commercial risk management tools.

IV. SUPPORTING ARGUMENTS

For the following reasons, the Commission should approve the proposed rule amendment as soon as possible:

A. The Commission has the Authority to Approve the Rule Amendment.

Section 1a(49)(D) of the Commodity Exchange Act ("CEA") as amended by the Dodd-Frank Act, and new CFTC Regulation 1.3(ggg)(4)(v) authorize the Commission to change or modify the requirements of the *de minimis* exception to the "swap dealer" definition by rule or regulation, without engaging in further joint rulemaking or joint interpretative guidance with the Securities and Exchange Commission. The Adopting Release acknowledges this. See footnote 464 at 77 Fed. Reg. 30634, and related text.

Section 1a(49)(D) provides as follows:

...(D) *DE MINIMIS* EXCEPTION – The Commission shall exempt from designation as a swap dealer an entity that engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to making of this determination to exempt."

As the Commission notes on page 30702 of the Adopting Release, "... CEA Section 1a(49)(D) directs the CFTC to promulgate regulations to establish factors with respect to the making of the determination to apply the *de minimis* exceptions to the definition of the term "swap dealer."

[14] The Adopting Release notes that the statute's *de minimis* exception intended to increase competition within markets for swaps by encouraging new entrants, thereby decreasing costs for commercial end users and decreasing systemic risks by lessening concentration of dealing activity among a few major financial market participants. See 77 Fed. Reg. 30629. Ironically the special entity sub-threshold acts directly contrary to this stated statutory and regulatory objective. For Utility Special Entities hedging commercial risks, the sub-threshold will serve to discourage new entrants and concentrate the Utility Special Entity's counterparty credit risk. The proposed rule amendment would restore this competitive, and less risky, market structure.

New CFTC Regulation 1.3(ggg)(4)(v) provides as follows:

"...(v) Future adjustments to scope of the de minimum exception. The Commission may by rule or regulation change the requirements of the *de minimis* exception described in paragraphs (ggg)(4)(i) through (iv) of this section.

Clearly the Commission has the authority to approve the proposed rule amendment.

B. The Factors Set Forth the Proposed Rule Amendment are Distinctly and Uniquely Applicable to Utility Operations-Related Swaps and to Utility Special Entities.

The proposed rule amendment will have no affect on the *de minimis* exception to the "security-based swap dealer" definition. Nor will the proposed rule amendment have any affect on the *de minimis* exception to the Commission's "swap dealer" definition as it applies in general to special entities (including Utility Special Entities) engaging in financial swaps or nonfinancial" other commodity" swaps, other than those product types critical to hedging or mitigating commercial risks in the utility industry.

The factors set forth in the proposed rule amendment are not applicable to security-based swap dealers or to their counterparties. Counterparties to security-based swaps do not need such security-based swaps to "hedge or mitigate commercial risks", as is the case with commercial end users' need for nonfinancial commodity swaps to hedge or mitigate commercial risks. Congress specifically recognized the importance of protecting "commercial end users" access to nonfinancial commodity swaps when it emphasized that the Dodd-Frank Act's focus on financial market stability and price and market transparency should not be achieved without also preserving commercial end users' access to swaps used to hedge or mitigate commercial risks.[15]

The factors that argue in favor of the Commission approving the proposed rule amendment are also inapplicable to entities involved in agricultural or metal commodities transactions and swaps. Such entities are simply not subject to public service obligation comparable to those that apply to utilities that require Utility Operations-Related Swaps to hedge commercial risks associated with utility facilities, operations and public service obligations. Utilities (including Utility Special Entities) have public service obligations under Federal, state and local laws and regulations, and utility reliability obligations, that other industries simply do not share. Congress recognized these important obligations throughout the Dodd-Frank Act as deserving of the Commission's regulatory deference. See Section 720 of the Dodd-Frank Act calling for FERC/CFTC memoranda of understanding, new CEA Section 2(a)(1)(I) regarding jurisdiction of the various energy regulatory agencies, and new CEA Section 4(c)(6) directing the Commission to consider public interest waivers of its jurisdiction.

[15] *See* 156 Cong Rec. H5238 (the "Dodd-Lincoln letter").

The Commission clearly has the authority to approve the proposed rule amendment. The factors that argue in favor of the proposed rule amendment, and limit its affect, reflect the unique and the different characteristics of these types of "swaps" and these market participants, and recognize the differing applicable laws and regulations, and statutory and regulatory policies The Commission should approve the proposed rule amendment and do so as soon as possible.

C. Nothing in the Dodd-Frank Act or the CEA Requires the Special Entity Sub-Threshold.

The proposed rule amendment is narrowly tailored to achieve both the statutory goals and Congressional intent underlying the Dodd-Frank Act, and to leave in place the supplemental investor protection objectives of the Commission in including the Special Entity Sub-Threshold in the "swap dealer" definition.

In the Dodd-Frank Act, Congress imposed on registered "swap dealers" heightened business conduct standards when advising, offering or entering into swaps with "special entities." Nothing in the Dodd-Frank Act imposes or requires the Commission to impose business conduct standards on entities that are not required to register as "swap dealers." Nothing in the Dodd-Frank Act requires the Commission to impose an exponentially smaller *de minimis* sub-threshold for counterparties that are not registered "swap dealers" and that enter into swaps to which "special entities" are counterparties. The Adopting Release acknowledges as much, characterizing the lower threshold as "*consistent with* the fact that Title VII's requirements applicable to swap dealers . . . provide heightened protection to these types of entities." 77 Fed. Reg. at 30630 (*emphasis added*).

The Adopting Release cites the Dodd-Frank Act provisions that impose on *registered* swap dealers and major swap participants (those market professionals whose activities are directly regulated by the Commission) heightened business conduct standards and documentation requirements for interacting with "special entities." The Adopting Release then extrapolates without explanation as to why it is consistent for the Commission to extend its regulatory reach beyond the market professionals registered as "swap dealers," whose conduct the statute intends it to regulate, to impose restrictions on the activities of entities that are not swap dealers, and whose *de minimis* "swap dealing activities" do not require such registration. The Special Entity Sub-Threshold is a clear regulatory overreach by the Commission, and should be modified where such regulatory overreach negatively affects the ability of yet another group of entities that are not "swap dealing" – the "Utility Special Entities" – to hedge or mitigate the commercial risks of their nonfinancial, public service enterprises.

The Adopting Release gives examples of situations where the special entity "lacked the requisite sophistication and experience to independently evaluate *the risks of the investment* and exposed the [special entity] to a heightened risk of catastrophic loss ultimately led to a complete loss of their investments." See footnote 425 and text

accompanying at 77 Fed. Reg. 30630 (*emphasis added)*. In the examples, the special entities were acting outside the scope of their core operations as investors in financial derivatives, interacting with financial institution or "financial entity" market professionals, using cash reserves or other cash assets of the special entity to invest (for profit or loss) in financial derivatives instruments. By contrast, the Utility Special Entities use Utility Operations-Related Swaps to hedge the commercial risks of their core utility operations, not to invest for profit.

D. The Proposed Rule Amendment is Consistent with Both Congressional Intent of the Dodd-Frank Act and Will have No Affect on the Commission's Investor Protection Policy Objectives.

The investor protection objectives of the Dodd-Frank Act, and the Commission's own "consistent" and supplemental investor protection objectives as expressed in the Adopting Release, would not be affected or compromised by the proposed rule amendment. As is clear from the proposed definition of "Utility Operations-Related Swap," the Utility Special Entity enters into such a nonfinancial commodity swap to hedge commercial risks that arise from its utility facilities, operations and public service obligations.

The proposed rule amendment is drafted narrowly to respect the Commission's investor protection policies but to achieve the distinct, but equally important, Congressional intent of the Dodd-Frank Act: to preserve cost-effective (and comparative, competitively equal) access to nonfinancial commodity swaps that Utility Special Entities use "to hedge or mitigate commercial risks."

The proposed rule amendment does not amend either the general *de minimis* threshold for swap dealing activity. The general *de minimis* threshold would continue to apply to Utility Operations-Related Swaps to which Utility Special Entities are counterparties. Nor does the proposed rule amendment change the "special entity sub-threshold" for swaps in asset classes or product types other than Utility Operations-Related Swaps to which Utility Special Entities are counterparties.

In defining the term "Special Entity" in Section 4s(h)(2)(C) of the Dodd-Frank Act and establishing the heightened business conduct standards for registered "swap dealers," Congress did not intend for the Commission expand its regulatory oversight beyond oversight of regulated "swap dealers" to place restrictions on entities that are not required to register as "swap dealers." In establishing the Special Entity Sub-Threshold and then not substantially raising it when it raised the general de minimis threshold, lhte Commission restricted Utility Special Entities' competitive abilities, and severely restricted Utility Special Entities' access to the nonfinancial commodity swaps needed to cost-effectively hedge or mitigate commercial risks.

V. PROCESS AND TIMELINE FOR PETITION

The Petitioners respectfully request the Commission to act as soon as possible on the proposed rule amendment -- to remove continuing regulatory uncertainty for the Utility Special Entities and counterparties that would, but for the Special Entity Sub-Threshold, be available to enter into Utility Operations-Related Transactions with Utility Special Entities. As the Commission's new "swap" regulations are proposed, become final and implementation begins, market participants are evaluating whether and how to participate in the new market structure for "swaps." At the same time, Utility Special Entities have continuing utility public service obligations to provide affordable, reliable utility service to their customers, and consequently have both short-term and long-term commercial risks to hedge.

As the effective dates and compliance dates approach for the new "swap" regulatory regime, market participants are beginning to turn their attention away from current activities in nonfinancial commodities and commodity swaps in general. The challenges of the new regulatory requirements applicable to "swaps," including challenges for systems, staffing, compliance, documentation and reporting are overwhelming, even for the largest financial institutions and financial markets professionals, especially given the tight and interrelated compliance timelines.

The added challenge of determining whether to register as a "swap dealer" for one or more asset classes or product types of "swaps" are even more daunting for a nonfinancial entity, whose primary and ongoing business is not trading or investing or dealing in the financial markets, but drilling for natural gas, mining coal, or generating, transmitting and/or delivering electric energy or natural gas to consumers.[16]

[16] A number of the nonfinancial entities with whom the Petitioners (or the trade association Petitioners' members) transact in Utility Operations-Related Swaps have told us that they are currently evaluating their nonfinancial commodity "swap" activities in light of the final Entity Definitions rules, the Interim Final Rule in Section 1.3(ggg)(6)(iii), and the statutory guidance provided in the Adopting Release and elsewhere in the CFTC's regulations, interpretations and precedents. Such nonfinancial entities are also awaiting the CFTC's final rules defining the term "swap," which is the foundational rulemaking which will enable the energy industry to understand the scope of the CFTC's jurisdiction over our industry's transactions. As of July 10, 2012, for the electric and natural gas utility industry, the challenges are compounded by the continuing uncertainty as to what is and isn't a "swap," a "nonfinancial commodity forward" transaction, a nonfinancial commodity forward with embedded optionality, or a "trade option." See footnote 6 above. Once the rules defining "swap" are final with respect to our industry's transactions, each nonfinancial entity will then (and can only then) analyze which of its activities will fall within the definition of "swap," and therefore would or could be "swap dealing," which of its activities will be excluded as "hedging a physical position" (depending on the outcome of that final rulemaking), or fit within other safe harbors under the interpretive guidance provided by the Commission. Then and only then can the nonfinancial entity decide, as a business matter, whether to continue all or any of its swap dealing activities, and whether to register as a "swap dealer" or to register for a limited designation as a "swap dealer" for certain asset classes and product types (that may or may not include particular Utility Operations-Related Swaps). Alternatively, only then can such a nonfinancial entity alternatively decide to wind down any swap activities which the Commission might consider to be "swap dealing activities." Nothing requires a nonfinancial entity (whose primary business is not to engage in financial markets transactions like "swaps") to continue its past or current business strategies. If a particular nonfinancial

Continued on following page

If a market participant decides to continue some amount of "swap dealing activity" in Utility Operations-Related Swaps, it will carefully evaluate and then establish compliance procedures to monitor the two *de minimis* thesholds. In doing so, it will certainly hesitate or delay incurring the expense of setting up specially calibrated systems, compliance processes and staff training in order to engage in one or two such swaps with Utility Special Entities within a 12-month period. A nonfinancial counterparty that does not choose to register as a "swap dealer" will instead understandably focus on modifying its business processes and documents to engage in swaps with counterparties other than Utility Special Entities, under the general *de minimis* exception threshold.

We request that the Commission promptly publish the proposed rule amendment for comment in the Federal Register, without waiting for the effective date of the Entity Definitions rules. We recommend a public comment period of no longer than 20 days, and respectfully request publication of the Commission's final approval or grounds for denying the rule amendment within 10 days thereafter.[17] The Petitioners request that the amended rule be retroactive and prospective for all Utility Operations-Related Swaps to which a Utility Special Entity is a counterparty entered into after the effective date of the Entity Definition rules.

VI. CONCLUSION

The Petitioners respectfully petition the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 1(ggg)(4), which implements the *de minimis* exception to the definition of "swap dealer," as described above.

Continued from previous page

entity decides to continue some level of swap dealing activity, it may decide not to continue such activity as a registered "swap dealer." At last decision point, once the new Dodd-Frank Act rules are effective and as compliance dates approach, these entities will restrict their swap dealing activity to stay well below the two very different *de minimis* exception thresholds in the CFTC's swap dealer definition.

[17] The proposed rule amendment relieves a competitive restriction on Utility Special Entities, and modifies the special entity sub-threshold to the *de minimis* exception to the definition of "swap dealer." The Commission and interested persons in the electr c and natural gas industry have been on notice of the Utility Special Entities' concerns since early May 2012. As a result, the proposed rule amendment is entitled to the earlier effective date permitted by CFTC Regulation 13.6.

SIGNATURE PAGE – SPECIAL ENTITY SUB-THRESHOLD PETITION

Please contact any of the individuals below or Patricia Dondanville, Reed Smith LLP, 10 South Wacker Drive, 40th Floor, Chicago Illinois 60606, telephone (312) 207-3911, or e-mail pdondanville@reedsmith.com, if you have questions regarding this Petition.

Respectfully submitted,

AMERICAN PUBLIC POWER ASSOCIATION

Susan N Kelly

____

Susan N. Kelly
Senior Vice President of Policy Analysis
and General Counsel
1875 Connecticut Avenue, N.W.
Suite 1200
Washington, D.C. 20009-5715
Tel: (202) 467-2933
E-mail: skelly@publicpower.org

LARGE PUBLIC POWER COUNCIL

____

Noreen Roche-Carter
Chair, Tax and Finance Task Force
c/o Sacramento Municipal Utility District
6201 S Street
Sacramento, CA 95817-1899
Tel: (916) 732-6509
E-mail: nrochec@smud.org

TRANSMISSION ACCESS POLICY STUDY GROUP

____

John Twitty
Executive Director
4203 East Woodland Street
Springfield, MO 65809
Tel: (414) 838-8576
E-mail: 835consulting@gmail.com

AMERICAN PUBLIC GAS ASSOCIATION

____

David Schryver
Executive Vice President
201 Massachusetts Avenue, NE
Suite C-4
Washington, DC 20002
Tel: (202) 464-0835
E-mail: dschryver@apga.org

BONNEVILLE POWER ADMINISTRATION

____

Virginia K. Schaeffer
Attorney
Office of the General Counsel – LC-7
P.O. Box 3621
Portland, Oregon 98208-3621
Tel: (503)230-4030
Email: vkschaeffer@bpa.gov

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E-mail: skelly@publicpower.org

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Executive Vice President
201 Massachusetts Avenue, NE
Suite C-4
Washington, DC 20002
Tel: (202) 464-0835
E-mail: dschryver@apga.org

BONNEVILLE POWER ADMINISTRATION

____

Virginia K. Schaeffer
Attorney
Office of the General Counsel – LC-7
P.O. Box 3621
Portland, Oregon 98208-3621
Tel: (503)230-4030
Email: vkschaeffer@bpa.gov

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Tel: (202) 467-2933
E-mail: skelly@publicpower.org

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Tel: (414) 838-8576
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BONNEVILLE POWER ADMINISTRATION

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Attorney
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Suite C-4
Washington, DC 20002
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Suite 1200
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Tel: (202) 467-2933
E-mail: skelly@publicpower.org

TRANSMISSION ACCESS POLICY STUDY GROUP

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Executive Director
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Springfield, MO 65809
Tel: (414) 838-8576
E-mail: 835consulting@gmail.com

BONNEVILLE POWER ADMINISTRATION

Virginia K. Schaeffer
Attorney
Office of the General Counsel – LC-7
P.O. Box 3621
Portland, Oregon 98208-3621
Tel: (503)230-4030
Email: vkschaeffer@bpa.gov

LARGE PUBLIC POWER COUNCIL

Noreen Roche-Carter
Chair, Tax and Finance Task Force
c/o Sacramento Municipal Utility District
6201 S Street
Sacramento, CA 95817-1899
Tel: (916) 732-6509
E-mail: nrochec@smud.org

AMERICAN PUBLIC GAS ASSOCIATION

David Schryver
Executive Vice President
201 Massachusetts Avenue, NE
Suite C-4
Washington, DC 20002
Tel: (202) 464-0835
E-mail: dschryver@apga.org

cc: Honorable Gary Gensler, Chairman
Honorable Bart Chilton, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Mark Wetjen, Commissioner
Office of the CFTC General Counsel

ReedSmith

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CFTC

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Office of the
Secretariat

LEG 5/36

Reed Smith LLP
10 South Wacker Drive
Chicago, IL 60606-7507
+1 312 207 1000
Fax +1 312 207 6400
reedsmith.com

Patricia Dondanville
Direct Phone: +1 312 207 3911
Email: pdondanville@reedsmith.com

July 12, 2012

VIA MESSENGER
Mr. David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4)

Dear Mr. Stawick:

Enclosed please find a copy of the Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4), filed today pursuant to CFTC Regulation 13.2 on behalf of the following Petitioners:

American Public Power Association
Large Public Power Council
American Public Gas Association
Transmission Access Policy Study Group
Bonneville Power Administration

Very truly yours,

Patricia Dondanville PLK
Patricia Dondanville

PD:esh
Enclosure

U20120293300A

American Public Power Association
PublicPower.org

American Public Gas Association

TAPS

BPA 75 YEARS
SERVING THE NORTHWEST

July 12, 2012

Via Email and Messenger Delivery

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4)

Dear Mr. Stawick:

The American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), the American Public Gas Association ("APGA"), the Transmission Access Policy Study Group ("TAPS") and the Bonneville Power Administration ("BPA")(collectively, the "Petitioners") respectfully petition the Commodity Futures Trading Commission (the "Commission" or the "CFTC") under CFTC Regulation 13.2 to amend CFTC Regulation 1.3(ggg)(4),[1] which implements the *de minimis* exception to the definition of "swap dealer." The Petitioners specifically request that the rule amendment exclude from the "special entity sub-threshold," which appears in Regulation 1.3(ggg)(4)(i), "Utility Operations-Related Swaps" to which the Petitioners and other "Utility Special Entities" are, or may in the future be, counterparties. The definitions of "Utility Operations-Related Swap" and "Utility Special Entity" are included directly in the text of the proposed rule amendment, and narrowly circumscribe the scope of the proposed rule amendment.

[1] 77 Fed. Reg. 30596, at 30744.

Such a rule amendment is permitted by Section 1a(49)(D) of the Commodity Exchange Act ("CEA") as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"),[2] and is specifically contemplated by CFTC Regulation 1.3(ggg)(4)(v).[3] The rule amendment is necessary in order to preserve uninterrupted and cost-effective access to the customized, nonfinancial commodity swaps that Petitioners and other Utility Special Entities use to hedge or mitigate commercial risks arising from their utility facilities, operations and public service obligations.

The information required by CFTC Regulation 13.2 follows:

I. THE TEXT OF THE PROPOSED RULE AMENDMENT (Additional language is underlined and italicized)

PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

***

Section 1.3 Definitions.

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(ggg) Swap Dealer.

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(4) *De minimis* exception. (i) Except as provided in paragraph (ggg)(4)(vi) of this section, a person that is not currently registered as a swap dealer shall be deemed not to be a swap dealer as a result of its swap dealing activity involving counterparties, so long as the swap positions connected with those dealing activities into which the person – or any other entity controlling, controlled by or under common control with the person – enters over the course of the immediately preceding 12 months (or following the effective date of final rules implementing Section 1a(47) of the Act, 7 U.S.C. 1a(47), if that period is less than 12 months) have an aggregate gross notional amount of no more than \$3 billion, subject to a phase in level of an aggregate gross notional amount of no more than \$8 billion applied in accordance with paragraph (ggg)(4)(ii) of this section, and an aggregate gross notional amount of no more than \$25 million *(the "special entity sub-threshold")* with regard to swaps in which the counterparty is a "special entity" (as that term is defined in Section 4s(h)(2)(C) of the Act, 7 U.S.C. 6s(h)(2)(C), and §23.401(c) of this chapter)*; provided that such \$25 million special entity sub-threshold shall* ***not*** *apply with regard to "utility operations related swaps" to which the counterparty is a "utility special entity." For purposes of this paragraph, (A) a "utility special entity" means a government "special entity" (as described in clause (i) or (ii) of Section 4s(h)(2)(C) of the Act or in clause (1) or (2) of §23.401(c) of this chapter) that owns or operates electric or natural gas facilities or electric or natural gas operations (or anticipated facilities or operations), supplies natural gas and/or electric energy to other*

[2] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[3] 77 Fed. Reg. 30744-30745.

utility special entities, has public service obligations (or anticipated public service obligations) under Federal, State or local law or regulation to deliver electric energy and/or natural gas service to utility customers, or is a Federal power marketing agency as defined in Section 3 of the Federal Power Act (16 U.S.C. 796(19)), and (B) a "utility operations-related swap" shall mean any swap that a utility special entity enters into "to hedge or mitigate commercial risks" (as such phrase is used in Section 2(h)(7)(A)(ii) of the Act) intrinsically related to the electric or natural gas facilities that the utility special entity owns or operates or its electric or natural gas operations (or anticipated facilities or operations), or to the utility special entity's supply of natural gas and/or electric energy to other utility special entities or to its public service obligations (or anticipated public service obligations) to deliver electric energy or natural gas service to utility customers. For the avoidance of doubt, "intrinsically related" shall include all transactions related to (i) the generation or production, purchase or sale, and transmission or transportation of electric energy or natural gas, or the supply of natural gas and/or electric energy to other utility special entities, or delivery of electric energy or natural gas service to utility customers, (ii) all fuel supply for the utility special entity's electric facilities or operations, (iii) compliance with electric system reliability obligations applicable to the utility special entity, its electric facilities or operations, (iv) compliance with energy, energy efficiency, conservation or renewable energy or environmental statutes, regulations or government orders applicable to the utility special entity, its facilities or operations, or (v) any other electric or natural gas utility operations-related swap to which the utility special entity is a party. Utility operations-related swaps shall ***not*** *include a swap based or derived on, or referencing, commodities in the interest rates, credit, equity or currency asset classes, or a product type or category in the "other commodity" asset class that is based or derived on, or referencing, metals, or agricultural commodities or crude oil or gasoline commodities of any grade not used as fuel for electric generation.* For purposes of this paragraph, if the stated notional amount of a swap is leveraged or enhanced by the structure of the swap, the calculation shall be based on the effective notional amount of the swap rather than on the stated notional amount.

II. THE PETITIONERS

APPA is the national association that represents the interests of approximately 2000 government-owned electric utilities in the United States. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. Government-owned electric utilities provide over 15% of all KWh sales to retail electric customers.

LPPC is an organization representing 26 of the largest government-owned electric utilities in the nation. LPPC members own and operate over 86,000 megawatts of generation capacity and nearly 35,000 circuit miles of high voltage transmission lines, representing nearly 90% of the transmission investment owned by non-Federal government-owned electric utilities in the United States.

TAPS is an association of transmission dependent electric utilities located in more than 30 states. All of TAPS member electric utilities except one are government-owned electric utilities.

APGA is the national association that represents government-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and over 720 of these systems are APGA members. Government-owned natural gas distribution systems are not-for-profit entities owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other government agencies that have natural gas distribution facilities.

Some government-owned utilities are both electric utilities and natural gas distribution utilities, and are therefore members of both APPA and APGA. The purpose of a government-owned electric utility or natural gas distribution system is to provide reliable, safe and affordable electric energy and/or natural gas service to the community it serves.

BPA is a self-financed, non-profit Federal agency created in 1937 by Congress that primarily markets electric power from 31 federally owned and operated projects, and supplies over one-third of the electricity used in the Pacific Northwest. BPA also owns and operates approximately 75 percent of the high-voltage transmission in the Pacific Northwest. BPA's primary statutory responsibility is to market its Federal system power at cost-based rates to its "preference customers."[4] BPA also funds one of the largest wildlife protection and restoration programs in the world.

III. NATURE OF THE PETITIONERS' INTEREST

APPA, LPPC, TAPS and APGA represent thousands of government-owned electric and natural gas utilities throughout the United States, all of which are "special entities" as that term is defined in Section 4s(h)(2)(C) of the Commodity Exchange Act, as amended by the Dodd-Frank Act, and §23.401(c) of the Commission's regulations. BPA and the other Federal power agencies are "special entities" as well.[5] The Petitioners

[4] BPA has 130 preference customers made up of electric utilities which are not subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC"), including Indian tribes, electric cooperatives, state and municipally chartered electric utilities, and other Federal agencies located in the Pacific Northwest.

[5] According to the Energy Information Administration, there are nine Federal electric utilities in the United States, which are part of several agencies of the United States Government (see, http://www.eia.gov/cneaf/electricity/page/prim2/toc2.html): the Army Corps of Engineers; the Bureau of Indian Affairs and the Bureau of Reclamation in the Department of the Interior, the International Boundary and Water Commission in the Department of State , the Power Marketing Administrations in the Department of Energy (BPA, Western Area Power Administration, Southwestern Area Power Administration, and Southeastern Area Power Administration), and the Tennessee Valley Authority (TVA). In addition, three Federal agencies operate electric generating facilities: TVA, the largest Federal power producer; the U.S. Army Corps of Engineers; and the U.S. Bureau of Reclamation.

respectfully seek the rule amendment for the benefit of all "Utility Special Entities" that currently, or may in the future, enter into Utility Operations-Related Swaps with counterparties that are not registered with the Commission as "swap dealers."

"Utility Special Entities," as defined in the proposed rule amendment, are a narrow category of special entities distinguishable by their electric energy and/or natural gas utility facilities, operations and public service obligations. None of the Utility Special Entities is a "financial entity;" all are nonfinancial entities and "commercial end users" as such term is used by Congress and regulatory policy makers. "Utility Operations-Related Swaps," as defined in the proposed rule amendment, are a narrow category of "swaps"[6] in the nonfinancial or "other commodity" asset class. Such swaps are, by definition, of product types intrinsically related to the commercial risks associated with utility facilities, operations and public service obligations, and are used to hedge or mitigate such commercial risks. Such customized nonfinancial commodity swaps are typically not available on exchanges or electronic trading platforms, due to the myriad non-numeric operational conditions, requirements and permutations embedded in such swaps.

The Petitioners commented on the Commission's proposed rules further defining "swap dealer" raising concerns that **both** the general *de minimis* threshold and the "special entity sub-threshold" needed to be raised significantly. See comments filed by NFP Electric End User Coalition, including APPA and LPPC with assistance from TAPS, in the Commission's "Entity Definitions" docket, a link to which appears at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27917&SearchText=

[6] This term has not yet been defined by the Commission to the extent required to provide regulatory clarity to Petitioners and others in the utility industry. The Petitioners and others in the utility industry await publication in the Federal Register of rules further defining "swap," along with the Commission's response to public comments on any further questions asked by the Commission in the most recent statutory interpretations relevant to the definition of "swap," the Commission's response to comments solicited on the nonfinancial commodity "trade option" Interim Final Rule, the CFTC/FERC jurisdictional Memoranda of Understanding called for by Section 720 of the Dodd-Frank Act, the "tariffed transaction exemption(s)" and "between FPA 201(f) transaction exemption" called for in new CEA Sections 4(c)(6), and other final rules, interpretations and exemptions. See the comment letter filed by the Electric Trade Associations in the "Product Definitions" or "Definition of 'Swap'" docket at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47934&SearchText=Wasson, and other comment letters, applications and petitions filed by the Petitioners and others in the utility industry.

There is no need to wait to consider the proposed rule amendment for the effective date of the Commission's final rules further defining the term "swap." The proposed rule amendment, as drafted, will only be applicable to those utility operations-related transactions which are ultimately subject to the Commission's jurisdiction as "swaps," and would therefore be considered part of an entity's "swap dealing activity," and counted against either the general *de minimis* threshold or the special entity sub-threshold. In this manner, the proposed rule amendment is similar to all the Commission's regulations that include the term "swap," including the Entity Definition rules themselves. None of these regulations can be fully understood or applied to Petitioners' and other market participants' businesses until the Commission's final rules further defining "swap" and other foundational terms that include the term "swap" are effective for relevant asset classes and product types.

rural at 18-19, supporting the comments filed by the Edison Electric Institute and the Electric Power Supply Association in the same docket requesting significantly higher thresholds for ***both*** the general *de minimis* threshold and the special entity sub-threshold than were proposed by the Commission, a link to which appears at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27918&SearchText=

The Commission acknowledges the Petitioners' comments in numerous places in the Adopting Release for the Entity Definitions rules (the "Adopting Release"). See, for example, 77 Fed. Reg. 30627 and 30707. In the final rules, however, the Commission raised the general *de minimis* threshold by a factor of 80 during the phase in period (and by a factor of 30 thereafter) - from $100 million to $8 billion during the phase in period (and $3 billion thereafter). In contrast, the Commission left the special entity sub-threshold unchanged at $25 million. The Petitioners' concern about the competitive disadvantage represented by the discrepancy between the two thresholds in the final rules is the reason for this Petition.

A. Utility Special Entities Require Customized Utility Operations-Related Swaps.

Utility Special Entities depend on nonfinancial commodity transactions, trade options and "swaps," as well as the futures markets, to hedge commercial risks that arise from their utility facilities, operations and public service obligations. Together, these nonfinancial commodity markets play a central role in government-owned utilities securing electric energy, fuel for generation and natural gas supplies for delivery to consumers at reasonable and stable prices. Specifically, many government-owned utilities purchase firm electric energy, fuel and gas supplies in the physical delivery markets (in the "cash" or "spot" or "forward" markets) at prevailing and fluctuating market prices, and enter into bilateral, financially–settled nonfinancial commodity swaps with customized terms to hedge the unique operational risks to which each Utility Special Entity is subject.

The Utility Special Entities use Utility Operations-Related Swaps to ensure reliability of utility service and to reduce utility customers' exposure to future commodity price fluctuations and to stabilize utility rates. In hedging, mitigating or managing the commercial risks of its utility facilities operations or public service obligations, the Utility Special Entity are engaged in commercial risk management activities that are no different from the operations-related hedging of an investor-owned utility or an electric cooperative located in the same geographic region.

B. The "Market" for Each Particular Utility Operations-Related Swap is Illiquid.

Utility Special Entities enter into these bilateral customized swaps in illiquid regional or local "markets."[7] Some counterparties available to transact with Utility Special Entities

[7] The word "markets" is used in quotations in this context, as Utility Operations-Related Swaps do not occur with anywhere near the frequency or uniformity that financial "swaps" occur, or that agricultural,

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will be major financial institutions or other financial entities, such as hedge funds, that may or may not transact in other swap asset classes or product types. Other available counterparties will be nonfinancial counterparties, those which are not "financial entities" as such term is defined in CEA Section 2(h)(7)(C).

Each Utility Special Entity actively seeks out available swap counterparties in order to hedge its unique, ongoing and dynamically-changing commercial risks.[8] Commercial risk management policies in the energy industry typically require diversification of suppliers and swap counterparties, limited concentration of supplier/vendor/counterparty credit risk, and other commercial risk management metrics to prudently manage the commercial risks of bilateral contracting processes.

Each regional geographic market has a somewhat different group of financial entity and nonfinancial counterparties available to enter into customized Utility Operations-Related Swaps. An available counterparty may own or operate commercial businesses related to the particular nonfinancial commodity that underlies the Utility Operations-Related Swap. It may be a neighboring utility or electric cooperative, the owner of a merchant electric generation facility located in the area, or a natural gas or coal company with production assets in the region.

For example, a large natural gas utility or the owner of a large merchant electric generation station in western Alabama might be available as a nonfinancial counterparty for swaps referencing an Alabama delivery point. But that same entity would not necessarily offer the type of customized Utility Operations-Related Swap required by a Utility Special Entity located in Oregon. Or, a natural gas producer or coal producer with production assets in Wyoming might offer Utility Operations-Related Swaps required by a California-based or Oregon-based Utility Special Entity. But the same counterparty would not necessarily enter into a similar Utility Operations-Related Swap referencing a nonfinancial commodity delivered in the Southeast. Nor would it

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metals, global oil or other product types of "swaps" in the "other commodity" asset class occur. Utility Operations-Related Swaps are, in some cases, negotiated over a period of days, weeks or months. Some may be documented based on a master agreement template, with many pages of specialized operational, credit and other risk management provisions included by the bilateral counterparties as schedules. Transacting under standardized master agreement templates (with bilaterally negotiated schedules and transaction documents) should not be confused with a conclusion or an assumption that there is a trading "market" for Utility Operations-Related Swaps having, standardized or "market" terms.

[8] Utility Special Entities may also be called upon from time to time by other utilities located in the same geographic region, by or in coordination with electric reliability organizations, to act as counterparties in Utility Operations-Related Swaps for electric system reliability purposes. Such swaps should not be considered "swap dealing activity" by the utility counterparty or counterparties to such swaps. Otherwise, the Utility Special Entities may not be able to participate in such swaps for reliability purposes without causing the counterparty to exceed the Special Entity Sub-Threshold, which may compromise the reliability of the interconnected electric system.

necessarily offer a Utility Operations-Relatec Swap referencing electric energy in any regional market.

C. Utility Special Entities Need All Available Utility Operations-Related Swap Counterparties.

Due to the limited number of counterparties for any particular Utility Operations-Related Swap in any particular region, each available financial or nonfinancial swap counterparty, whether or not a registered "swap dealer," brings important market liquidity or supplier/counterparty diversity for a Utility Special Entity. Multiple available counterparties create price competition for the customized swaps that a Utility Special Entity requires to cost-effectively hedge or mitigate unique commercial risks.[9]

Based on an informal survey of some of the larger Utility Special Entities, a substantial percentage of the counterparties that are currently available to enter into Utility Operations-Related Swaps with such Utility Special Entities are nonfinancial entities engaged in the electric, natural gas, coal or another aspect of the energy industry in the same geographic area as the specific Utility Special Entity.

Wall Street financial institutions and other financial entities tend to offer such swaps only where there is standardization of transaction terms and liquid trading markets: at trading hubs where the financial entity's swaps can be promptly and effectively hedged to maintain a "balanced book." Nonfinancial entities with assets or operations located in the geographic region may, as a result, face parallel commercial risks and can use the Utility Operations-Related Swap to manage some portion or aspect of the commercial risks inherent in its own physical assets, liabilities and commercial obligations.[10]

Because the Utility Special Entity is hedging a commercial risk, its focus is to align the Utility Operations-Related Swap as closely as possible with the underlying and unique commercial risk being hedged, rather than to settle for a more standardized, shorter-

[9] In the Adopting Release, the Commission cites comments made by Petitioners' representatives and other energy industry market participants at the Commission Roundtable and meetings on these important points. See 77 Fed. Reg. at 30707-30708. Although a Utility Special Entity may be able to seek out a CFTC-registered Wall Street "swap dealer" or another financial entity, such as a hedge fund, to provide such a customized Utility Operations-Related Swap, if the "swap dealer" does not have assets in the region or is not otherwise active in the particular regional nonfinancial commodity swap market, the pricing and customization of the Utility Operations-Related Swap it offers are unlikely to be competitive.

[10] The nonfinancial counterparty may itself be entering into a Utility Operations-Related Swap "for the purpose of hedging physical positions," as that phrase appears in CFTC Regulation 1.3(ggg)(6)(iii) and about which the Commission is seeking further comment in the Adopting Release. That regulation is identified as an "interim final rule," and therefore presumably is still subject to further Commission rulemaking before the rules defining "swap dealer" are, indeed, final. See 77 Fed Reg. 30612. See also footnote 6 with reference to the Commission's anticipated further rulemakings on the definition of "swap" and nonfinancial commodity "trade options."

term, and therefore less "perfect" (and consequently less cost-effective) hedge for such commercial risk.[11]

D. Utility Operations-Related Swaps Often Have Large Notional Amounts.

Many Utility Operations-Related Swaps have longer terms than may be typical in other swap asset classes or product types, as a result of the long-term commercial risks being hedged – risks arising from long-term utility service obligations, construction projects, generation outage or availability projections, or long term fuel needs. Consequently, the notional amount of such swaps can be quite large. In addition, due to the volatile nature of the market prices of these nonfinancial commodities, the notional amounts can fluctuate dramatically over the term of a Utility Operations-Related Swap. The prices of electric energy, fuel and natural gas are among the most volatile of traded commodities, especially prices for illiquid delivery points, subject to regional supply and demand factors such as weather, and with customized operational conditions and terms.

A single one-year 100 MW swap or a single three-year 10,000 mmBtu/day swap may have a notional value of $25 million.[12] A nonfinancial entity would, therefore, be available to enter into only one such swap with Utility Special Entity counterparties in any rolling twelve-month period. Otherwise, the nonfinancial entity risks exceeding the special entity sub-threshold, and would be required to register with the Commission as a "swap dealer."

E. Utility Special Entities are At a Competitive Disadvantage to Similarly-Situated Market Participants due to the Special Entity Sub-Threshold.

If the Commission denies the proposed rule amendment, Utility Special Entities could still look to CFTC-registered swap dealers for these types of swaps, or could use less customized, more expensive commercial risk management solutions that might be

[11] We have discussed the Special Entity Sub-Threshold issue with energy trade associations and with large nonfinancial entities that currently act as regular counterparties to Utility Special Entities in these types of swaps. A number of these entities have indicated to Petitioners that they share our concern about the sub-threshold, and that they are prepared to file comments in support of this Petition. See footnote 16.

[12] These examples are based on available quotes for 100 MWs of 7x24 electric energy for calendar year 2013 at Mid-C, PJM West and SP-15 for "Firm LD" power, and on Henry Hub calendar strip prices for natural gas. Each of these examples is for a relatively liquid delivery point, and for swaps that are not customized as are many Utility Operations-Related Swaps. To put these examples (and the $25 million Sub-Threshold) in context, the Los Angeles Department of Water and Power owns or operates 6000 MWs of electric generation, and the New York Powe· Authority owns or operates 7400 MWs of electric generation. JEA, formerly the Jacksonville Electric Authority, hedges approximately 13.8 million mmBtus of natural gas in an average year as part of its fuel procurement process for electric operations, based on the past 5 years actual hedging activity. If each of these Utility Special Entities was limited to one $25 million hedge per year with each non-"swap dealer" counterparty, it would dramatically limit the ability of these Utility Special Entities to hedge or mitigate commercial risks arising from everyday utility operations.

available on an exchange. Or Utility Special Entities could simply forego using nonfinancial commodity swaps for commercial risk management purposes entirely. At the same time, the available counterparties for Utility Operations-Related Swaps could enter into up to $8 Billion notional in swaps, or even $8 Billion in Utility Operations-Related Swaps, with counterparties ***other than*** Utility Special Entities, including neighboring investor-owned utilities and electric cooperatives. As a direct result of the Special Entity Sub-Threshold, Utility Special Entities are denied a level playing field in the competition for available counterparties for these commercial risk hedging swaps. Utility Special Entities are denied comparable, cost-effective access to such commercial risk management tools that will instead be offered to neighboring investor-owned utilities and electric cooperatives by otherwise available market participants.[13]

In today's regional markets, a Utility Special Entity is equally as likely as an investor-owned utility in the same region to be an attractive counterparty for an entity that chooses to "deal" in Utility Operations-Related Swaps, whether the entity is a nonfinancial company hedging its own commercial risks (or "hedging a physical position" as such phrase is more narrowly defined in the CFTC's definition of "swap dealer"), trading for profit (speculating), or engaging in a regular business of dealing in such swaps. The "playing field" between the Utility Special Entity and the investor-owned utility, electric cooperative or any other counterparty is currently "level."

Moreover, in today's regional markets, if a market participant (such as the Alabama merchant generator or the Wyoming natural gas or coal producer referenced above) is considering establishing a new entrant "swap dealing" business in specific regional product types of Utility Operations-Related Swaps, it will similarly consider the Utility Special Entity as a potential counterparty with the same ability to transact as any other potential counterparty. The Utility Special Entity benefits from any new or additional price competition.

Once the CFTC's Entity Definition rules are effective, as a result of the significant disparity between the general *de minimis* threshold and the special entity sub-threshold, the Alabama-based merchant generator or the Wyoming-based natural gas or coal producer, or any other market participant not intending to register as a "swap dealer," will substantially limit its swap dealing activity in Utility Operations-Related Swaps with Utility Special Entities. Indeed, in regions like California and the Southeast United

[13] An unintended consequence of the $25 million Special Entity Sub-Threshold applied to Utility Operations-Related Swaps will be to limit the Utility Special Entities' available counterparties and force Utility Special Entities to engage in Utility Operations-Related Swaps with financial institutions and other entities that are registered with the CFTC. This would concentrate, not disperse, risk to the United States financial system. For financial institutions, such activity may or may not be an activity in which such financial institutions or their "banking entity" affiliates are permitted to engage once the regulations implementing the Volcker Rule and other provisions of the Dodd-Frank Act rulemakings are finalized. Such Utility Operations-Related Swaps with "swap dealer" counterparties may also require the posting of margin by Utility Special Entities (depending on the applicable regulators' final rules on capital and margin).

States, where there are geographic concentrations of Utility Special Entities, a non-"swap dealer" counterparty may only be able to execute one such Utility Operations-Related Swap with one such Utility Special entity in a 12-month period without the risk of exceeding the $25 million sub-threshold. The entity will set up its swap dealing activity business, its business processes, its documentation and its compliance programs to transact with counterparties ***other than*** the Utility Special Entities, including neighboring investor-owned utilities and electric cooperatives.[14] The unworkably low, and comparatively disadvartageous, Special Entity Sub-Threshold threatens the Utility Special Entities' uninterrupted access to these important and cost-effective commercial risk management tools.

IV. SUPPORTING ARGUMENTS

For the following reasons, the Commission should approve the proposed rule amendment as soon as possible:

A. The Commission has the Authority to Approve the Rule Amendment.

Section 1a(49)(D) of the Commodity Exchange Act ("CEA") as amended by the Dodd-Frank Act, and new CFTC Regulation 1.3(ggg)(4)(v) authorize the Commission to change or modify the requirements of the *de minimis* exception to the "swap dealer" definition by rule or regulation, without engaging in further joint rulemaking or joint interpretative guidance with the Securities and Exchange Commission. The Adopting Release acknowledges this. See footnote 464 at 77 Fed. Reg. 30634, and related text.

Section 1a(49)(D) provides as follows:

...(D) *DE MINIMIS* EXCEPTION – The Commission shall exempt from designation as a swap dealer an entity that engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to making of this determination to exempt."

As the Commission notes on page 30702 of the Adopting Release, "... CEA Section 1a(49)(D) directs the CFTC to promulgate regulations to establish factors with respect to the making of the determination to apply the *de minimis* exceptions to the definition of the term "swap dealer."

[14] The Adopting Release notes that the statute's *de minimis* exception intended to increase competition within markets for swaps by encouraging new entrants, thereby decreasing costs for commercial end users and decreasing systemic risks by lessening concentration of dealing activity among a few major financial market participants. See 77 Fed. Reg. 30629. Ironically the special entity sub-threshold acts directly contrary to this stated statutory and regulatory objective. For Utility Special Entities hedging commercial risks, the sub-threshold will serve to discourage new entrants and concentrate the Utility Special Entity's counterparty credit risk. The proposed rule amendment would restore this competitive, and less risky, market structure.

New CFTC Regulation 1.3(ggg)(4)(v) provides as follows:

"...(v) Future adjustments to scope of the de minimum exception. The Commission may by rule or regulation change the requirements of the *de minimis* exception described in paragraphs (ggg)(4)(i) through (iv) of this section.

Clearly the Commission has the authority to approve the proposed rule amendment.

B. The Factors Set Forth the Proposed Rule Amendment are Distinctly and Uniquely Applicable to Utility Operations-Related Swaps and to Utility Special Entities.

The proposed rule amendment will have no affect on the *de minimis* exception to the "security-based swap dealer" definition. Nor will the proposed rule amendment have any affect on the *de minimis* exception to the Commission's "swap dealer" definition as it applies in general to special entities (including Utility Special Entities) engaging in financial swaps or nonfinancial" other commodity" swaps, other than those product types critical to hedging or mitigating commercial risks in the utility industry.

The factors set forth in the proposed rule amendment are not applicable to security-based swap dealers or to their counterparties. Counterparties to security-based swaps do not need such security-based swaps to "hedge or mitigate commercial risks", as is the case with commercial end users' need for nonfinancial commodity swaps to hedge or mitigate commercial risks. Congress specifically recognized the importance of protecting "commercial end users" access to nonfinancial commodity swaps when it emphasized that the Dodd-Frank Act's focus on financial market stability and price and market transparency should not be achieved without also preserving commercial end users' access to swaps used to hedge or mitigate commercial risks.[15]

The factors that argue in favor of the Commission approving the proposed rule amendment are also inapplicable to entities involved in agricultural or metal commodities transactions and swaps. Such entities are simply not subject to public service obligation comparable to those that apply to utilities that require Utility Operations-Related Swaps to hedge commercial risks associated with utility facilities, operations and public service obligations. Utilities (including Utility Special Entities) have public service obligations under Federal, state and local laws and regulations, and utility reliability obligations, that other industries simply do not share. Congress recognized these important obligations throughout the Dodd-Frank Act as deserving of the Commission's regulatory deference. See Section 720 of the Dodd-Frank Act calling for FERC/CFTC memoranda of understanding, new CEA Section 2(a)(1)(I) regarding jurisdiction of the various energy regulatory agencies, and new CEA Section 4(c)(6) directing the Commission to consider public interest waivers of its jurisdiction.

[15] *See* 156 Cong Rec. H5238 (the "Dodd-Lincoln letter").

The Commission clearly has the authority to approve the proposed rule amendment. The factors that argue in favor of the proposed rule amendment, and limit its affect, reflect the unique and the different characteristics of these types of "swaps" and these market participants, and recognize the differing applicable laws and regulations, and statutory and regulatory policies The Commission should approve the proposed rule amendment and do so as soon as possible.

C. Nothing in the Dodd-Frank Act or the CEA Requires the Special Entity Sub-Threshold.

The proposed rule amendment is narrowly tailored to achieve both the statutory goals and Congressional intent underlying the Dodd-Frank Act, and to leave in place the supplemental investor protection objectives of the Commission in including the Special Entity Sub-Threshold in the "swap dealer" definition.

In the Dodd-Frank Act, Congress imposed on registered "swap dealers" heightened business conduct standards when advising, offering or entering into swaps with "special entities." Nothing in the Dodd-Frank Act imposes or requires the Commission to impose business conduct standards on entities that are not required to register as "swap dealers." Nothing in the Dodd-Frank Act requires the Commission to impose an exponentially smaller *de minimis* sub-threshold for counterparties that are not registered "swap dealers" and that enter into swaps to which "special entities" are counterparties. The Adopting Release acknowledges as much, characterizing the lower threshold as "*consistent with* the fact that Title VII's requirements applicable to swap dealers . . . provide heightened protection to these types of entities." 77 Fed. Reg. at 30630 (*emphasis added*).

The Adopting Release cites the Dodd-Frank Act provisions that impose on *registered* swap dealers and major swap participants (those market professionals whose activities are directly regulated by the Commission) heightened business conduct standards and documentation requirements for interacting with "special entities." The Adopting Release then extrapolates without explanation as to why it is consistent for the Commission to extend its regulatory reach beyond the market professionals registered as "swap dealers," whose conduct the statute intends it to regulate, to impose restrictions on the activities of entities that are not swap dealers, and whose *de minimis* "swap dealing activities" do not require such registration. The Special Entity Sub-Threshold is a clear regulatory overreach by the Commission, and should be modified where such regulatory overreach negatively affects the ability of yet another group of entities that are not "swap dealing" – the "Utility Special Entities" – to hedge or mitigate the commercial risks of their nonfinancial, public service enterprises.

The Adopting Release gives examples of situations where the special entity "lacked the requisite sophistication and experience to independently evaluate *the risks of the investment* and exposed the [special entity] to a heightened risk of catastrophic loss ultimately led to a complete loss of their investments." See footnote 425 and text

accompanying at 77 Fed. Reg. 30630 (*emphasis added).* In the examples, the special entities were acting outside the scope of their core operations as investors in financial derivatives, interacting with financial institution or "financial entity" market professionals, using cash reserves or other cash assets of the special entity to invest (for profit or loss) in financial derivatives instruments. By contrast, the Utility Special Entities use Utility Operations-Related Swaps to hedge the commercial risks of their core utility operations, not to invest for profit.

D. The Proposed Rule Amendment is Consistent with Both Congressional Intent of the Dodd-Frank Act and Will have No Affect on the Commission's Investor Protection Policy Objectives.

The investor protection objectives of the Dodd-Frank Act, and the Commission's own "consistent" and supplemental investor protection objectives as expressed in the Adopting Release, would not be affected or compromised by the proposed rule amendment. As is clear from the proposed definition of "Utility Operations-Related Swap," the Utility Special Entity enters into such a nonfinancial commodity swap to hedge commercial risks that arise from its utility facilities, operations and public service obligations.

The proposed rule amendment is drafted narrowly to respect the Commission's investor protection policies but to achieve the distinct, but equally important, Congressional intent of the Dodd-Frank Act: to preserve cost-effective (and comparative, competitively equal) access to nonfinancial commodity swaps that Utility Special Entities use "to hedge or mitigate commercial risks."

The proposed rule amendment does not amend either the general *de minimis* threshold for swap dealing activity. The general *de minimis* threshold would continue to apply to Utility Operations-Related Swaps to which Utility Special Entities are counterparties. Nor does the proposed rule amendment change the "special entity sub-threshold" for swaps in asset classes or product types other than Utility Operations-Related Swaps to which Utility Special Entities are counterparties.

In defining the term "Special Entity" in Section 4s(h)(2)(C) of the Dodd-Frank Act and establishing the heightened business conduct standards for registered "swap dealers," Congress did not intend for the Commission expand its regulatory oversight beyond oversight of regulated "swap dealers" to place restrictions on entities that are not required to register as "swap dealers." In establishing the Special Entity Sub-Threshold and then not substantially raising it when it raised the general de minimis threshold, Ihte Commission restricted Utility Special Entities' competitive abilities, and severely restricted Utility Special Entities' access to the nonfinancial commodity swaps needed to cost-effectively hedge or mitigate commercial risks.

V. PROCESS AND TIMELINE FOR PETITION

The Petitioners respectfully request the Commission to act as soon as possible on the proposed rule amendment -- to remove continuing regulatory uncertainty for the Utility Special Entities and counterparties that would, but for the Special Entity Sub-Threshold, be available to enter into Utility Operations-Related Transactions with Utility Special Entities. As the Commission's new "swap" regulations are proposed, become final and implementation begins, market participants are evaluating whether and how to participate in the new market structure for "swaps." At the same time, Utility Special Entities have continuing utility public service obligations to provide affordable, reliable utility service to their customers, and consequently have both short-term and long-term commercial risks to hedge.

As the effective dates and compliance dates approach for the new "swap" regulatory regime, market participants are beginning to turn their attention away from current activities in nonfinancial commodities and commodity swaps in general. The challenges of the new regulatory requirements applicable to "swaps," including challenges for systems, staffing, compliance, documentation and reporting are overwhelming, even for the largest financial institutions and financial markets professionals, especially given the tight and interrelated compliance timelines.

The added challenge of determining whether to register as a "swap dealer" for one or more asset classes or product types of "swaps" are even more daunting for a nonfinancial entity, whose primary and ongoing business is not trading or investing or dealing in the financial markets, but drilling for natural gas, mining coal, or generating, transmitting and/or delivering electric energy or natural gas to consumers.[16]

[16] A number of the nonfinancial entities with whom the Petitioners (or the trade association Petitioners' members) transact in Utility Operations-Related Swaps have told us that they are currently evaluating their nonfinancial commodity "swap" activities in light of the final Entity Definitions rules, the Interim Final Rule in Section 1.3(ggg)(6)(iii), and the statutory guidance provided in the Adopting Release and elsewhere in the CFTC's regulations, interpretations and precedents. Such nonfinancial entities are also awaiting the CFTC's final rules defining the term "swap," which is the foundational rulemaking which will enable the energy industry to understand the scope of the CFTC's jurisdiction over our industry's transactions. As of July 10, 2012, for the electric and natural gas utility industry, the challenges are compounded by the continuing uncertainty as to what is and isn't a "swap," a "nonfinancial commodity forward" transaction, a nonfinancial commodity forward with embedded optionality, or a "trade option." See footnote 6 above. Once the rules defining "swap" are final with respect to our industry's transactions, each nonfinancial entity will then (and can only then) analyze which of its activities will fall within the definition of "swap," and therefore would or could be "swap dealing," which of its activities will be excluded as "hedging a physical position" (depending on the outcome of that final rulemaking), or fit within other safe harbors under the interpretive guidance provided by the Commission. Then and only then can the nonfinancial entity decide, as a business matter, whether to continue all or any of its swap dealing activities, and whether to register as a "swap dealer" or to register for a limited designation as a "swap dealer" for certain asset classes and product types (that may or may not include particular Utility Operations-Related Swaps). Alternatively, only then can such a nonfinancial entity alternatively decide to wind down any swap activities which the Commission might consider to be "swap dealing activities." Nothing requires a nonfinancial entity (whose primary business is not to engage in financial markets transactions like "swaps") to continue its past or current business strategies. If a particular nonfinancial

Continued on following page

If a market participant decides to continue some amount of "swap dealing activity" in Utility Operations-Related Swaps, it will carefully evaluate and then establish compliance procedures to monitor the two *de minimis* thesholds. In doing so, it will certainly hesitate or delay incurring the expense of setting up specially calibrated systems, compliance processes and staff training in order to engage in one or two such swaps with Utility Special Entities within a 12-month period. A nonfinancial counterparty that does not choose to register as a "swap dealer" will instead understandably focus on modifying its business processes and documents to engage in swaps with counterparties other than Utility Special Entities, under the general *de minimis* exception threshold.

We request that the Commission promptly publish the proposed rule amendment for comment in the Federal Register, without waiting for the effective date of the Entity Definitions rules. We recommend a public comment period of no longer than 20 days, and respectfully request publication of the Commission's final approval or grounds for denying the rule amendment within 10 days thereafter.[17] The Petitioners request that the amended rule be retroactive and prospective for all Utility Operations-Related Swaps to which a Utility Special Entity is a counterparty entered into after the effective date of the Entity Definition rules.

VI. CONCLUSION

The Petitioners respectfully petition the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 1(ggg)(4), which implements the *de minimis* exception to the definition of "swap dealer," as described above.

Continued from previous page

entity decides to continue some level of swap dealing activity, it may decide not to continue such activity as a registered "swap dealer." At last decision point, once the new Dodd-Frank Act rules are effective and as compliance dates approach, these entities will restrict their swap dealing activity to stay well below the two very different *de minimis* exception thresholds in the CFTC's swap dealer definition.

[17] The proposed rule amendment relieves a competitive restriction on Utility Special Entities, and modifies the special entity sub-threshold to the *de minimis* exception to the definition of "swap dealer." The Commission and interested persons in the electric and natural gas industry have been on notice of the Utility Special Entities' concerns since early May 2012. As a result, the proposed rule amendment is entitled to the earlier effective date permitted by CFTC Regulation 13.6.

SIGNATURE PAGE – SPECIAL ENTITY SUB-THRESHOLD PETITION

Please contact any of the individuals below or Patricia Dondanville, Reed Smith LLP, 10 South Wacker Drive, 40th Floor, Chicago Illinois 60606, telephone (312) 207-3911, or e-mail pdondanville@reedsmith.com, if you have questions regarding this Petition.

Respectfully submitted,

AMERICAN PUBLIC POWER ASSOCIATION

Susan N Kelly

Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel
1875 Connecticut Avenue, N.W.
Suite 1200
Washington, D.C. 20009-5715
Tel: (202) 467-2933
E-mail: skelly@publicpower.org

LARGE PUBLIC POWER COUNCIL

Noreen Roche-Carter
Chair, Tax and Finance Task Force
c/o Sacramento Municipal Utility District
6201 S Street
Sacramento, CA 95817-1899
Tel: (916) 732-6509
E-mail: nrochec@smud.org

TRANSMISSION ACCESS POLICY STUDY GROUP

John Twitty
Executive Director
4203 East Woodland Street
Springfield, MO 65809
Tel: (414) 838-8576
E-mail: 835consulting@gmail.com

AMERICAN PUBLIC GAS ASSOCIATION

David Schryver
Executive Vice President
201 Massachusetts Avenue, NE
Suite C-4
Washington, DC 20002
Tel: (202) 464-0835
E-mail: dschryver@apga.org

BONNEVILLE POWER ADMINISTRATION

Virginia K. Schaeffer
Attorney
Office of the General Counsel – LC-7
P.O. Box 3621
Portland, Oregon 98208-3621
Tel: (503)230-4030
Email: vkschaeffer@bpa.gov

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Virginia K. Schaeffer
Attorney
Office of the General Counsel – LC-7
P.O. Box 3621
Portland, Oregon 98208-3621
Tel: (503)230-4030
Email: vkschaeffer@bpa.gov

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E-mail: nrochec@smud.org

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Executive Vice President
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Attorney
Office of the General Counsel – LC-7
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Portland, Oregon 98208-3621
Tel: (503)230-4030
Email: vkschaeffer@bpa.gov

cc: Honorable Gary Gensler, Chairman
Honorable Bart Chilton, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Mark Wetjen, Commissioner
Office of the CFTC General Counsel

NFA NATIONAL FUTURES ASSOCIATION

C.F.T.C.
OFFICE OF THE SECRETARIAT
2010 AUG 19 PM 3 23

August 18, 2010

PRC 17

Via E-Mail and Overnight Mail

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 4.5

Dear Mr. Stawick:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 4.5, which provides an exclusion from the definition of the term "commodity pool operator" for otherwise regulated persons operating certain qualifying entities.[1] Prior to 2003, persons claiming this exclusion had to file a notice of eligibility pursuant to CFTC Regulation 4.5(c) and represent, in part, that the person will operate the qualifying entity such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for *bona fide* hedging purposes and, with respect to positions held for non-*bona fide* hedging purposes the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

For the reasons set forth below, we request that the CFTC amend Regulation 4.5(c) to restore operating restrictions on registered investment companies that are substantially similar to those in effect prior to 2003. The information required by CFTC Regulation 13.2 follows:

[1] NFA withdrew its June 29, 2010 Petition for Rulemaking to Amend CFTC Regulation 4.5 by separate letter dated August 18, 2010.

I. Text of Proposed Rule Amendments [additions are underlined]

Part 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

4.5 Exclusion from the definition of the term "commodity pool operator."

* * *

(c)

* * *

(2) The notice of eligibility must contain representations that such person will operate the qualifying entity specified therein in a manner such that the qualifying entity:

(i) Will disclose in writing to each participant, whether existing or prospective, that the qualifying entity is operated by a person who has claimed an exclusion from the definition of the term "commodity pool operator" under the Act and, therefore, who is not subject to registration or regulation as a pool operator under the Act; *Provided*, that such disclosure is made in accordance with the requirements of any other federal or state regulatory authority to which the qualifying entity is subject. The qualifying entity may make such disclosure by including the information in any document that its other federal or state regulator requires to be furnished routinely to participants or, if no such document is furnished routinely, the information may be disclosed in any instrument establishing the entity's investment policies and objectives that the other regulator requires to be made available to the entity's participants; and

(ii) Will submit to such special calls as the Commission may make to require the qualifying entity to demonstrate compliance with the provision of this § 4.5(c);

(iii) Furthermore, if the person claiming the exclusion is an investment company registered under the Investment Company Act of 1940, then the notice of

eligibility must also contain representations that such person will operate the qualifying entity as described in § 4.5(b)(1) in a manner such that the qualifying entity:

(a) Will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1); *Provided, however,* That in addition, with respect to positions in commodity futures or commodity option contracts that may be held by a qualifying entity only which do not come within the meaning and intent of § 1.3(z)(1), a qualifying entity may represent that the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; and, *Provided further,* That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such 5 percent;

(b) Will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets;

Provided further, however, That the making of such representations shall not be deemed a substitute for compliance with any criteria applicable to commodity futures or commodity options trading established by any regulator to which such person or qualifying entity is subject.

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. One of NFA's primary purposes is to ensure the protection of customers participating in the commodity futures markets. Recently, NFA has become aware of at least three entities filing for exclusions under Regulation 4.5 with respect to registered investment companies that they operate. These mutual funds are marketed to customers, including retail investors, as commodity futures investments

and are indirectly invested substantially in derivatives and futures products. In fact, although these funds are structured differently than public commodity pools and conduct the futures trading through a subsidiary for tax and mutual fund regulatory purposes, their aim is the same—targeting retail investors with in some cases minimum investment amounts of as little as $1,000 who want exposure to actively managed futures strategies.

Importantly, as noted above, these three funds invest in commodity futures instruments and/or other managed futures trading programs through a wholly-owned and controlled subsidiary. The fund invests up to 25% of its total assets in this subsidiary, and by leveraging assets at a 4 to 1 ratio, a fund is able to achieve a managed futures exposure equal to the full net value of the fund.

NFA is interested in ensuring that registered investment companies that engage in more than a *de minimis* amount of futures trading and that are offered to retail customers or are marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets are subject to the appropriate regulatory requirements and oversight by regulatory bodies with primary expertise in commodity futures. NFA believes that requiring persons that market commodity funds to the retail public and whose funds engage in more than a *de minimis* amount of futures trading or investment to be registered as commodity pool operators ("CPOs") furthers that goal.

III. Supporting Arguments

CFTC Regulation 4.5 currently makes available to eligible persons an exclusion from the definition of CPO with respect to the operation of certain qualifying entities, including registered investment companies, that would otherwise constitute commodity pools but that are already subject to extensive federal and/or state operating requirements. Prior to 2003, eligible persons claiming this exclusion were required to represent that commodity futures and option contracts were used solely for *bona fide* hedging purposes, and that for positions in commodity futures and option contracts that were not used for *bona fide* hedging purposes, the aggregate initial margin and premiums do not exceed 5% of the liquidating value of the qualifying entity's portfolio after taking into account unrealized profits and losses. In addition, eligible persons were

required to represent that the qualifying entity will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets.

In March 2003, the Commission proposed amendments to Regulation 4.5 to eliminate the limitation on non-hedge trading. At the same time, the Commission proposed formally adopting CFTC Regulation 4.13(a)(4) to provide an additional exemption from CPO registration based *solely* on a pool participant's purported sophistication, without any requirement that the pool operator must be subject to another regulatory scheme and without any restriction whatsoever on the purpose and scope of the pool's commodity interest trading. The Commission further stated that "since the eligible persons and qualifying entities of Rule 4.5 are, as stated in the title of the rule, 'otherwise regulated,' the Commission believes that, like the unregulated CPOs for whom it is proposing relief below, these persons and entities may not need to be subject to any commodity interest trading criteria to qualify for relief under Rule 4.5."[2]

At this time, the Commission also stated its view that Regulation 4.5's "no-marketing" restriction should remain in place. The Commission noted that eligible persons should remain prohibited from marketing a qualifying entity as a commodity pool or otherwise as a vehicle to trade commodity interests and indicated that this restriction was necessary because members of the retail public may participate in the trading vehicles subject to a Regulation 4.5 exclusion. The Commission nonetheless requested comment on the merits of maintaining this marketing prohibition.[3]

By letter dated May 1, 2003 to the CFTC, NFA supported maintaining Regulation 4.5's "no marketing" restriction. In particular, NFA stated that "current and proposed Rule 4.5 both provide that the exclusion is not available if the vehicles are marketed as commodity pools. Since Rule 4.5 is an exclusion rather than an exemption, the anti-fraud provisions of Section 4(o) of the CEA do not apply. Investments in these vehicles can be - and often are - sold to unsophisticated customers. While the sale of these investment vehicles is subject to the anti-fraud provisions in other statutes, unsophisticated customers should also have the benefit of Section 4(o) if the investment is marketed as a commodity pool. Therefore, we agree

[2] See 68 Fed. Reg. 12622,12626 (March 17, 2003).
[3] See Id.

that the exclusion should not be available if the vehicles are marketed as commodity pools." NFA felt that with this "no-marketing" restriction in place, it made sense to eliminate the limitation on non-hedge commodity trading due to certain concerns regarding margin levels expressed at that time.

In August 2003, after receiving comments that supported eliminating both the limitation on non-hedge commodity trading and the prohibition on marketing these qualifying entities, the Commission adopted amendments to Regulation 4.5 to eliminate both these provisions. In doing so, the Commission stated that "one commenter agreed with the proposed retention of the 'no marketing' criterion (and with the Commission's rationale therefore) but several commenters disagreed with it. The Commission noted, in part, that these commenters claimed that, in the absence of any trading restriction, the "otherwise regulated nature" of the qualifying entities specified in Regulation 4.5 would provide adequate customer protection.[4]

Over the past several months, at least three entities that previously filed notices for exclusions under Regulation 4.5 with respect to certain registered investment companies launched these mutual funds. These mutual funds are marketed to customers, including retail investors, as commodity futures investments and are indirectly invested via a subsidiary structure substantially in derivatives and futures products. Customers may use an electronic brokerage account to trade one of these mutual funds, which are sold by broker/dealers on internet platforms in which retail investors only need to point and click to either buy or redeem shares in a fund that offers exposure to an actively managed futures product.

NFA staff has reviewed the prospectuses and promotional material prepared for these funds.[5] One fund's prospectus indicates that it pursues its investment strategy by mainly investing in a combination of exchange traded futures

[4] See 68 Fed. Reg. 47221, 47223 (August 8, 2003).

[5] See MutualHedge Frontier Legends Fund—http://mutualhedge.com/default.aspx; AQR Fund—http://www.aqrfunds.com/Our_Funds/Individual/FundID_12/Overview/Managed_Futures_Strategy_Fund.fs;and Highbridge Fund—https://www.jpmorganfunds.com/cm/Satellite?pagename=jpmfVanityWrapper&UserFriendlyURL=fundoverview&cusip=48121A696

and options contracts, forward contracts, swaps, and other over the counter derivatives and fixed income securities, often referred to as a "managed futures strategy."[6]

This fund's promotional material indicates that the fund's inception date was December 31, 2009, and the fund has a minimum investment amount of $2,500 (subsequent investments of $500) and offers two share classes, A and C. Class A has a maximum sales charge of 5.75% and a net expense ratio of 2.20% and Class C has no sales charge but a net expense ratio of 2.95%.[7] The fund's promotional material also states that the fund is "A Pioneering Managed Futures Investment" that is accessible, comprehensive, innovative, and has proven management.[8] The material also specifically notes that the fund has a "lower cost structure than most retail managed futures funds" and is "the first mutual fund to generate managed futures returns through net-long, actively managed CTAs." The fund's assets are traded pursuant to five managed futures trading programs. In particular, the fund's prospectus states that the subsidiary's investment adviser (which is also the fund's adviser) expects to invest the assets of the subsidiary in a manner designed to provide exposure to five global macro programs.

In adopting the 2003 changes to Regulation 4.5, the CFTC eliminated the prior "no-marketing" restriction and did not place any qualification standards on the type of customers who may invest in a qualifying entity. Without these types of operating

[6] A second fund's prospectus states that in order to pursue its investment objective, the fund invests in futures contracts and futures-related instruments including, but not limited to, equity index futures, currency forwards, commodity futures, swaps on commodity futures, fixed income futures, bond futures and swaps on bond futures (collectively, the Instruments) either by investing directly in those Instruments, or indirectly by investing in a subsidiary that invests in those Instruments. The third fund's prospectus states that the fund seeks to achieve its objective by investing in a diversified portfolio of commodity-linked derivatives and fixed income securities. The prospectus additionally states that the fund invests in commodity-linked derivative instruments, such as commodity-linked notes, swap agreements, commodity options, futures and options on futures that provide exposure to the investment returns of the commodities markets without investing directly in physical commodities.

[7] The other two funds also commenced in January 2010 and these also have various share classes with minimum investment amounts ranging from $5,000 to $1 million and $1,000 to $1 million, respectively.

[8] A second fund's Fact Sheet makes similar statements and indicates that "The Fund delivers an active long/short Managed Futures strategy in a mutual fund vehicle." The fund's investment objective states the fund "seeks to generate positive absolute returns."

restrictions, these mutual funds are marketed and sold to customers, including retail investors, who may be unsophisticated in commodity futures investments. NFA believes that any commodity futures investment that is marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading or investing in (or otherwise seeking exposure to) the commodity futures or commodity options markets should be subject to the regulatory requirements and protections contained in the CFTC's Part 4 regulations.

In reviewing these funds' prospectuses, NFA found that the offering material omits substantial disclosures that would otherwise be mandated by Part 4. Among other things, the prospectuses do not include detailed information about the fund's futures commission merchants and potential conflicts of interest, and performance information for the fund (assuming it has three months performance) or other funds operated by the investment adviser. Additionally, to the extent the funds' prospectuses state that the fund and/or subsidiary will invest in other actively managed futures trading programs, the prospectuses provide little information about these managed futures trading programs, these programs' fee structures, and the past performance results of their trading managers.

NFA also has customer protection concerns relating to these mutual funds' use of a wholly-owned and controlled subsidiary to invest in commodity futures transactions on behalf of the fund. NFA understands from reviewing some of these funds' prospectuses that the funds' investment in a subsidiary is intended to provide the funds with exposure to futures and commodities in a manner consistent with the limitations of the federal tax requirements in Sub-chapter M of the IRS Code. Sub-chapter M requires, in part, that at least 90% of a fund's income be derived from securities or derived with respect to its business of investment in securities (i.e., qualifying income). The funds rely upon IRS private letter rulings to other mutual funds, which indicate income from a fund's investment in a subsidiary will constitute qualifying income.

However, while these funds' offering materials indicate that the subsidiaries are subject to certain investment restrictions applicable to the funds themselves, these subsidiaries are neither commodity pools regulated by the CFTC and NFA nor registered investment companies. Additionally, the prospectuses make clear that the subsidiaries are not subject to the Investment Company Act of 1940's customer

protection regime. The vast majority of the regulated funds' holdings appear to be money market instruments to serve as collateral for the subsidiaries' derivatives positions; yet, the subsidiaries' daily operations, including their actual derivatives positions (including the positions' leverage amounts) and fees charged are not entirely transparent.

Given these funds' offerings, NFA proposes the aforementioned amendments to Regulation 4.5 since we believe the premises underlying the Commission's elimination in 2003 of the "no-marketing" and "five-percent trading test" limitations as applied to registered investment companies may no longer be valid. To the extent the Commission used proposed Regulation 4.13(a)(4) as a rationale to eliminate the "five-percent trading test", NFA believes that the Commission should review whether this rationale remains appropriate in light of these actively managed retail futures funds.[9]

NFA believes at this time that Regulation 4.13(a)(4)'s exemption from CPO registration does not support the 2003 elimination of the "five-percent trading test." Specifically, although Regulation 4.13(a)(4) does not contain any restriction on the purpose or scope of a pool's commodity interest trading, we believe a critical distinction between a Regulation 4.5 qualifying entity and a Regulation 4.13(a)(4) pool is the qualifications of the fund participants[10]—Regulation 4.13(a)(4)(ii)(A) requires every natural person pool participant to be a "qualified eligible person" as defined in Commission Regulation 4.7(a)(2). In contrast, Regulation 4.5 has no qualification requirement for customers who may invest in a qualifying entity, including a registered investment company. Moreover, NFA strongly believes that in circumstances in which no qualification requirement exists for fund participants, then NFA and the CFTC should

[9] NFA recognizes that registered investment companies may need to engage in futures transactions for bona fide hedging purposes and believes they should be permitted to engage a *de minimis* amount of speculative futures trading without the necessity to be registered with and regulated by the CFTC.

[10] Another distinction is interests in Regulation 4.13(a)(4) pools are exempt from registration under the Securities Act of 1933 while Regulation 4.5 qualifying entities are operated by otherwise regulated persons. For the reasons explained in this letter, however, NFA believes that to the extent that the Commission's 2003 amendments to Regulation 4.5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid.

have regulatory oversight of collective investment vehicles that engage in more than a *de minimis* amount of futures trading. [11]

Additionally, to the extent that the Commission's 2003 amendments to Regulation 4.5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid. As noted above, despite the fact that these registered investment companies are marketed to retail customers as an actively managed futures fund, they are not subject to customer protection rules entirely comparable to the CFTC's Part 4 Regulations and NFA's Compliance Rules. NFA believes that a registered investment company that is marketed, in part, to unsophisticated retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking exposure to) the commodity futures or commodity options markets or that engages in more than a *de minimis* amount of non-hedge futures trading should be subject to the CFTC's Part 4 regulatory requirements and protections, and the oversight of the CFTC and NFA who have the experience and expertise in regulating managed retail futures products. The CFTC alone has the Congressional mandate to regulate retail managed futures trading and products, and over the years has developed the specialized body of skill and knowledge necessary to fulfill this mandate.

Additionally, NFA is deeply concerned that a number of CPOs who currently operate public pools will avail themselves of this alternative registered investment company structure. Given our concern with this registered investment company structure and the lack of adequate retail customer protections in some areas comparable to those afforded prospective investors in a public commodity pool subject to Part 4, NFA does not believe that retail futures customers would be served well if this migration were to occur.

[11] NFA notes that Commission Regulation 4.13(a)(3) provides an exemption from CPO registration, which requires a pool to meet one of two tests with respect to its commodity interest positions, including positions in security futures products, whether entered into for bona fide hedging purposes or otherwise—the aggregate initial margin and premiums required to establish such positions will not exceed 5% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into or the aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into. Moreover, CFTC Regulation 4.13(a)(3)(iii) requires natural person pool participants to at least meet the accredited investor qualification standards.

For these reasons, NFA respectfully requests that the Commission amend Regulation 4.5(c) to require a registered investment company claiming an exclusion from the definition of the term "commodity pool operator" to represent in the notice of eligibility that the qualifying entity (i.e. registered investment company) will be operated such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for bona fide hedging purposes and, with respect to positions that may be held by the qualifying entity only for non-bona fide hedging purposes the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

Lastly, NFA recognizes that, if adopted, the proposed amendments to Regulation 4.5 will impose the same operating restrictions on registered investment companies that were in place prior to 2003. Obviously, since 2003, a number of persons have filed notices of eligibility pursuant to Regulation 4.5(c) on behalf of registered investment companies, and those entities may no longer be eligible for exclusion from CPO registration in the future if the proposed amendments are adopted. Therefore, NFA encourages the Commission to provide adequate time for these registered investment companies to comply with the Commission's applicable regulations or seek the appropriate relief therefrom.

Additionally, to the extent that the Commission has granted operational relief from certain Part 4 Regulations (e.g. disclosure document and reporting and recordkeeping) to exchange traded funds—that are commodity pools organized as Delaware statutory trusts—NFA encourages the CFTC to determine whether it is appropriate to grant similar and/or other relief to public commodity pools and listed pools that may want to continue operating as registered investment companies. If the Commission desires, NFA is willing to participate in discussions in the future with Commission staff to achieve this result, which may necessitate harmonizing CFTC and SEC regulatory requirements.

NFA respectfully petitions the Commission to amend Regulations 4.5 as described above.

Very truly yours,

Thomas W. Sexton, III
Senior Vice President
and General Counsel

cc: Via Email:
Honorable Gary Gensler, CFTC Chairman
Honorable Michael Dunn, CFTC Commissioner
Honorable Scott O'Malia, CFTC Commissioner
Honorable Jill E. Sommers, CFTC Commissioner
Honorable Bart Chilton, CFTC Commissioner
Mr. Ananda Radhakrishnan, CFTC Director
Mr. William Penner, CFTC Deputy Director

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TAL 7-1/17

NFA NATIONAL FUTURES ASSOCIATION

August 18, 2010

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C.F.T.C.
OFFICE OF THE SECRETARIAT

Via E-Mail and Overnight Mail

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 4.5

Dear Mr. Stawick:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 4.5, which provides an exclusion from the definition of the term "commodity pool operator" for otherwise regulated persons operating certain qualifying entities.[1] Prior to 2003, persons claiming this exclusion had to file a notice of eligibility pursuant to CFTC Regulation 4.5(c) and represent, in part, that the person will operate the qualifying entity such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for *bona fide* hedging purposes and, with respect to positions held for non-*bona fide* hedging purposes the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

For the reasons set forth below, we request that the CFTC amend Regulation 4.5(c) to restore operating restrictions on registered investment companies that are substantially similar to those in effect prior to 2003. The information required by CFTC Regulation 13.2 follows:

[1] NFA withdrew its June 29, 2010 Petition for Rulemaking to Amend CFTC Regulation 4.5 by separate letter dated August 18, 2010.

I. Text of Proposed Rule Amendments [additions are underlined]

Part 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

4.5 Exclusion from the definition of the term "commodity pool operator."

* * *

(c)

* * *

(2) The notice of eligibility must contain representations that such person will operate the qualifying entity specified therein in a manner such that the qualifying entity:

(i) Will disclose in writing to each participant, whether existing or prospective, that the qualifying entity is operated by a person who has claimed an exclusion from the definition of the term "commodity pool operator" under the Act and, therefore, who is not subject to registration or regulation as a pool operator under the Act; *Provided*, that such disclosure is made in accordance with the requirements of any other federal or state regulatory authority to which the qualifying entity is subject. The qualifying entity may make such disclosure by including the information in any document that its other federal or state regulator requires to be furnished routinely to participants or, if no such document is furnished routinely, the information may be disclosed in any instrument establishing the entity's investment policies and objectives that the other regulator requires to be made available to the entity's participants; and

(ii) Will submit to such special calls as the Commission may make to require the qualifying entity to demonstrate compliance with the provision of this § 4.5(c);

(iii) Furthermore, if the person claiming the exclusion is an investment company registered under the Investment Company Act of 1940, then the notice of

eligibility must also contain representations that such person will operate the qualifying entity as described in § 4.5(b)(1) in a manner such that the qualifying entity:

(a) Will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1); *Provided, however,* That in addition, with respect to positions in commodity futures or commodity option contracts that may be held by a qualifying entity only which do not come within the meaning and intent of § 1.3(z)(1), a qualifying entity may represent that the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; and, *Provided further,* That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such 5 percent;

(b) Will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets;

Provided further, however, That the making of such representations shall not be deemed a substitute for compliance with any criteria applicable to commodity futures or commodity options trading established by any regulator to which such person or qualifying entity is subject.

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. One of NFA's primary purposes is to ensure the protection of customers participating in the commodity futures markets. Recently, NFA has become aware of at least three entities filing for exclusions under Regulation 4.5 with respect to registered investment companies that they operate. These mutual funds are marketed to customers, including retail investors, as commodity futures investments

and are indirectly invested substantially in derivatives and futures products. In fact, although these funds are structured differently than public commodity pools and conduct the futures trading through a subsidiary for tax and mutual fund regulatory purposes, their aim is the same—targeting retail investors with in some cases minimum investment amounts of as little as $1,000 who want exposure to actively managed futures strategies.

Importantly, as noted above, these three funds invest in commodity futures instruments and/or other managed futures trading programs through a wholly-owned and controlled subsidiary. The fund invests up to 25% of its total assets in this subsidiary, and by leveraging assets at a 4 to 1 ratio, a fund is able to achieve a managed futures exposure equal to the full net value of the fund.

NFA is interested in ensuring that registered investment companies that engage in more than a *de minimis* amount of futures trading and that are offered to retail customers or are marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets are subject to the appropriate regulatory requirements and oversight by regulatory bodies with primary expertise in commodity futures. NFA believes that requiring persons that market commodity funds to the retail public and whose funds engage in more than a *de minimis* amount of futures trading or investment to be registered as commodity pool operators ("CPOs") furthers that goal.

III. Supporting Arguments

CFTC Regulation 4.5 currently makes available to eligible persons an exclusion from the definition of CPO with respect to the operation of certain qualifying entities, including registered investment companies, that would otherwise constitute commodity pools but that are already subject to extensive federal and/or state operating requirements. Prior to 2003, eligible persons claiming this exclusion were required to represent that commodity futures and option contracts were used solely for *bona fide* hedging purposes, and that for positions in commodity futures and option contracts that were not used for *bona fide* hedging purposes, the aggregate initial margin and premiums do not exceed 5% of the liquidating value of the qualifying entity's portfolio after taking into account unrealized profits and losses. In addition, eligible persons were

required to represent that the qualifying entity will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets.

In March 2003, the Commission proposed amendments to Regulation 4.5 to eliminate the limitation on non-hedge trading. At the same time, the Commission proposed formally adopting CFTC Regulation 4.13(a)(4) to provide an additional exemption from CPO registration based *solely* on a pool participant's purported sophistication, without any requirement that the pool operator must be subject to another regulatory scheme and without any restriction whatsoever on the purpose and scope of the pool's commodity interest trading. The Commission further stated that "since the eligible persons and qualifying entities of Rule 4.5 are, as stated in the title of the rule, 'otherwise regulated,' the Commission believes that, like the unregulated CPOs for whom it is proposing relief below, these persons and entities may not need to be subject to any commodity interest trading criteria to qualify for relief under Rule 4.5."[2]

At this time, the Commission also stated its view that Regulation 4.5's "no-marketing" restriction should remain in place. The Commission noted that eligible persons should remain prohibited from marketing a qualifying entity as a commodity pool or otherwise as a vehicle to trade commodity interests and indicated that this restriction was necessary because members of the retail public may participate in the trading vehicles subject to a Regulation 4.5 exclusion. The Commission nonetheless requested comment on the merits of maintaining this marketing prohibition.[3]

By letter dated May 1, 2003 to the CFTC, NFA supported maintaining Regulation 4.5's "no marketing" restriction. In particular, NFA stated that "current and proposed Rule 4.5 both provide that the exclusion is not available if the vehicles are marketed as commodity pools. Since Rule 4.5 is an exclusion rather than an exemption, the anti-fraud provisions of Section 4(o) of the CEA do not apply. Investments in these vehicles can be - and often are - sold to unsophisticated customers. While the sale of these investment vehicles is subject to the anti-fraud provisions in other statutes, unsophisticated customers should also have the benefit of Section 4(o) if the investment is marketed as a commodity pool. Therefore, we agree

[2] See 68 Fed. Reg. 12622,12626 (March 17, 2003).
[3] See Id.

that the exclusion should not be available if the vehicles are marketed as commodity pools." NFA felt that with this "no-marketing" restriction in place, it made sense to eliminate the limitation on non-hedge commodity trading due to certain concerns regarding margin levels expressed at that time.

In August 2003, after receiving comments that supported eliminating both the limitation on non-hedge commodity trading and the prohibition on marketing these qualifying entities, the Commission adopted amendments to Regulation 4.5 to eliminate both these provisions. In doing so, the Commission stated that "one commenter agreed with the proposed retention of the 'no marketing' criterion (and with the Commission's rationale therefore) but several commenters disagreed with it. The Commission noted, in part, that these commenters claimed that, in the absence of any trading restriction, the "otherwise regulated nature" of the qualifying entities specified in Regulation 4.5 would provide adequate customer protection.[4]

Over the past several months, at least three entities that previously filed notices for exclusions under Regulation 4.5 with respect to certain registered investment companies launched these mutual funds. These mutual funds are marketed to customers, including retail investors, as commodity futures investments and are indirectly invested via a subsidiary structure substantially in derivatives and futures products. Customers may use an electronic brokerage account to trade one of these mutual funds, which are sold by broker/dealers on internet platforms in which retail investors only need to point and click to either buy or redeem shares in a fund that offers exposure to an actively managed futures product.

NFA staff has reviewed the prospectuses and promotional material prepared for these funds.[5] One fund's prospectus indicates that it pursues its investment strategy by mainly investing in a combination of exchange traded futures

[4] See 68 Fed. Reg. 47221, 47223 (August 8, 2003).

[5] See MutualHedge Frontier Legends Fund—http://mutualhedge.com/default.aspx; AQR Fund—http://www.aqrfunds.com/Our_Funds/Individual/FundID_12/Overview/Managed_Futures_Strategy_Fund.fs;and Highbridge Fund—https://www.jpmorganfunds.com/cm/Satellite?pagename=jpmfVanityWrapper&UserFriendlyURL=fundoverview&cusip=48121A696

and options contracts, forward contracts, swaps, and other over the counter derivatives and fixed income securities, often referred to as a "managed futures strategy."[6]

This fund's promotional material indicates that the fund's inception date was December 31, 2009, and the fund has a minimum investment amount of $2,500 (subsequent investments of $500) and offers two share classes, A and C. Class A has a maximum sales charge of 5.75% and a net expense ratio of 2.20% and Class C has no sales charge but a net expense ratio of 2.95%.[7] The fund's promotional material also states that the fund is "A Pioneering Managed Futures Investment" that is accessible, comprehensive, innovative, and has proven management.[8] The material also specifically notes that the fund has a "lower cost structure than most retail managed futures funds" and is "the first mutual fund to generate managed futures returns through net-long, actively managed CTAs." The fund's assets are traded pursuant to five managed futures trading programs. In particular, the fund's prospectus states that the subsidiary's investment adviser (which is also the fund's adviser) expects to invest the assets of the subsidiary in a manner designed to provide exposure to five global macro programs.

In adopting the 2003 changes to Regulation 4.5, the CFTC eliminated the prior "no-marketing" restriction and did not place any qualification standards on the type of customers who may invest in a qualifying entity. Without these types of operating

[6] A second fund's prospectus states that in order to pursue its investment objective, the fund invests in futures contracts and futures-related instruments including, but not limited to, equity index futures, currency forwards, commodity futures, swaps on commodity futures, fixed income futures, bond futures and swaps on bond futures (collectively, the Instruments) either by investing directly in those Instruments, or indirectly by investing in a subsidiary that invests in those Instruments. The third fund's prospectus states that the fund seeks to achieve its objective by investing in a diversified portfolio of commodity-linked derivatives and fixed income securities. The prospectus additionally states that the fund invests in commodity-linked derivative instruments, such as commodity-linked notes, swap agreements, commodity options, futures and options on futures that provide exposure to the investment returns of the commodities markets without investing directly in physical commodities.

[7] The other two funds also commenced in January 2010 and these also have various share classes with minimum investment amounts ranging from $5,000 to $1 million and $1,000 to $1 million, respectively.

[8] A second fund's Fact Sheet makes similar statements and indicates that "The Fund delivers an active long/short Managed Futures strategy in a mutual fund vehicle." The fund's investment objective states the fund "seeks to generate positive absolute returns."

restrictions, these mutual funds are marketed and sold to customers, including retail investors, who may be unsophisticated in commodity futures investments. NFA believes that any commodity futures investment that is marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading or investing in (or otherwise seeking exposure to) the commodity futures or commodity options markets should be subject to the regulatory requirements and protections contained in the CFTC's Part 4 regulations.

In reviewing these funds' prospectuses, NFA found that the offering material omits substantial disclosures that would otherwise be mandated by Part 4. Among other things, the prospectuses do not include detailed information about the fund's futures commission merchants and potential conflicts of interest, and performance information for the fund (assuming it has three months performance) or other funds operated by the investment adviser. Additionally, to the extent the funds' prospectuses state that the fund and/or subsidiary will invest in other actively managed futures trading programs, the prospectuses provide little information about these managed futures trading programs, these programs' fee structures, and the past performance results of their trading managers.

NFA also has customer protection concerns relating to these mutual funds' use of a wholly-owned and controlled subsidiary to invest in commodity futures transactions on behalf of the fund. NFA understands from reviewing some of these funds' prospectuses that the funds' investment in a subsidiary is intended to provide the funds with exposure to futures and commodities in a manner consistent with the limitations of the federal tax requirements in Sub-chapter M of the IRS Code. Sub-chapter M requires, in part, that at least 90% of a fund's income be derived from securities or derived with respect to its business of investment in securities (i.e., qualifying income). The funds rely upon IRS private letter rulings to other mutual funds, which indicate income from a fund's investment in a subsidiary will constitute qualifying income.

However, while these funds' offering materials indicate that the subsidiaries are subject to certain investment restrictions applicable to the funds themselves, these subsidiaries are neither commodity pools regulated by the CFTC and NFA nor registered investment companies. Additionally, the prospectuses make clear that the subsidiaries are not subject to the Investment Company Act of 1940's customer

protection regime. The vast majority of the regulated funds' holdings appear to be money market instruments to serve as collateral for the subsidiaries' derivatives positions; yet, the subsidiaries' daily operations, including their actual derivatives positions (including the positions' leverage amounts) and fees charged are not entirely transparent.

Given these funds' offerings, NFA proposes the aforementioned amendments to Regulation 4.5 since we believe the premises underlying the Commission's elimination in 2003 of the "no-marketing" and "five-percent trading test" limitations as applied to registered investment companies may no longer be valid. To the extent the Commission used proposed Regulation 4.13(a)(4) as a rationale to eliminate the "five-percent trading test", NFA believes that the Commission should review whether this rationale remains appropriate in light of these actively managed retail futures funds.[9]

NFA believes at this time that Regulation 4.13(a)(4)'s exemption from CPO registration does not support the 2003 elimination of the "five-percent trading test." Specifically, although Regulation 4.13(a)(4) does not contain any restriction on the purpose or scope of a pool's commodity interest trading, we believe a critical distinction between a Regulation 4.5 qualifying entity and a Regulation 4.13(a)(4) pool is the qualifications of the fund participants[10]—Regulation 4.13(a)(4)(ii)(A) requires every natural person pool participant to be a "qualified eligible person" as defined in Commission Regulation 4.7(a)(2). In contrast, Regulation 4.5 has no qualification requirement for customers who may invest in a qualifying entity, including a registered investment company. Moreover, NFA strongly believes that in circumstances in which no qualification requirement exists for fund participants, then NFA and the CFTC should

[9] NFA recognizes that registered investment companies may need to engage in futures transactions for bona fide hedging purposes and believes they should be permitted to engage a *de minimis* amount of speculative futures trading without the necessity to be registered with and regulated by the CFTC.

[10] Another distinction is interests in Regulation 4.13(a)(4) pools are exempt from registration under the Securities Act of 1933 while Regulation 4.5 qualifying entities are operated by otherwise regulated persons. For the reasons explained in this letter, however, NFA believes that to the extent that the Commission's 2003 amendments to Regulation 4.5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid.

have regulatory oversight of collective investment vehicles that engage in more than a *de minimis* amount of futures trading. [11]

Additionally, to the extent that the Commission's 2003 amendments to Regulation 4.5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid. As noted above, despite the fact that these registered investment companies are marketed to retail customers as an actively managed futures fund, they are not subject to customer protection rules entirely comparable to the CFTC's Part 4 Regulations and NFA's Compliance Rules. NFA believes that a registered investment company that is marketed, in part, to unsophisticated retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking exposure to) the commodity futures or commodity options markets or that engages in more than a *de minimis* amount of non-hedge futures trading should be subject to the CFTC's Part 4 regulatory requirements and protections, and the oversight of the CFTC and NFA who have the experience and expertise in regulating managed retail futures products. The CFTC alone has the Congressional mandate to regulate retail managed futures trading and products, and over the years has developed the specialized body of skill and knowledge necessary to fulfill this mandate.

Additionally, NFA is deeply concerned that a number of CPOs who currently operate public pools will avail themselves of this alternative registered investment company structure. Given our concern with this registered investment company structure and the lack of adequate retail customer protections in some areas comparable to those afforded prospective investors in a public commodity pool subject to Part 4, NFA does not believe that retail futures customers would be served well if this migration were to occur.

[11] NFA notes that Commission Regulation 4.13(a)(3) provides an exemption from CPO registration, which requires a pool to meet one of two tests with respect to its commodity interest positions, including positions in security futures products, whether entered into for bona fide hedging purposes or otherwise—the aggregate initial margin and premiums required to establish such positions will not exceed 5% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into or the aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into. Moreover, CFTC Regulation 4.13(a)(3)(iii) requires natural person pool participants to at least meet the accredited investor qualification standards.

For these reasons, NFA respectfully requests that the Commission amend Regulation 4.5(c) to require a registered investment company claiming an exclusion from the definition of the term "commodity pool operator" to represent in the notice of eligibility that the qualifying entity (i.e. registered investment company) will be operated such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for bona fide hedging purposes and, with respect to positions that may be held by the qualifying entity only for non-bona fide hedging purposes the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

Lastly, NFA recognizes that, if adopted, the proposed amendments to Regulation 4.5 will impose the same operating restrictions on registered investment companies that were in place prior to 2003. Obviously, since 2003, a number of persons have filed notices of eligibility pursuant to Regulation 4.5(c) on behalf of registered investment companies, and those entities may no longer be eligible for exclusion from CPO registration in the future if the proposed amendments are adopted. Therefore, NFA encourages the Commission to provide adequate time for these registered investment companies to comply with the Commission's applicable regulations or seek the appropriate relief therefrom.

Additionally, to the extent that the Commission has granted operational relief from certain Part 4 Regulations (e.g. disclosure document and reporting and recordkeeping) to exchange traded funds—that are commodity pools organized as Delaware statutory trusts—NFA encourages the CFTC to determine whether it is appropriate to grant similar and/or other relief to public commodity pools and listed pools that may want to continue operating as registered investment companies. If the Commission desires, NFA is willing to participate in discussions in the future with Commission staff to achieve this result, which may necessitate harmonizing CFTC and SEC regulatory requirements.

NFA respectfully petitions the Commission to amend Regulations 4.5 as described above.

Very truly yours,

Thomas W. Sexton, III
Senior Vice President
and General Counsel

cc: Via Email:
Honorable Gary Gensler, CFTC Chairman
Honorable Michael Dunn, CFTC Commissioner
Honorable Scott O'Malia, CFTC Commissioner
Honorable Jill E. Sommers, CFTC Commissioner
Honorable Bart Chilton, CFTC Commissioner
Mr. Ananda Radhakrishnan, CFTC Director
Mr. William Penner, CFTC Deputy Director

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U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521
www.cftc.gov

Office of the Secretariat

April 8, 2021

Alberto Thomas
Fideres Partners LLP
575 Lexington Avenue
New York, NY 10022

Re: Petition for Rulemaking on data retention time for Bloomberg chatrooms

Dear Mr. Thomas:

This acknowledges receipt by the Commodity Futures Trading Commission ("CFTC" or "Commission") of the petition submitted by the Fideres Partners LLP, pursuant to Commission Rule 13.1 (17 CFR 13.1). The petition seeks a rulemaking by the Commission to ensure (1) regulated entities and Bloomberg take appropriate action to ensure chatroom communications are retained for a certain period of time and (2) regulated entities put in place data retention systems to compensate for Bloomberg's reduction in its data retention period.

According to Commission policy, this petition will be publically posted to the CFTC website unless the Commission determines that there is a reason to withhold the petition from publication, in whole or in part. If you believe there is a basis for full or partial withholding of the petition, and have not already done so, please submit an explanation of your position to secretary@cftc.gov no later than April 16, 2021.

As provided in Rule 13.1, this petition will be referred to the Commission for such action as the Commission may deem appropriate. This office will notify you of any action taken by the Commission on the petition.

Sincerely,

Robert N. Sidman
Deputy Secretary of the Commission

FIDE
USE TAKE

Alberto Thomas
Fideres Partners LLP
575 Lexington Ave
New York, NY 10022
Tel: +1-646-992-8510

Mr Christopher J Kirkpatrick,
Secretary of the Commission,
Commodity Futures Trading Commission,
1155 21st Street, NW
Washington, DC 20581

New York, 31 March 2021

Dear Madam/Sir,

Re: Change of data retention time for Bloomberg chatrooms

In our letter date 30 July 2020, we alerted the CFTC about the reported widespread use of encrypted chatrooms by traders, to exchange market sensitive information.

In an email dated 18 March 2021, Bloomberg communicated to its clients that, commencing 15 July 2021 they will cut the chatroom retention period from 6 years to 2 years. They motivate this decision with the following reason: "*This update is part of an ongoing effort to enhance Bloomberg's Compliance Data pipeline in order to standardize policies, optimize storage efficiency, improve overall product performance, and accommodate customer demand for greater control over data retention periods*" (emphasis added).

In the aftermath of the Great Financial Crisis, regulatory enforcement actions by financial regulatory bodies around the world has been crucial to identify illegal conduct in, among others, the coordinated manipulation of IBOR rates, WM/Reuters fix, ISDAfix, The Gold Fix and many others. Most of the regulatory fines have relied heavily on chatroom transcript to identify examples of illicit conduct such as collusion and market manipulation.

We therefore propose that the CFTC emanate a new rule that:

1. Regulated entities and Bloomberg take appropriate actions to ensure that chatroom communications are retained for a period of time at least equal to the limitation period applicable to the type of law violations that regulators and private undertakings may be able to enforce
2. CFTC will take action to ensure that regulated entities will put in place data retention systems to compensate for Bloomberg's reduction in data retention period

We believe that the combination of, the previously reported use of encrypted chatrooms and the reduction of the chatroom retention period, if not addressed, will threaten the CFTC's 'ability to enforce financial regulations and the public trust in financial institutions.

We look forward to your acknowledgement and response,

Yours sincerely,

Alberto Thomas, Partner
Fideres Partners LLP

The Secretariat
JUL 18 2019
Received

New Civil Liberties Alliance

July 18, 2017

Via Hand Delivery

Heath P. Tarbert
Chairman
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Brian D. Quintenz
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Rostin Behnam
Commissioner
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Dawn DuBerry Stump
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Christopher Kirkpatrick
Secretary
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Daniel J. Davis
General Counsel
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Dan M. Berkovitz
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: *Petition for Rulemaking to Promulgate Regulations Prohibiting the Issuance, Reliance on, or Defense of Improper Agency Guidance.*

Dear Chairman Tarbert, Commissioners Quintenz, Behnam, Stump and Berkovitz, and Messrs Kirkpatrick and Davis,

Please find attached a petition for rulemaking from the New Civil Liberties Alliance. As the petition sets out in detail, NCLA asks CFTC to cease its *ad hoc* promulgation of guidance by which CFTC seeks to bind private parties with the force of law. As the November 2017 Sessions Memo, the January 2018 Brand Memo from the U.S. Department of Justice and the April 2019 OMB Memo explain, such a practice is unlawful. The Supreme Court's recent decision in *Kisor v. Wilkie* reinforces that *all* externally binding rules must implement statutory instructions and be adopted through notice-and-comment rulemaking. By adopting the rule outlined in this petition, CFTC can bring its rulemaking practices into conformity with the Constitution, as well as help its rules withstand court challenges and endure beyond the preferences of the current administration.

NCLA believes many of the requirements in the proposed rule represent constitutional minimums, so embodying them in a rule will also help ensure that no future Commission can revert to the old practice of using guidance in an unconstitutional way. In particular, if a future administration were to repeal the rule requested in this petition and thus facilitate the use of unconstitutional guidance, NCLA would be prepared to bring a facial challenge to the repeal of the rule on constitutional grounds.

We would be delighted to meet with you to discuss any questions you may have with respect to this petition.

Very truly yours,

/s/Peggy Little

Margaret A. Little
Senior Litigation Counsel

cc: Philip Hamburger, President, NCLA
Mark Chenoweth, Executive Director and General Counsel, NCLA

**PETITION FOR RULEMAKING TO
PROMULGATE REGULATIONS PROHIBITING THE ISSUANCE, RELIANCE ON
OR DEFENSE OF IMPROPER AGENCY GUIDANCE**

**SUBMITTED TO
U. S. COMMODITY FUTURES TRADING COMMISSION
JULY 18, 2019**

The Secretariat
JUL 18 2019
Received

Christopher Kirkpatrick
Secretary
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Heath P. Tarbert
Chairman
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Brian D. Quintenz
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Rostin Behnam
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Dawn DuBerry Stump
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Dan M. Berkovitz
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Daniel J. Davis
General Counsel
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Submitted by:

New Civil Liberties Alliance
1225 19th Street NW, Suite 450
Washington, DC 20036
tel.: (202) 869-5210
www.nclalegal.org

I. Statement of the Petitioner

Pursuant to the Administrative Procedure Act (APA), 5 U.S.C. § 553(e), 17 C.F.R. § 13.2 and 7 U.S.C. § 2(a)(12), the New Civil Liberties Alliance (NCLA) hereby petitions the Commodity Futures Trading Commission (hereinafter "CFTC" or "Commission") to initiate a rulemaking process to promulgate regulations prohibiting any Commission component from issuing, relying on, or defending improper agency guidance. The proposed rule would formalize and permanentize policies and best practices from other agencies concerning any agency guidance that improperly attempts to create rights or obligations binding on persons or entities outside the Commission. Additionally, the proposed rule would provide affected parties with a means of redress for improper agency action.

II. Summary of the Petition

Even though both the Constitution and the Administrative Procedure Act prohibit the practice, federal departments and agencies often engage in the "commonplace and dangerous" acts of issuing informal interpretations, advice, statements of policy, and other forms of "guidance" that "make law simply by declaring their views about what the public should do." Philip Hamburger, *Is Administrative Law Unlawful?* 260, 114 (2014). This practice evades legal requirements, and often is "used for the purpose of coercing persons or entities outside the federal government into taking any action or refraining from taking any action beyond what is required by the terms of the applicable statute or regulation." Memorandum from Attorney General Jefferson B. Sessions III, *Prohibition on Improper Guidance Documents*, at 2 (Nov. 16, 2017), *available at* https://www.justice.gov/opa/press-release/file/1012271/download. Despite being prohibited by law, improper guidance is typically "immuniz[ed]" from judicial review by procedural limits. *See Appalachian Power Co. v. Envtl. Prot. Agency*, 208 F.3d 1015, 1020 (D.C.

Cir. 2000). This conduct results in a form of illegal and unconstitutional "extortion" where agencies obtain compliance through "extralegal lawmaking." Hamburger, *supra*, at 260, 114-15.

To rein in these abuses, NCLA proposes that the Commission issue a formal rule prohibiting the Commission or any of its offices from issuing, relying on, or defending the validity of improper guidance. The proposed rule not only adopts existing legal limitations on such improper agency action, but, critically, also creates a permanent and binding set of limits on future departmental practice. The proposed rule also sets out a means to enforce these limits by empowering regulated parties to petition the Commission to rescind improper guidance and to seek judicial review of improper agency actions.

III. Statement of Interest

The New Civil Liberties Alliance is a nonprofit civil rights organization founded to defend constitutional rights through original litigation, amicus curiae briefs, and other means, including participating in the regulatory process at federal agencies. The "civil liberties" of the organization's name include rights at least as old as the U.S. Constitution itself, such as trial by jury, due process of law, the right to live under laws made by the nation's elected lawmakers rather than by prosecutors or bureaucrats, and the right to be tried in front of an impartial and independent judge.

NCLA defends civil liberties by asserting constitutional constraints on the administrative state. Although Americans still enjoy the shell of their Republic, there has developed within it a very different sort of government—a type, in fact, that the Constitution was framed to prevent. This unconstitutional administrative state that has developed within the United States violates more rights of more Americans than any other aspect of American law, and it is therefore the focus of NCLA's efforts.

Even where NCLA has not yet brought a suit to challenge an agency's unconstitutional exercise of administrative power, it encourages agencies themselves to curb the unlawful exercise of such power by establishing meaningful limitations on administrative rulemaking, guidance, adjudication, and enforcement. The courts are not the only government bodies with the duty to attend to the law. Even more immediately, agencies and agency heads have a duty to follow the law, not least by avoiding unlawful modes of governance. NCLA therefore advises that all agencies and agency heads examine whether their modes of rulemaking, guidance, adjudication, and enforcement comply with the APA and with the Constitution.

NCLA is thus an "interested" party concerning the proposed rule set out in this Petition for Rulemaking. *See* 5 U.S.C. § 553(e).

IV. Legal Authority to Promulgate the Rule

NCLA submits this Petition for Rulemaking pursuant to 5 U.S.C. § 553(e), which provides any "interested person the right to petition [an agency] for the issuance ... of a rule." The Commission has authority "to promulgate such rules and regulations as it deems necessary to govern the operating procedures and conduct of the business of the Commission" under 7 U.S.C. § 2(a)(12) of the Commodity Exchange Act.

CFTC and its component offices are "agencies" as the APA defines the term, and NCLA's proposed rule is a CFTC statement of general applicability and future effect, designed to prescribe procedure and practice requirements applicable to the entire Commission. *See* 5 U.S.C. § 551(1) & (4). Thus the Commission should adopt the proposed rule in accordance with the rulemaking requirements set out in 5 U.S.C. § 553.

V. Reasons for Creating the Rule

A. Legal Background

No agency has any inherent power to make law. Article I, § 1 of the U.S. Constitution vests "[a]ll legislative powers" in the Congress, and "the lawmaking function belongs to Congress … and may not be conveyed to another branch or entity." *Loving v. United States*, 517 U.S. 748, 758 (1996). This is a constitutional barrier to an exercise of legislative power by an agency. Further, "an agency literally has no power to act … unless and until Congress confers power upon it." *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986). Thus, even if an agency could constitutionally exercise legislative power, it cannot purport to bind anyone without congressional authorization.

Instead of conferring such power, Congress has categorically *prohibited* the issuance of binding guidance. Congress passed the Administrative Procedure Act in 1946 in order "to introduce greater uniformity of procedure and standardization of administrative practice among the diverse agencies whose customs had departed widely from each other." *Wong Yang Sung v. McGrath*, 339 U.S. 33, 41 (1950). As a result, it sets out a comprehensive set of rules governing administrative action.

Consistent with this design, the APA established a process by which agencies could engage in "rule making." 5 U.S.C. § 553. The APA explains that a "rule" "means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency[.]" 5 U.S.C. § 551(4).

Rules, by and large, may be promulgated by agencies only following notice-and-comment procedures. First, an agency must post a "general notice" of the proposed rulemaking in a prominent place and seek commentary from private parties. 5 U.S.C. § 553(b). This notice must set out "the time, place and nature" of the proposed "public rule making proceedings," "the legal authority under which the rule is proposed," and "either the terms or substance of the proposed rule or a description of the subjects and issues involved." *Id.* at §§ 553(b)(1)-(3).

After the notice has been posted, the agency must "give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments." *Id.* at § 553(c). "An agency must consider and respond to significant comments received during the period for public comment." *Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199, 1203 (2015). In response to submitted comments, a "general statement" of the purpose of the rules must also be "incorporate[d] in the rules adopted." 5 U.S.C. § 553(c).

The APA's notice-and-comment period "does not apply ... to interpretive rules, general statements of policy, or rules of agency organization procedure, or practice." *Id.* at § 553(b). Instead, this requirement applies only to "substantive rules," which are sometimes referred to as "legislative rules." *Mendoza v. Perez*, 754 F.3d 1002, 1021 (D.C. Cir. 2014); *see also* 5 U.S.C. § 553(d) (distinguishing between "substantive" and "interpretive" rules for publication and service).

A "substantive" or "legislative" rule is any "[a]gency action that purports to impose legally binding obligations or prohibitions on regulated parties." *Nat'l Mining Ass'n v. McCarthy*, 758 F.3d 243, 251 (D.C. Cir. 2014). Stated differently: "A rule is legislative if it supplements a statute, adopts a new position inconsistent with existing regulations, or otherwise effects a substantive change in existing law or policy." *Mendoza*, 754 F.3d at 1021. Such "legislative rules" have the "force and effect of law." *Chrysler Corp. v. Brown*, 441 U.S. 281, 302-03 (1979). Legislative rules are also accorded deference from courts. *See United States v. Mead Corp.*, 533 U.S. 218, 230 (2001).

In contrast, "interpretive rules" are not subject to notice-and-comment requirements. *See Mendoza*, 754 F.3d at 1021. Interpretative rules "do not have the force and effect of law and are not accorded that weight in the adjudicatory process." *Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 99 (1995).

An interpretative rule is any "agency action that merely interprets a prior statute or regulation, and does not itself purport to impose new obligations or prohibitions or requirements on regulated parties[.]" *Nat'l Mining Ass'n*, 758 F.3d at 252. "[I]nterpretive rules ... are issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers." *Perez*, 135 S. Ct. at 1204 (internal citation and quotation marks omitted). Such a rule simply "describes the agency's view of the meaning of an existing statute or regulation." *Batterton v. Marshall*, 648 F.2d 694, 702 n. 34 (D.C. Cir. 1980).

Aside from being a technical requirement under the APA, the notice-and-comment process serves important purposes. As the Supreme Court has explained, "Congress contemplates administrative action with the effect of law when it provides for a relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement of such force." *Mead Corp.*, 533 U.S. at 230. "APA notice and comment" is one such relatively formal procedure, "designed to assure due deliberation." *Ibid* (quoting *Smiley v. Citibank (South Dakota) N.A.*, 517 U.S. 735, 741 (1996)).

Informal interpretations, such as policy statements, agency manuals, enforcement guidelines and opinion letters "lack the force of law" and warrant, at best, only limited "respect" from courts concerning matters of interpretation. *Christensen v. Harris Cnty*, 529 U.S. 576, 587

(2000). Further, to the extent that a court grants any "respect" to these interpretations, the strength of such respect varies widely depending on the degree of formality employed by the agency. *See Mead Corp.*, 533 U.S. at 228 (discussing the deference owed to agency decisions). It depends in many instances on an agency's use of "notice-and-comment rulemaking or formal adjudication." *Id.* at 228-30 (internal citation and quotation marks omitted). A court gives the least amount of respect to "agency practice [that lacks] any indication [the agency] set out with a lawmaking pretense in mind" when it acted. *Id.* at 233.

Despite the relatively straightforward legal distinction, it is not always easy for courts or regulators to draw practical distinctions between "legislative" and "interpretive" rules. Because each agency action is unique, determining whether a given agency action is a legislative rule or interpretive rule "is an extraordinarily case-specific endeavor." *Am. Hosp. Ass'n v. Bowen*, 834 F.2d 1037, 1045 (D.C. Cir. 1987).

Perhaps because of this difficulty, or perhaps for more invidious reasons, agencies continue to promulgate legislative rules under the guise of being mere guidance, without following the notice-and-comment requirements of the APA. Accordingly, courts have often struck down such rules. *See, e.g.*, *Mendoza*, 754 F.3d at 1025 (vacating guidance documents as legislative rules that failed to comply with APA notice-and-comment requirements); *Elec. Privacy Info. Ctr. v. U.S. Dep't of Homeland Sec.*, 653 F.3d 1, 8 (D.C. Cir. 2011) (same); *Hemp Indus. Ass'n v. Drug Enforcement Admin.*, 333 F.3d 1082, 1091 (9th Cir. 2003) (same); *Nat'l Family Planning & Reprod. Health Ass'n, Inc. v. Sullivan*, 979 F.2d 227, 231 (D.C. Cir. 1992) (same); *Securities Industry and Financial Markets Association v. Commodity Futures Trading Commission*, 67 F. Supp. 3d 373 (D.D.C. 2014) (Agency "policy statement" while not subject to notice-and-comment, failed to consider requisite costs and benefits and was thus arbitrary and capricious, and remand ordered.); *Commodity Futures Trading Commission v. Zelener*, 373 F. 3d 861 (7th Cir. 2004) (CFTC's interpretation that speculative transactions in foreign currency are "contracts of sale of a commodity for future delivery" rejected and entitled to no deference.); *Commodity Futures Trading Commission v. Monex Credit Company,* 331 F. Supp. 3d 1173 (C.D. Cal. 2018) (CFTC's interpretation of "actual delivery" under the Commodity Exchange Act rejected.)

But the prevalence of court invalidation of improper guidance vastly understates the problem, as "extralegal" agency action "usually occurs out of view." Hamburger, *supra*, at 260. "To escape even the notice-and-comment requirement for lawmaking interpretation, agencies increasingly make law simply by declaring their views about what the public should do." *Id.* at 114. Such improper guidance statements are often deliberate "evasions" of legal requirements, and "an end run around [an agency's] other modes of lawmaking." *Ibid* (internal citation and quotation marks omitted). In many instances, an agency's "guidance" is actually a means of "extralegal lawmaking" that confuses even sophisticated members of regulated industries. *Id.* at 115.

Agencies have strong incentives to resort to this kind of extralegal lawmaking. The "absence of a notice-and-comment obligation makes the process of issuing interpretive rules comparatively easier for agencies than issuing legislative rules." *Perez*, 135 S. Ct. at 1204. An agency operating in this fashion can issue rules "quickly and inexpensively without following any statutorily prescribed procedures." *Appalachian Power Co.*, 208 F.3d at 1020. When this happens, "[l]aw is made, without notice and comment, without public participation, and without publication in the Federal Register or the Code of Federal Regulations." *Ibid.*

More troubling, "[w]hen agencies want to impose restrictions they cannot openly adopt as administrative rules, and that they cannot plausibly call 'interpretation,' they typically place the restrictions in guidance, advice, or other informal directives." Hamburger, *supra*, at 260. This is "a sort of extortion," because an agency can secure compliance by "threatening" enforcement or other regulatory action, even if the agency has no genuine authority to act in the first place. *Id.* at 260-61. An agency's informal "views about what the public should do," almost always comes "with the unmistakable hint that it is advisable to comply." *Id.* at 114.

This extortion is enabled, primarily, by the judiciary's inability to review improper guidance. Indeed, an agency often realizes that "another advantage" to issuing guidance documents, is "immunizing its lawmaking from judicial review." *Appalachian Power Co.*, 208 F.3d at 1020. As discussed above, legislative rules will only be invalidated for failure to conform to the notice-and-comment process after they have been determined to be legislative in the first place. This is neither a simple nor a quick task.

Simultaneously, even invalid, binding legislative rules may escape judicial review. The APA typically allows review only of "final agency action." 5 U.S.C. § 704. "[T]wo conditions must be satisfied for agency action to be final: First, the action must mark the consummation of the agency's decisionmaking process … And second, the action must be one by which rights or obligations have been determined, or from which legal consequences will flow." *Bennett v. Spear*, 520 U.S. 154, 177-78 (1997) (internal citations and quotation marks omitted).

But "an agency's action is not necessarily final merely because it is binding." *Appalachian Power Co.*, 208 F.3d at 1022. An initial or interim ruling, even one that binds, "does not mark the consummation of agency decisionmaking" and thus might not constitute final agency action. *Soundboard Ass'n v. Fed. Trade Comm'n*, 888 F.3d 1261, 1271 (D.C. Cir. 2018);

see also Ctr. for Food Safety v. Burwell, 126 F. Supp. 3d 114, 118 (D.D.C. 2015) (Contreras, J.) (discussing binding "Interim Policy" of agency that was in effect for 17 years but evaded judicial review as non-final action).

As a result, courts rarely consider the genuinely coercive effects of guidance documents as sufficiently binding to permit review. For example, a warning letter issued by an agency to a party, alleging a violation of a regulation, and even threatening the initiation of enforcement action, will not establish sufficiently concrete "legal consequences" to permit review of final agency action. *Holistic Candlers & Consumers Ass'n v. Food & Drug Admin.*, 664 F.3d 940, 944 (D.C. Cir. 2012). Indeed, "practical consequences, such as the threat of having to defend itself in an administrative hearing should the agency actually decide to pursue enforcement, are insufficient to bring an agency's conduct under [a court's] purview." *Indep. Equip. Dealers Ass'n v. Envtl. Prot. Agency*, 372 F.3d 420, 428 (D.C. Cir. 2004) (internal citation and quotation marks omitted). Even to the extent that such action coerces compliance from a regulated entity, and even to the extent this might result in "a dramatic impact on the [affected] industry," it still may not be considered final action subject to review. *Soundboard Ass'n*, 888 F.3d at 1272; *see also Nat'l Mining Ass'n*, 758 F.3d at 253 (agency action is not final even if a regulated entity "really has no choice when faced with [] 'recommendations' except to fold," and might "feel pressure to voluntarily conform their behavior because the writing is on the wall")

This use of guidance thus results in "commonplace and dangerous" abuses of administrative power, and "often leaves Americans at the mercy of administrative agencies." Hamburger, *supra*, at 260, 335. "It allows agencies to exercise a profound under-the-table power, far greater than the above-board government powers, even greater than the above-board administrative powers, and agencies thuggishly use it to secure what they euphemistically call 'cooperation.'" *Id.* at 335. This results in an "evasion" of the Constitution, and an affront to the basic premise that laws can only be made by the Congress. *Id.* at 113-14; *see also La. Pub. Serv. Comm'n*, 476 U.S. at 374. It is also statutorily forbidden. *See Mendoza*, 754 F.3d at 1021. And it often results in violations of the due process of law. Hamburger, *supra*, at 241, 353. But, perhaps by design, such improper agency conduct routinely occurs without any hope of judicial intervention. *See Appalachian Power Co.*, 208 F.3d at 1020.

B. Prior Responses to These Problems

1. The 2007 Bulletin for Agency Good Guidance Practices

On January 18, 2007, the Office of Management and Budget for the Executive Office of the President, addressed the ongoing problem caused by the issuance of "poorly designed or improperly implemented" "guidance documents" from administrative entities. Office of Mgmt. & Budget, Executive Office of the President, *Final Bulletin for Agency Good Guidance Practices*, 72 Fed. Reg. 3432, 3432 (Jan. 18, 2007) (OMB Bulletin). OMB explained that many stakeholders had ongoing "[c]oncern about whether agencies" had been improperly issuing guidance documents that actually "establish new policy positions that the agency treats as binding," without following the notice-and-comment requirements of the APA. *Id.* at 3433. In addition to promulgating formal rules with the effect of law, many "agencies increasingly have relied on guidance documents to inform the public and to provide direction to their staffs." *Id.* at 3432.

While the bulletin characterized this practice as generally positive, it noted that many guidance documents do "not receive the benefit of careful consideration accorded under the procedures for regulatory development and review." Worse, "[b]ecause it is procedurally easier to issue guidance documents, there also may be an incentive for regulators to issue guidance documents in lieu of regulations." Some of these guidance documents also improperly "establish new policy positions that the agency treats as binding," despite failures to comply with the APA's notice-and-comment and judicial review provisions. *Id.* at 3433. To combat this problem, OMB issued its Final Bulletin to help ensure that guidance documents issued by Executive Branch departments and agencies under the OMB's management would not improperly issue "legally binding requirements." *Ibid.*

First, the OMB Bulletin directed each agency to "develop or have written procedures for the approval of significant guidance documents," in order to "ensure that the issuance of significant guidance documents is approved by appropriate senior agency officials." *Id.* at 3436, 3440. The OMB Bulletin also suggested that each significant guidance document adhere to the following:

> a. Include the term ''guidance'' or its functional equivalent;
>
> b. Identify the agenc(ies) or office(s) issuing the document;
>
> c. Identify the activity to which and the persons to whom the significant guidance document applies;
>
> d. Include the date of issuance;
>
> e. Note if it is a revision to a previously issued guidance document and, if so, identify the document that it replaces;
>
> f. Provide the title of the document, and any document identification number, if one exists;
>
> g. Include the citation to the statutory provision or regulation (in Code of Federal Regulations format) which it applies to or interprets; and
>
> h. Not include mandatory language such as ''shall,'' ''must,'' ''required'' or ''requirement,'' unless the agency is using these words to describe a statutory or regulatory requirement, or the language is addressed to agency staff and will not foreclose agency consideration of positions advanced by affected private parties.

Id. at 3440.

Finally, the OMB Bulletin suggested that each agency establish procedures for improving public access and feedback for significant guidance documents. In the case of "economically significant guidance documents," these suggestions included following notice-and-comment procedures in certain cases. *Id.* at 3438.

The OMB Bulletin was limited in two important ways. First, it only applied to the issuance of "significant guidance documents" by Executive Branch agencies. *Id.* at 3432. This was defined as a "document disseminated to regulated entities or the general public that may reasonably be anticipated to: (i) lead to an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (ii) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (iii) materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (iv) raise novel legal or policy issues arising out of legal mandates[.]" *Id.* at 3439.

Second, the OMB Bulletin did not create any means of review or redress should agencies choose to disregard it. Under a heading entitled "Judicial Review," the Bulletin provided that it was meant only "to improve the internal management of the Executive Branch and is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity, against the United States, its agencies or other entities, its officers or employees, or any other person." *Ibid.*

2. Department of Justice's 2017 and 2018 Policy Memoranda

Following the OMB Bulletin's lead more than a decade later, on November 16, 2017, Attorney General Jeff Sessions issued a memorandum for all Justice Department components entitled *Prohibition on Improper Guidance Documents* (Sessions Memo). This memo immediately prohibited all Department of Justice components from issuing agency guidance documents that "purport to create rights or obligations binding on persons or entities outside the Executive Branch." Office of the Att'y Gen., *Prohibition on Improper Guidance Documents* at 1, *available at* https://www.justice.gov/opa/press-release/file/1012271/download.

The Sessions Memo explained that "the Department has in the past published guidance documents—or similar instruments of future effect by other names, such as letters to regulated entities—that effectively bind private parties without undergoing the rulemaking process." It also explained that guidance documents might improperly "be used for the purpose of coercing persons or entities outside the federal government into taking any action or refraining from taking any action beyond what is required by the terms of the applicable statute or regulation." This practice often evaded "notice-and-comment" rules "required by law," and deprived the agencies "of more complete information about a proposed rule's effects than the agency could ascertain on its own." *Ibid.*

The new policy prohibited any agency operating within the Department of Justice from using regulatory guidance "as a substitute for rulemaking." As such, guidance documents would no longer be promulgated that either "impose new requirements on entities outside the Executive Branch," or "create binding standards by which the Department will determine compliance with existing regulatory or statutory requirements." Future guidance documents would only be issued to "educate regulated parties through plain-language restatements of existing legal requirements or provide non-binding advice on technical issues through examples or practices to guide the application or interpretation of statutes and regulations." *Ibid.*

To support these goals, Attorney General Sessions set out the following five "principles" to which all components "should adhere" "when issuing guidelines":

> [1] Guidance documents should identify themselves as guidance, disclaim any force or effect of law, and avoid language suggesting that the public has obligations that go beyond those set forth in the applicable statutes or legislative rules.
>
> [2] Guidance documents should clearly state that they are not final agency actions, have no legally binding effect on persons or entities outside the federal government, and may be rescinded or modified in the Department's complete discretion.
>
> [3] Guidance documents should not be used for the purpose of coercing persons or entities outside the federal government into taking any action or refraining from taking any action beyond what is required by the terms of the applicable statute or regulation.
>
> [4] Guidance documents should not use mandatory language such as "shall," "must," "required," or "requirement" to direct parties outside the federal government to take or refrain from taking action, except when restating—with citations to statutes, regulations, or binding judicial precedent—clear mandates contained in a statute or regulation. In all cases, guidance documents should clearly identify the underlying law that they are explaining.
>
> [5] To the extent guidance documents set out voluntary standards (e.g., recommended practices), they should clearly state that compliance with those standards is voluntary and that noncompliance will not, in itself, result in any enforcement action.

Id. at 2.

The memo also defined "guidance documents" to include "any Department statements of general applicability and future effect, whether styled as guidance or otherwise that are designed to advise parties outside the federal Executive Branch about legal rights and obligations falling within the Department's regulatory or enforcement authority." *Ibid.* Notably, this definition excluded "internal directives [and] memoranda." *Id.* at 2-3.

In accordance with this new policy, the Attorney General also directed the Justice Department's Regulatory Reform Task Force "to work with components to identify existing guidance documents that should be repealed, replaced, or modified in light of these principles." *Id.* at 2.

Finally, the memo made clear that it "is an internal Department of Justice policy directed at Department components and employees. As such, it is not intended to, does not, and may not be relied upon to, create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal." *Id.* at 3.

Just over a month later, the Attorney General announced that he was applying his November memo and "rescinding 25 [guidance] documents that were unnecessary, inconsistent with existing law, or otherwise improper." Press Release, *Attorney General Sessions Rescinds 25 Guidance Documents*, Department of Justice, Office of Public Affairs, Press Release No. 17-1469 (Dec. 21, 2017) *available at* https://www.justice.gov/opa/pr/attorney-general-jeff-sessions-rescinds-25-guidance-documents. Then on July 3, 2018, the Attorney General rescinded 24 more improper guidance documents. Press Release, *Attorney General Jeff Sessions Rescinds 24 Guidance Documents*, Department of Justice, Office of Public Affairs, Press Release No. 18-883 (July 3, 2018) *available at* https://www.justice.gov/opa/pr/attorney-general-jeff-sessions-rescinds-24-guidance-documents. The Attorney General also said that the Department would "continu[e] its review of existing guidance documents to repeal, replace, or modify." *Ibid.*

On January 25, 2018, Associate Attorney General Rachel Brand, who was then the chair of the Department's Regulatory Reform Task Force, issued a memorandum entitled *Limiting Use of Agency Guidance Documents in Affirmative Civil Enforcement Cases* (Brand Memo), for all Justice Department litigators. This memo echoed the Sessions Memo's concerns that Justice

Department agencies had previously issued "guidance documents that purport to create rights or obligations binding on persons or entities outside the Executive Branch." *Id.* at 1, *available at* https://www.justice.gov/file/1028756/download.

Associate Attorney General Brand therefore directed that for all affirmative civil enforcement (ACE) cases, "the Department may not use its enforcement authority to effectively convert agency guidance documents into binding rules." *Id.* at 2. To accomplish this goal, the Brand Memo went further than the Sessions Memo and applied to "guide Department litigators in determining the legal relevance of *other agencies'* guidance documents," including the Commodity Futures Trading Commission. *Id.* at 1 (emphasis added). In addition, ACE litigators were also prohibited from "us[ing] noncompliance with guidance documents as a basis for proving violations of applicable law." *Id.* at 2. "That a party fails to comply with agency guidance expanding upon statutory or regulatory requirements does not mean that the party violated those underlying legal requirements; agency guidance documents cannot create any additional legal obligations." *Ibid.*

As with the Sessions Memo, the Brand Memo contained an elaborate disclaimer carefully setting out that it had no binding effect on any party outside the Department of Justice. "As such, it is not intended to, does not, and may not be relied upon to, create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal." *Ibid.*

3. The 2019 Guidance on Compliance with the Congressional Review Act Memorandum

On April 11, 2019, OMB issued a memorandum to all heads of executive departments and agencies, directing them to abide by their Congressional Review Act (CRA) obligations. Office of Mgmt. & Budget, Executive Office of the President, *Guidance on Compliance with the Congressional Review Act*, No. M-19-14, at 1 (Apr. 11, 2019) (OMB Memo). Among other things, the CRA establishes a process by which Congress, typically through notification by the Office of Information and Regulatory Affairs (OIRA) and the Government Accountability Office (GAO), may exercise direct oversight of agencies by resolving to disapprove of agencies' proposed major rulemaking. *See* 5 U.S.C. § 801(b). At first glance, it may seem peculiar that OMB would have to "*reinforce*[] the obligations of Federal agencies[,]" but agencies have been disregarding their statutory rulemaking obligations with impunity for years. *See* OMB Memo at 1, 2 (emphasis added). In fact,

> OIRA does not consistently receive from agencies the information necessary to determine whether a rule is major, in part because some regulatory actions are rules under the CRA are not submitted to OIRA through the centralized review process of Executive Order 12866.

Id. at 4.

The OMB Memo reaffirmed "the broad applicability of the CRA to all Federal agencies and a wide range of rules[.]" *Id.* at 2. It also noted that the CRA adopts the APA's "expansive definition of 'rule.'" *Ibid.* Thus, the OMB Memo concluded that

> [t]he CRA applies to more than just notice-and-comment rules; it also encompasses a wide range of other regulatory actions, including, *inter alia*, guidance documents, general statements of policy, and interpretive rules.

Id. at 3 (citing 5 U.S.C. § 551(4)). Effective May 11, 2019, all proposed rules—whether the agency believes a rule to be major or minor or legislative or interpretive—*must* be submitted to OIRA for review. *See id.* at 5. This mandatory reporting requirement encompasses all CFTC guidance that alter the legal duties of private parties.

4. The 2019 *Kisor v. Wilkie* Decision

On June 26, 2019, the Supreme Court decided *Kisor v. Wilkie*. The Court reiterated its long-held opinion that rulemaking under APA Section 553 "mandates that an agency use notice-

and-comment procedures before issuing legislative rules." *Kisor v. Wilkie*, No. 18-15, 588 U.S. ____, slip op. at 22 (2019). An agency may avoid notice-and-comment procedures only where a proposed rule is interpretive and "not supposed to 'have the force and effect of law'—or, otherwise said, to bind private parties." *Ibid.* The Court explained that "interpretive rules are meant only to 'advise the public' of how the agency understands, and is likely to apply, its binding statutes and legislative rules." *Ibid.* Since interpretive rules "never" form the basis of enforcement actions, courts cannot—and will not—attribute the force of law to interpretive rules. *See id.* at 23. Thus, when reviewing agency action, courts "must heed the same procedural values as [APA] Section 553 reflects[,]" when considering whether the agency has issued "authoritative and considered judgments." *See id.*

5. The Commission's Review of Guidance

The Sessions and Brand Memoranda are unequivocal—Executive Branch departments and agencies must cease the unconstitutional practice of issuing guidance as a means of avoiding notice-and-comment procedures when promulgating substantive rules. Indeed, as the *Kisor* Court emphatically stated, "[n]o binding of anyone occurs merely by [an] agency's say-so." *Ibid.*

Laudably, Former CFTC Chairman J. Christopher Giancarlo has recognized that the CFTC must "reinterpret its regulatory mission" in the spirit of a presidential election "to turn the tide of over-regulation." Speech to International Futures Industry Conference, March 15, 2017. Giancarlo announced "an agency-wide review of CFTC rules, regulations and practices to make them simpler, less burdensome and less costly." "The era of Dodd-Frank implementation at the CFTC is now drawing to a close" heralding a "time for the agency to resume normalized operations and practices, and a return to greater care and precision in rule drafting, more thorough econometric analysis … and a reduced docket of new rules and regulations to be absorbed by market participants." *Id.*

CFTC has also proposed a rule update for securities futures products (SFPs) that will provide greater liquidity in SFP trading and keep pace with position limits on securities options regulated by the SEC.

Despite these positive steps, the CFTC's pending notices of rulemaking do not include a proposed rule that would unequivocally and permanently bind the Commission in a manner consistent with the Justice Department Memoranda. The Commission's dilatory approach to cementing the Justice Department's directive is puzzling given Chairman Giancarlo's stated commitment to regulatory reform. While regulatory redesign is laudable, these actions do not address the CFTC's past, present, or future use of guidance. Indeed, the Commission's regulatory reform and deregulatory initiatives, while important, are only one component of the Administration's larger strategy to reform the regulatory landscape and the relationship between the regulators and the regulated. The other co-equal regulatory reform component is transparent, open, and accountable notice-and-comment rulemaking where agencies seek to create, define, and regulate the rights, duties, and powers of private parties. In fact, to call this regulatory "reform" may be a bit of a misnomer, as the Supreme Court has long held that agencies cannot avoid notice-and-comment procedures when promulgating substantive rules because such procedures "were designed to assure fairness and mature consideration of rules of general application." *See NLRB v. Wyman-Gordon Co.*, 394 U.S. 759, 764 (1969).

Moreover, adopting the Justice Department's position on guidance—that all externally binding guidance is unconstitutional—would be in the Commission's best interest. As mandated by the 2019 OMB Memo, by May 11, 2019, the Commission will submit all its proposed actions to OIRA for review—including Commission-designated guidance. And even if OIRA mistakenly allows guidance to be enforced against private parties without APA notice-and-comment, courts have exhibited no qualms about invalidating improper agency actions in such circumstances. For example, in 2014, the District Court for the District of Columbia scrutinized a purported CFTC guidance document to see if it constituted an unlawful, binding, legislative rule. *Sec. Indus. & Fin. Markets Ass'n v. Commodity Futures Trading Comm'n*, 67 F. Supp. 3d 373, 418 (D.D.C. 2014). The court fully examined the character, effect, and usage of the CFTC document and was only willing to uphold it because the court was "satisfied that no CFTC staff member or market participant could, after consulting the [document] in its entirety, reasonably construe it as setting forth binding norms." *Id.* In doing so, the court emphasized that the "important fact in this case is that [the plaintiffs] remain completely free to ignore" the Commission's guidance. *Id.* at 422 (internal quotation marks omitted).

C. The Rule is Necessary Because Meta-Guidance Is Insufficient

Given the legal background just discussed, the various reform efforts outlined above are important measures to rein in the improper use of guidance documents. The 2007 OMB Bulletin and 2019 Memo, in conjunction with the Sessions and Brand Memos, clearly identify some of the worst features of the guidance problem and provide a good start in the broader regulatory reform effort. However, even these documents do not go far enough to combat the pernicious harms caused by binding guidance, primarily because they constitute, at most, mere "guidance on guidance."

While these meta-guidance documents advance essential points, and identify key regulatory pathologies, they are ultimately policy announcements within their supervised agencies. Hence, they should not be the sole model for the Commission's reform efforts.To solve the underlying problems completely, the Commission should issue binding and final rules prohibiting any Commission component from issuing, relying on, or defending improper agency guidance.[1] The first and most significant problem with the previously mentioned meta-guidance documents is that they lack any permanent or binding effect. Even though the 2007 OMB Bulletin was issued following notice-and-comment proceedings, it nevertheless serves only as a guide for good agency practice in future contexts. It provides non-binding suggestions for good practice, and specifically disclaims the creation of "any right or benefit, substantive or procedural, enforceable at law or in equity, against the United States, its agencies or other entities, its officers or employees, or any other person." OMB Bulletin, 72 Fed. Reg. at 3439. In other words, to the extent that the OMB Bulletin might be ignored, an affected party has no means of redress.

Notably, since the OMB Bulletin was issued, Executive Branch agency action has been promulgated in apparent defiance of the bulletin. *See, e.g.*, *Elec. Privacy Info. Ctr.*, 653 F.3d at 8 (invalidating Department of Homeland Security rule as legislative rule that failed to comply with APA notice-and-comment requirements); *Hemp Indus. Ass'n*, 333 F.3d at 1091 (same for DEA rule); *Texas v. United States*, 201 F. Supp. 3d at 825 (N.D. Tex. 2016) (same for Department of Education rule). Further, to the extent that improper guidance may escape judicial review for other reasons, one may only guess how many other improper guidance documents have been issued notwithstanding the bulletin. *See, e.g.*, *Soundboard Ass'n*, 888 F.3d at 1271-73 (FTC

[1] The proposed internal rule would be controlling only within the Commission and is not strictly a "substantive" or "legislative rule" as that term is otherwise used in this document. NCLA invokes the Commission's authority under 7 U.S.C. § 2(a)(12) "to promulgate such rules and regulations as it deems necessary to govern the operating procedures and conduct of the business of the Commission." Such rules should be considered "housekeeping" rules that have a controlling effect within the Commission but cannot bind parties outside the Commission without an additional grant of rulemaking authority. *Chrysler Corp.*, 441 U.S. at 310-11.

agency documents issued in 2009 and 2016 could not be reviewed even if "regulated entities could assert a dramatic impact on their industry" resulting from the documents).

The Sessions and Brand Memos suffer from this same defect. In fact, both disclaim that those documents even rise to the level of "guidance" at all, and insist instead that they are mere "internal directives [and] memoranda." Sessions Memo at 2-3; Brand Memo at 1. Thus, to the extent offices or individuals within the CFTC ignore these guidelines, they could "not be relied upon to, create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal." Sessions Memo at 3; Brand Memo at 2.

Constituting little more than noble policy goals. these documents could also be immediately rescinded at any time, and without seeking any input from affected entities. While the OMB Bulletin followed notice-and-comment procedures, it was not required to have done so, because it was not a binding legislative rule. *See* 5 U.S.C. § 553(b). And, if a new administration chose to summarily rescind it, it would be entitled to do so without any formal procedures. *See Perez*, 135 S. Ct. at 1203 (agency action not subject to mandatory notice-and-comment procedures may be altered or rescinded at will). Similarly, the Sessions and Brand Memos be rescinded with little notice or fanfare.

Moreover, none of these efforts solved the underlying problem that prior, improperly-issued guidance documents evaded judicial review—and continue to do so. As discussed, even where "regulated entities could assert a dramatic impact on their industry," and even when such agency guidance is actually improper legislative rulemaking, it may nevertheless escape judicial review as non-final action. *See Soundboard Ass'n*, 888 F.3d at 1272. Add to this list the fact that an agency action might also violate the OMB Bulletin, and still escape meaningful judicial scrutiny.. The inability to subject such action to judicial review can have momentous, and even disastrous, consequences for regulated industries that might "feel pressure to voluntarily conform their behavior because the writing is on the wall." *Nat'l Mining Ass'n*, 758 F.3d at 253.

Finally, even to the extent that the documents genuinely confine improper rulemaking, each contains significant limitations to its scope. The OMB Bulletin only applies to "significant guidance" documents issued by the limited number of "Executive Branch departments and agencies," not to independent agencies. OMB Bulletin, 72 Fed. Reg. at 3433, 3436. Similarly, the Sessions Memo only applies to a subset of Department of Justice actions. Sessions Memo at 1. And while the Brand Memo has some effect when external agency guidance documents are relevant to DOJ action, it is still confined to an extremely narrow class of future "affirmative civil enforcement" cases. Brand Memo at 1.

The 2019 OMB Memo, however, is much broader in scope—it seeks to stop unlawful agency rulemaking Executive Department-wide. As such, it could rectify the shortcomings of the Sessions and Brand Memos, but it is not clear what enforcement mechanisms will be in place, if any, to ensure that departments and agencies comply. Moreover, the Commission does not have a policy or rule in place that contemplates OIRA's review of all proposed departmental action, as mandated by the 2019 OMB Memo. Only a new rule binding the CFTC and its various components can ensure regulated parties that the Commission will refrain from the improper use of guidance in the future. For that reason, Petitioner has provided the text for an adequate and effective rule below.

D. Text of the Proposed Rule

While the most effective, efficient, and logical way to promote the following rule would be to do so at the organizational level, the following text could be readily adapted by individual CFTC divisions and offices wishing to pursue reform on their own, if necessary.

Section 1: Congressional Review Act Compliance

a. The Commodity Futures Trading Commission and its divisions and offices ("CFTC" or "Commission") will comply with all Congressional Review Act, 5 U.S.C. §§ 801-808, requirements for review of all proposed regulatory actions, including, but not limited to, legislative rules, regulations, guidance documents, general statements of policy, and interpretive rules.

b. All proposed regulatory actions that the CFTC submits to the Office of Information and Regulatory Affairs ("OIRA") pursuant to Executive Order 12866, will include:

i. a CFTC-proposed significance determination; and

ii. a CFTC-proposed determination as to whether the regulatory action meets the definition of a "major rule" under 5 U.S.C. § 804(2).

c. Where proposed regulatory actions would not meet Executive Order 12866's OIRA review requirement, and where the category of regulatory action had not been previously designated as presumptively not-major by OIRA, the Commission will notify OIRA of the proposed regulatory action in writing. The written notification to OIRA will include:

i. the CFTC's summary of the proposed regulatory action;

ii. the CFTC's assessment as to the nature of the proposed regulatory action, including, but not limited to, whether the action is legislative or interpretive and whether it is applicable to the Commission or to private parties outside the Commission; and

iii. the CFTC's recommended designation of the regulatory action as a major rule or not, as defined by 5 U.S.C. § 804(2).

d. If OIRA designates the CFTC's proposed regulatory action as a possible major rule, the Commission will:

i. submit the proposed regulatory action to OIRA for CRA review at least 30 days before the Commission publishes the proposed rule in the *Federal Register* or otherwise publicly releases the rule;

ii. submit an analysis sufficient to allow OIRA to make its major rule determination. This analysis should include, but not be limited to, information regarding the degree of uncertainty concerning the regulatory action's impacts; and

iii. provide all required information, analysis, and documentation to OIRA in a manner consistent with the principles and metrics enunciated in OMB Circular A-4 (Sept. 17, 2003) and Part IV of OMB Memorandum M-19-14 (Apr. 11, 2019).

e. If OIRA designates the proposed regulatory action not-major, the Commission may proceed with its rulemaking procedures without submitting a CRA report to Congress.

f. If OIRA designates the proposed regulatory action a major rule, the Commission will:

i. submit a CRA report to Congress and the Comptroller in accordance with the provisions of 5 U.S.C. § 801(a);

ii. publish the major rule in the *Federal Register*; and

iii. delay the effective date of the major rule for 60 days after the later of the major rule's submission to Congress or its *Federal Register* publication date.

g. All CFTC rules will include the following statement: "Pursuant to the Congressional Review Act (5 U.S.C. § 801 *et seq.*), the Office of Information and Regulatory Affairs designated this rule as [a 'major rule' or not a 'major rule'], as defined by 5 U.S.C. § 804(2)."

Section 2: Requirements for Issuance of Legislative Rules

a. Neither the Commodity Futures Trading Commission nor any office or division operating within the Commission may issue any "legislative rule" without complying with all requirements set out in 5 U.S.C. § 553.

b. Any pronouncement from the Commission or any office or division operating within the Commission that is not a "legislative rule" must:

i. Identify itself as "guidance" or its functional equivalent, or as an internal regulation of the Commission authorized by 7 U.S.C. § 2(a)(12);

ii. Disclaim any force or effect of law;

iii. Prominently state that it has no legally binding effect on persons or entities outside the agency or office itself;

iv. Not be used for purposes of coercing persons or entities outside the agency or office itself into taking any action or refraining from taking any action beyond what is already required by the terms of the applicable statute; and

v. Not use mandatory language such as "shall," "must," "required," or "requirement" to direct parties outside the federal government to take or refrain from taking action, except when restating—with citations to statutes or binding judicial precedent—clear mandates contained in a statute;

c. A regulated entity's noncompliance with any agency pronouncement other than a "legislative rule," issued from any agency (whether or not the agency or office is operating within the Commission), may not be considered by any entity within the Commission in determining whether to institute an enforcement action or as a basis for proving or adjudicating any violation of applicable law.

d. No office operating within the Commission may apply any "legislative rule," as defined by this rule, issued by the Commission or any other agency, no matter how styled, which has not complied with all requirements set out in 5 U.S.C. § 553.

e. No office operating within the Commission may defend the validity of any "legislative rule," as defined by this rule, issued by the Commission or any other agency, no matter how styled, which has not complied with all requirements set out in 5 U.S.C. § 553, in any court or administrative proceeding.

Section 2: Judicial Review

a. Any "interested party" may petition any office operating within the Commission to determine whether a prior agency pronouncement, no matter how styled, is a "legislative rule" as defined by this rule.

b. Such a petition for review shall be filed in writing with the agency or office, pursuant to the procedures set out in compliance with 5 U.S.C. § 553(e).

c. Any office operating within the Commission must respond to such a petition for review within 60 calendar days of receipt of the petition.

d. The office operating within the Commission must respond by either:

i. Rescinding the prior agency pronouncement; or

ii. Denying the petition for review on the basis that the agency pronouncement under review did not constitute a "legislative rule," or on the basis that the agency pronouncement was adopted in compliance with all of the requirements set out in 5 U.S.C. § 553.

e. Any agency determination under section (d) must be made in writing and must be promptly made publicly available and must include a formal statement of reasons for determining that the pronouncement under review does or does not constitute a "legislative rule," or does or does not comply with 5 U.S.C. § 553.

f. If the office fails to respond to a petition for review within the 60-day period, such an action shall constitute a denial of the petition on the basis that the agency pronouncement under review did not constitute a "legislative rule."

g. If any agency or office pronouncement is determined to not be a "legislative rule" under parts (d), (e) or (f), the agency or office shall promptly announce that the pronouncement has no binding force.

h. Any agency pronouncement, action or inaction set out in parts (d), (e), (f) or (g), shall constitute final agency action under

5 U.S.C. § 704, and shall be subject to review pursuant to 5 U.S.C. § 702.

i. For purposes of this rule, no matter how styled or when issued and irrespective of any other agency determination, the issuance of any "legislative rule" by any agency or office operating within the Commission shall be deemed final agency action under 5 U.S.C. § 704.

Section 3: Definitions

a. For purposes of this rule, the term "legislative rule" means any pronouncement or action from any covered agency or office that purports to:

i. Impose legally binding duties on entities outside the covered agency or office;

ii. Impose new requirements on entities outside the covered agency or office;

iii. Create binding standards by which the covered agency or office will determine compliance with existing statutory or regulatory requirements; or

iv. Adopt a position on the binding duties of entities outside the covered agency or office that is new, that is inconsistent with existing regulations, or that otherwise effects a substantive change in existing law;

b. For purposes of this rule, the term "interested person" has the same meaning used in 5 U.S.C. §§ 553, 555; *provided that* a person may be "interested" regardless of whether they would otherwise have standing under Article III of the United States Constitution to challenge an agency action.[2]

E. Benefits of the Rule

The proposed rule furthers the policy objectives of the OMB Bulletin and Memo, the Sessions and Brand Memos, and the Commission's own regulatory reform efforts, but it also

[2] *See Animal Legal Def. Fund, Inc. v. Vilsack*, 237 F. Supp. 3d 15, 21 (D.D.C. 2017) (Cooper, J.) (a party may be an "interested person" under the APA even without Article III standing).

addresses the significant limitations of those reforms. The proposed rule will establish the CFTC's position that all binding guidance is unlawful, and where the CFTC must act at the behest of Congress to promulgate rules that will have the force of law, it may only do so through APA notice-and-comment procedures.

Substantively, many of the proposed rule's edicts are found either in existing law or the OMB Bulletin, the OMB Memo, and Sessions and Brand Memos. Consistent with these sources, Section 4(a) adopts a comprehensive definition of the term "legislative rule," which accurately encompasses the binding and coercive nature of such agency action, regardless of how it might be styled. Section 2(b) also adopts clear rules for how Commission actions must be undertaken and prohibits improper attempts at evading more formal rulemaking procedures.

The proposed rule also fixes the gaps in those other policy statements. First, and most significantly, as a final rule, the proposed rule is binding and may not be rescinded at will. Section 2(a) directs that the Commission may not bypass formal procedures when issuing legislative rules. Section 2(b) further sets out mandatory requirements for informal Commission action. Section 2(c) also forbids improper coercive action. To that end, this section prohibits the Commission from considering a party's decision to abstain from non-binding suggestions in guidance as somehow constituting evidence of a violation of an actual legal obligation, or as a basis for instituting an enforcement action. Section 2(d) prohibits the Commission from applying any agency's legislative rules that do not conform to 5 U.S.C. § 553. Finally, Section 2(e) prohibits the Commission from defending the validity of improper agency guidance, whether or not it was promulgated within the Commission. These requirements are binding on the covered entities.

Critically, this proposed rule also creates a means to enforce these requirements, which applies to both new rules and those already in existence. Section 3 empowers interested parties to alert the Commission to improper action, whenever issued, and allows the Commission to rescind such action without complication. This provision efficiently allows those most affected by agency action to share their institutional knowledge with the agency, and it also allows the agency to correct improper actions efficiently.

But if this voluntary process falls short, Section 3 also allows an interested person the opportunity to petition for judicial review. If the Commission believes that its action is appropriate under this rule, it need only say so pursuant to Section 3(d), and explain why its action does not constitute improper legislative rulemaking. Sections 3(d), (e), (f) and (h) set out a process by which a court may decide this legal issue on the merits. Sections 3(g) and (h) also resolve the difficult finality question that commonly allows improper legislative rulemaking to evade judicial oversight. Section 3(g) designates the Commission's decision on a petition for review as final, thus establishing a concrete cause of action. Section 3(h), meanwhile, resolves the problem that may exist when agency action is improperly binding, but nevertheless evades review because it is not yet final, by deeming any binding action necessarily one that is also final.

VI. Conclusion

Americans should never be "at the mercy" of the whims of administrative agencies, set out in extralegal and extortionate "guidance" for approved behavior. Hamburger, *supra*, at 260. Purportedly binding rules masquerading as guidance are unlawful and unconstitutional and are among the very worst threats to liberty perpetrated by the administrative state. The Commodity Futures Trading Commission should enact clear rules that respect the limits set by the

Constitution, the APA, and all other statutes applicable to the CFTC regarding procedures for promulgating substantive, legislative rules. The Commission should therefore prohibit the issuance, reliance on, or defense of improper agency guidance, and promulgate the proposed rule set out in this Petition.

Sincerely,
Margaret Little
Margaret A. Little
Senior Litigation Counsel

Mark Chenoweth
General Counsel

New Civil Liberties Alliance
1225 19th Street, NW, Suite 450
Washington, DC 20036
peggy.little@ncla.legal
(202) 869-5210

July 18, 2019

The Secretariat
JUL 18 2019
Received

New Civil Liberties Alliance

July 18, 2017

Via Hand Delivery

Heath P. Tarbert
Chairman
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Brian D. Quintenz
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Rostin Behnam
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Dawn DuBerry Stump
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Christopher Kirkpatrick
Secretary
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Daniel J. Davis
General Counsel
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Dan M. Berkovitz
Commissioner
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

In re: *CFTC Rule Imposing Speech Restraints in Consent Orders*
Petition to Amend 17 C.F.R. Appendix A, Part 10

Dear Chairman Tarbert, Commissioners Quintenz, Behnam, Stump and Berkovitz, and Messrs. Kirkpatrick and Davis,

Please find enclosed a Petition to Amend 17 C.F.R. Appendix A, Part 10 filed today by the New Civil Liberties Alliance ("NCLA").

This rule violates the First Amendment under a variety of doctrines as set forth more fully in our Petition. In addition, because it was put into place without prior publication, notice and comment, its enactment violated the Administrative Procedure Act. NCLA's proposed rule, which would be promulgated under notice-and-comment rulemaking, remedies both the legal and constitutional violations that afflict the CFTC rule.

We would be delighted to meet with you to discuss any questions you may have with respect to this Petition.

Very truly yours,

/s/Peggy Little

Margaret A. Little
Senior Litigation Counsel

cc: Philip Hamburger, President, NCLA
Mark Chenoweth, Executive Director and General Counsel, NCLA

UNITED STATES COMMODITY FUTURES TRADING COMMISSION

The Secretariat
JUL 18 2019
Received

In re: CFTC Rule Imposing Speech)
Restraints in Consent Orders)
17 C.F.R. APPENDIX A to PART 10—)
Commission Policy)
Relating to the Acceptance of Settlements in)
Administrative and Civil Proceedings)

PETITION TO AMEND

Margaret A. Little
Mark Chenoweth
NEW CIVIL LIBERTIES ALLIANCE
1225 19th Street NW
Suite 450
Washington, DC 20036
(202) 869-5212
peggy.little@ncla.legal

Counsel for Petitioner New Civil Liberties Alliance
July 18, 2019

TABLE OF CONTENTS

INTRODUCTION 1

BACKGROUND 3

I. THE RULE RESTRAINING SPEECH 3

A. The Rule and Its Enactment 3

B. A Brief History of the Rule and Its Shifting Policy Justifications 4

C. The Rule as Applied in Consent Orders 5

D. NCLA's Modest Proposed Amendment to the Rule 7

II. THE NEW CIVIL LIBERTIES ALLIANCE'S INTEREST 7

ARGUMENT 9

I. CFTC'S GAG RULE VIOLATES FIRST AMENDMENT FREEDOMS OF SPEECH AND THE PRESS 9

A. The Gag Rule Is a Forbidden Prior Restraint 9

1. Prior Restraints Are Forbidden 9

2. The Gag Rule Is a Prior Restraint 10

B. The Gag Rule Is a Content-Based Restriction on Speech 11

1. The Gag Rule Mandates the Content of Speech 11

2. The Speech Ban Serves No Compelling Government Interest 12

3. The Gag Rule Is Anything but the Least Restrictive Means 15

C. The Gag Rule Prohibits Truthful Speech 17

D. The Gag Rule Silences Defendants in Perpetuity 18

E. The Gag Rule Is an Unconstitutional Condition 18

II. THE GAG RULE VIOLATES DUE PROCESS 21

A. The Gag Rule Is Unconstitutionally Vague 21

B. The Gag Rule Is Void as Against Public Policy 23

III. THE GAG RULE VIOLATES THE FIRST AMENDMENT RIGHT TO PETITION 24

IV. CFTC LACKED STATUTORY AUTHORITY TO ISSUE THE GAG RULE 25

A. Legal Background 25

B. None of the Statutes Cited by CFTC Gave It Authority to Issue the Gag Rule 26

C. CFTC Circumvented the APA's Requirement for Notice and Comment 27

V. THE GAG RULE IS BAD PUBLIC POLICY 28

A. The Rule Suppresses Information Critical to Agency Oversight 28

B. The Rule Implicates the Judiciary in Violating the Constitution and Law 31

C. The Rule Advances No Legitimate Public Policy 32

VI. THE PROPOSED AMENDED RULE 33

CONCLUSION 34

INTRODUCTION

Pursuant to the Administrative Procedure Act, 5 U.S.C. § 553(e), and 7 U.S.C. §2(a)(12) and Rule 13.2 of the U.S. Commodity Futures Trading Commission ("CFTC" or "Commission"), 17 C.F.R. § 13.2, the Petitioner New Civil Liberties Alliance ("NCLA") hereby petitions the Commission to amend its rule restricting speech that is set forth in 17 C.F.R. § Pt. 10, App. A ("the Gag Rule"). *See* Exhibit A. The Rule is unconstitutional, without legal authority, and represents ill-conceived policy.

CFTC's Gag Rule adopts a policy that will not "accept any offer of settlement submitted by any respondent or defendant in an administrative or civil proceeding, if [they wish] to continue to deny the allegations of the complaint or the findings of fact or conclusions of law to be made in the settlement order . . . . The Commission does not believe that it would be appropriate for it to be making or inviting a court to make such uncontested findings of violations ... [against a party who] is continuing to deny the alleged misconduct." 17 C.F.R. § Pt. 10, App. A. The CFTC Gag Rule further demands: "The refusal of a settling respondent or defendant to admit the allegations in a Commission-instituted complaint or the findings of fact or conclusions of law in the settlement order entered by the Commission or a court shall be treated as a denial, unless the party states that he or she neither admits nor denies the allegations or the findings and conclusions. In that event, the proposed offer of settlement, consent or consent order must include a provision stating that, by neither admitting nor denying the allegations, findings or conclusions, the settling respondent or defendant agrees that neither he or she nor any of his or her agents or employees under his authority or control shall take any action or make any public statement denying, directly or indirectly, any allegation in the complaint or findings or conclusions in the order, or creating, or tending to create, the impression that the complaint or the order is without a factual basis." *Id.*[1] The enacting publication for this rule states that the purpose of the rule is to "make

[1] The full text of the Gag Rule appears at Exhibit A to this Petition.

clear that settling defendants and respondents cannot continue to deny either the allegations in the complaint or the findings of fact or conclusions of law in a settlement order that is entered by the Commission or a court." Rules of Practice; Final Rules; Correction, 64 FR 30,902 (June 9, 1999).[2]

Pursuant to this policy and Rule, the Commission has required persons or entities charged in judicial or administrative proceedings of an accusatory nature who enter into consents to agree *in perpetuity* not to take any action or to make or cause to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis. The CFTC Gag Rule binds defendants to silence permanently.

The Gag Rule on its face and as applied in perpetuity in Consent Orders fails to pass constitutional or legal muster under many doctrines:

It is a forbidden prior restraint.

It is a content-based restriction on speech.

The Gag Rule prohibits truthful speech.

The Gag Rule silences defendants in perpetuity.

It is an unconstitutional condition.

It not only serves no compelling public interest, it disserves the public interest.

It violates due process in that it is unconstitutionally vague and is against public policy.

It violates the First Amendment right to petition.

CFTC lacked authority to issue the Gag Rule.

The Rule directly infringes upon the First Amendment rights of Americans and works to conceal the operations of agency enforcement from the American people. *Congress* could not lawfully pass a *statute* that silenced defendants about their prosecutions—such a statute would be

[2] The enacting publication of the Gag Rule in the Federal Register appears as Exhibit B to this Petition.

held unconstitutional in short order. CFTC cannot accomplish through rule-making what the Constitution forbids to Congress.

"The loss of First Amendment freedoms, for even minimal periods of time, unquestionably constitutes irreparable injury." *Elrod v. Burns*, 427 U.S. 347, 373 (1976). Given this ongoing irreparable injury, Petitioner requests that the Commission review this petition to amend on an expedited basis.

The proposed amended rule, removing the offending language, appears alongside the original rule at Exhibit A to this Petition.

BACKGROUND

I. The Rule Restraining Speech

A. The Rule and Its Enactment

In 1998, the Commission announced a policy whereby the Commission "will not enter into a settlement if the defendant or respondent wishes to continue to deny the allegations in the complaint" because "[t]he Commission does not believe it would be appropriate for it to be making … uncontested findings of violations if the party against whom the findings and conclusions are to be entered is continuing to deny the alleged misconduct." Rules of Practice; Final Rules; Correction, 64 FR 30,902 (June 9, 1999) (Exhibit B); Rules of Practice; Proposed Amendments, 63 Fed. Reg. 16,453 (April 3, 1998); *See also* 17 C.F.R. § Pt. 10, App. A (Exhibit A).

Asserting that "the foregoing amendment relates only to a statement of agency policy, the Commission finds that there is no need to provide the public with an opportunity to submit comments" as specified in 5 U.S.C. 553(b)(A), CFTC announced that the amendment was "effective immediately." Rules of Practice; Final Rules; Correction, 64 Fed. R 30,902.

B. A Brief History of the Rule and Its Shifting Policy Justifications

The Securities and Exchange Commission (SEC) summarily adopted a similar rule in 1972 "principally out of concern that defendants and respondents were entering into consent decrees and then publicly denying that they had done anything wrong or violated any law or regulation":

> Defendants and respondents would claim that there was no basis for the enforcement action and that they were settling the matter only to avoid the expense and hassle of litigation brought upon by an over-zealous, over-bearing and very powerful government agency. The ... policy reflected a concern that the public might buy in to this narrative and conclude that the SEC was acting arbitrarily, or worse unlawfully, which would undermine the agency's integrity and compromise its ability to protect the investing public. The purpose of the policy, in other words, *was to avoid the perception that the SEC had entered into a settlement when there was not in fact a violation.*

D. Rosenfeld, *Admissions in SEC Enforcement Cases: The Revolution that Wasn't*, 103 Iowa L. Rev. 113, 118-119 (2017) (Emphasis added, footnotes omitted), citing *SEC v. Vitesse Semiconductor Corp.*, 771 F. Supp. 2d 304, 308 (S.D.N.Y. 2011) (describing the policy's origins).

Then, "[i]n the wake of the financial crisis of 2008" and blistering judicial criticism of the rule's application to post-2008 settlements, the SEC's original concern ... gave way to a new concern that the public might believe that the agency was acting collusively with wrongdoers and allowing them to escape serious punishment with a slap on the wrist." *Id.* at 120. (footnote omitted).

In June 2013, in a major change, the SEC announced a policy that it would begin to require admissions from settling defendants. "The change was a reaction to stinging criticism that the agency was willing to sweep wrongdoing under the rug, or even worse, that it was acting collusively with wrongdoers." *Id.* at 114.

Similarly, many CFTC orders require admissions from settling defendants. *See, e.g.*, Order Instituting Proceedings Pursuant to Section 6(c) and (d) of the Commodity Exchange Act, Making Findings, and Imposing Remedial Sanctions, *In re Krishna Mohan*, CFTC Docket No. 19-06 (Feb

25, 2016).[3] Thus, this new policy, rarely and inconsistently applied, has led to further criticism, discussed in Section V.

C. The Rule as Applied in Consent Orders

Typical consent agreements secured by CFTC include some or all of the following language:

> 10. Agrees that neither he nor any of his agents or employees under his authority or control shall take any action or make any public statement denying, directly or indirectly, any allegation in the amended Complaint or the Findings of Fact or Conclusions of Law in this Consent Order, or creating or tending to create the impression that the amended Complaint and/or this Consent Order is without a factual basis; provided, however, that nothing in this provision shall affect his: (a) testimonial obligations or (b) right to take legal positions in other proceedings to which the Commission is not a party. [Defendant] shall undertake all steps necessary to ensure that all of his agents and/or employees under his authority or control understand and comply with this agreement;
>
> 11. By consenting to the entry of this Consent Order, [Defendant] neither admits nor denies the allegations of the amended Complaint or the Findings of Fact and Conclusions of Law in this Consent Order, except as to jurisdiction and venue, which he admits. Further, [Defendant] agrees and intends that the allegations contained in the amended Complaint and all of the Findings of Fact and Conclusions of Law contained in this Consent Order shall be taken as true and correct and be given preclusive effect, without further proof, in the course of: (a) any current or subsequent bankruptcy proceeding filed by, on behalf of, or against [Defendant] as a debtor; (b) any proceeding pursuant to Section 8a of the Act, 7 U.S.C. § 12a (2012), and/or Part 3 of the Regulations, 17 C.F.R. §§ 3.1 -3.75 (2015); and/or (c) any proceeding to enforce the terms of this Consent Order. Defendant does not consent to the use of this Consent Order, or the Findings of Fact and Conclusions of Law in this Consent Order, as the sole basis for any other proceeding brought by the Commission.

Consent Order for Permanent Injunction, Civil Monetary Penalty, and Other Equitable Relief Against Defendant Jon S. Corzine, *In re MF Glob. Holdings Ltd. Inv. Litig.*, 998 F. Supp. 2d 157 (S.D.N.Y. 2014) (signed Jan. 4, 2017) (Hereinafter "CFTC Sample Consent Order") *available at*

[3] NCLA does not represent Krishna Mohan and has had no contact with him or his counsel in preparing this Petition to Amend. This example of a consent order was pulled from public sources.

https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcorzineorder010517.pdf [4]

The Gag Rule expressly permits defendants to enter into consents without "admitting nor denying the allegations, findings or conclusions." 17 C.F.R. § Pt. 10, App. A. At the same time, the Rule seeks not only to prohibit defendants from making any public statement denying, directly or indirectly, any allegation in the complaint or from creating the "impression" that the complaint is without factual basis, but it also threatens the penalty of a reopened enforcement action should a defendant call into question any of the allegations of the complaint—a power authorized neither by the rule nor by law. In certain circumstances, the Commission "can vitiate the settlement in the event that the respondent or defendant subsequently provides testimony that is inconsistent with the statements [and m]oreover, the Commission will continue to prohibit settling respondents and defendants from taking legal positions in proceedings to which the Commission is a party that would tend to deny the allegations of the complaint … or would tend to create the impression that the complaint or order is without a factual basis." See Exhibit B. In short, to secure a consent agreement, CFTC simultaneously assures defendants that they are not admitting or denying guilt yet promises to punish any who might later create the impression of denying any part of the complaint against them with a reopened civil enforcement proceeding. To put it another way, what CFTC giveth with one hand, it taketh away with a gloved fist.

Judge Jed Rakoff, in *Vitesse Semiconductor Corp.*, took a hard look at the similar internally contradictory provisions of SEC's "standard" consent judgments and concluded:

> The result is a stew of confusion and hypocrisy unworthy of such a proud agency as the S.E.C. The defendant is free to proclaim that he has never remotely admitted the terrible wrongs alleged by the S.E.C.; but, by gosh, he had better be careful not to deny them either … here an agency of the United States is saying, in effect, "Although we claim that these defendants have done terrible things, they refuse to admit it and we do not propose to

[4] NCLA does not represent Jon S. Corzine and has had no contact with him or his counsel in preparing this Petition to Amend. This example of a consent order was pulled from public sources.

> prove it, but will simply resort to gagging their right to deny it." The disservice to the public inherent in such a practice is palpable.

771 F. Supp. 2d at 309.

D. NCLA's Modest Proposed Amendment to the Rule

Appellate courts have recognized that the no-admit-no-deny agreements are essential tools of settling civil enforcement proceedings; "requiring [] an admission [of culpability] would in most cases undermine any chance for compromise" with corporate defendants who face additional exposure from private lawsuits. *S.E.C. v. Citigroup Glob. Markets Inc.*, 673 F.3d 158, 165 (2d Cir. 2012). The amendment this Petition proposes, set forth in Section VI. below, would still allow parties to *consensually* agree to admit, deny or to neither-admit-nor-deny specific allegations in the complaint or order. It would merely end CFTC's requirement of a sweeping—and unconstitutional—prior restraint in perpetuity as a condition of settlement

II. THE NEW CIVIL LIBERTIES ALLIANCE'S INTEREST

The New Civil Liberties Alliance is a nonprofit civil rights organization founded to defend constitutional rights through original litigation, *amicus curiae* briefs, and other means. The "civil liberties" of the organization's name include rights at least as old as the U.S. Constitution itself, such as free speech, right to petition, jury trial, due process of law, the right to live under laws made by the nation's elected lawmakers rather than by prosecutors or bureaucrats, and the right to be tried in front of an impartial and independent judge whenever the government brings cases against private parties.

NCLA defends civil liberties primarily by asserting constitutional constraints on the administrative state. Although Americans still enjoy the shell of their Republic, there has developed within it a very different sort of government—a type that the Constitution was framed to prevent. This unconstitutional administrative state that has developed within the United States violates more rights of more Americans than any other aspect of American law, and it is therefore the focus of NCLA's efforts.

NCLA encourages agencies themselves to curb the unlawful exercise of administrative power. The courts are not the only government bodies with the duty to attend to the law. Even more immediately, agencies and agency heads have a duty to follow the law, not least by avoiding unlawful modes of governance. NCLA therefore advises that all agencies and agency heads must examine whether their modes of rulemaking, adjudication, and/or enforcement comply with the APA and with the Constitution. In this case, NCLA respectfully suggests that CFTC amend the Gag Rule, 17 C.F.R. § Pt. 10, App. A, for the reasons set forth below.

NCLA also brings this Petition to Amend, because defendants are justifiably afraid to challenge the Gag Rule in litigation, lest they incur the displeasure of the agency and suffer on that account. That understandable concern is present during the original proceedings when a defendant hoping to settle is presented with CFTC's non-negotiable "policy of the Commission not to accept any offer of settlement submitted by any respondent or defendant in an administrative or civil proceeding, if the settling respondent or defendant wishes to continue to deny the allegations of the complaint." *Id.* That fear is only heightened thereafter when the non-negotiable language of the consent order provides that if a defendant or respondent *ever* takes any action or makes or permits to be made "any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis" or speaks in any way that CFTC construes as a denial, or gives the impression of a denial, the settlement can be vacated and CFTC can petition to restore adversarial proceedings against that defendant or respondent to an active docket.

NCLA is an "interested" party concerning the proposed amendment, *see* 5 U.S.C. § 553(e), and petitions for amendment of the Gag Rule pursuant to 17 C.F.R. § 13.2.

ARGUMENT

I. CFTC's Gag Rule Violates First Amendment Freedoms of Speech and the Press

CFTC's Gag Rule violates the freedoms of speech and the press in several ways.

A. The Gag Rule Is a Forbidden Prior Restraint

1. Prior Restraints Are Forbidden

Prior restraints on speech and publication "are the most serious and the least tolerable infringement on First Amendment rights." *Neb. Press Ass'n v. Stuart*, 427 U.S. 539, 559 (1976). "A prior restraint … has an immediate and irreversible sanction," "[while] a threat of criminal or civil sanctions after publication 'chills' speech, prior restraint 'freezes it,'" and it is therefore presumptively impermissible. *Id.* at 559. An injunction against future expression issued because of prior acts is incompatible with the First Amendment. *Gayety Theatres, Inc. v. City of Miami*, 719 F.2d 1550, 1551–52 (11th Cir. 1983).

There are "two evils" that will not be tolerated in such schemes. *FW/PBS, Inc. v. City of Dallas*, 493 U.S. 215, 225 (1990), *holding modified by City of Littleton, Colo. v. Z.J. Gifts D-4, L.L.C.*, 541 U.S. 774 (2004). First, no system of prior restraint may place "'unbridled discretion in the hands of a government official or agency'" to determine what speech may be uttered. *Id.* at 225 (quoting *City of Lakewood v. Plain Dealer Pub. Co.*, 486 U.S. 750, 757 (1988)). Second, "a prior restraint that fails to place limits on the time within which the decisionmaker must issue the license is impermissible." *Id.* at 226. The Gag Rule perpetrates both "evils." It gives unfettered discretion to CFTC to decide if the speech could be construed as a denial or giving the impression of a denial, and it has no time limits at all.

A "predetermined judicial determination restraining specified expression" that is judicial in origin, that suppresses speech, punishable by contempt or other court sanction that seeks by judicial order to preclude a litigant from challenging its constitutionality, is unconstitutional. *City* *of Lakewood v. Plain Dealer Pub. Co.*, 486 U.S. 750, 757 (1988). A "free society prefers to punish the few who abuse rights of speech after they break the law than to throttle them and all others beforehand." *Southeastern Promotions, Ltd. v. Conrad*, 420 U.S. 546, 559 (1975); *Bernard*, 619 F. 2d at 469. Such "[p]rior restraints fall on speech with a brutality and a finality all their own. Even if they are ultimately lifted, they cause irremediable loss, a loss in the immediacy, the impact of speech." *Id.* at 469 (quoting A. Bickel, *The Morality of Consent* 61 (1975)).

2. The Gag Rule Is a Prior Restraint

The Gag Rule unlawfully enacts a speech licensing scheme whereby a defendant is permanently forbidden from contesting *all* allegations in the Commission's complaint, regardless of their accuracy and regardless of the truth of the forbidden speech, on pains of reopened and renewed prosecution. The First Amendment does not allow such a policy.

First, the Gag Rule requires defendants to enter unlawful consent decrees to settle any case brought by the Commission. As a condition of settlement, the rule requires any defendant to agree to be forever barred from "denying the allegations in the complaint or order for proceedings." This language puts the defendant in the position of authorizing future judicial proceedings against him if he speaks—irrespective of the truth of his utterance—a form of censorship that the Supreme Court held unconstitutional in *Near v. State of Minn. ex rel. Olson*, 283 U.S. 697, 716 (1931). In *Near*, a publisher, because of past conduct, was subjected to active state intervention that controlled his future speech. Such state intervention is a prior restraint because it embodies "the essence of censorship." *Id.* at 713. The First Circuit similarly recently invalidated a judicially imposed order prohibiting future speech, even when past conduct suggested that future defamatory conduct was likely to continue. *Sindi v. El-Moslimany*, 896 F.3d 1, 21-22 (1st Cir. 2018). Simply put, the Constitution forbids the kind of censorship the Gag Rule enforces.

That the defendant or respondent has "consented" to the ban on his future speech by entering into a consent decree does not make the practice lawful. In *Crosby v. Bradstreet Co.*, 312

F.2d 483, 485 (2d Cir. 1963), the court voided a consent order which bound a defendant from publishing matter about the plaintiff in the future. The Second Circuit held that such a prior restraint that prohibits a defendant by court order from publishing material in the future, even when entered on consent, is void:

> Such an injunction, enforceable through the contempt power, constitutes a prior restraint by the United States against the publication of facts which the community has a right to know and which Dun & Bradstreet had and has the right to publish. The court was without power to make such an order; that the parties may have agreed to it is immaterial.

Id.

This constitutional infirmity with gag orders was recognized by Judge Rakoff reviewing an SEC Consent Order, who noted: "On its face, the SEC's no-denial policy raises a potential First Amendment problem." *S.E.C. v. Citigroup Glob. Markets Inc.*, 827 F. Supp. 2d 328, 333 n. 5 (S.D.N.Y. 2011), *vacated and remanded on other grounds*, 752 F.3d 285 (2d Cir. 2014). Citing *Crosby*, 312 F.2d at 485, Judge Rakoff noted that law in the Second Circuit provides for reversing a consent settlement between two parties because the "injunction, enforceable through the contempt power, constitute[d] a prior restraint by the United States against the publication of facts which the community has a right to know." *Id.* at 333 n.5.

B. The Gag Rule Is a Content-Based Restriction on Speech

1. The Gag Rule Mandates the Content of Speech

Even if considered merely a post-publication restraint, the Gag Rule is an unconstitutional content-based restriction. The gag order regulates the content of speech because it mandates views about the content of the complaint that led to the consent agreement and because it threatens penalties if a defendant creates even an impression of a forbidden view of the complaint. Such restrictions are "presumptively invalid" and subject to the highest level of judicial scrutiny. *R.A.V. v. City of St. Paul, Minn.*, 505 U.S. 377, 382 (1992). *Sorrell v. IMS Health Inc.*, 564 U.S. 552 (2011), held that "heightened judicial scrutiny is warranted" any time a "content-based burden" is placed "on protected expression." 564 U.S. at 565. As an example, under the "Son of Sam" laws—which seek to prohibit criminals from profiting from accounts of their crimes—courts have held that the content of the publication may not be restrained. *See Simon & Schuster, Inc. v. Members of New York State Crime Victims Bd.*, 502 U.S. 105, 118 (1991) ("The Son of Sam law establishes a financial disincentive to create or publish works with a particular content. To justify such differential treatment, 'the State must show that its regulation is necessary to serve a compelling state interest and is narrowly drawn to achieve that end.'") (quoting *Arkansas Writers' Project v. Ragland*, 481 U.S. 221, 231 (1987)).

If murderers are free to publish books about their crimes and their prosecutions—as they must be in a free society—*a fortiori*, CFTC targets ought to be free to publish books and speak the truth about the enforcement proceedings brought against them.

2. The Speech Ban Serves No Compelling Government Interest

To pass constitutional muster, speech bans must be narrowly tailored and serve a compelling government interest by the least restrictive means. *United States v. Playboy Entm't Group*, 529 U.S. 803, 813 (2000); *Burk v. Augusta-Richmond County*, 365 F.3d 1247, 1255 (11th Cir. 2004).

As noted above, the initial Gag Rule was enacted in 1998 because "[t]he Commission does not believe it would be appropriate for it to be making ... uncontested findings of violations if the party against whom the findings and conclusions are to be entered is continuing to deny the alleged misconduct." Rules of Practice; Final Rules; Correction, 64 FR 30,902 (June 9, 1999) (Exhibit B); Rules of Practice; Proposed Amendments, 63 Fed. Reg. 16,453 (April 3, 1998); *See also* 17 C.F.R. § Pt. 10, App. A (Exhibit A). SEC's similar Gag Rule was enacted in 1972 "to avoid the perception that [the government] had entered into a settlement when there was not in fact a violation" of the securities laws. D. Rosenfeld, *supra*, p. 3 at 119-120.

The 2008 financial crisis gave rise "to a new concern that the public might believe that the agency was acting collusively with wrongdoers and allowing them to escape serious punishment." *Ibid.*[5] Judge Rakoff memorably articulated this latter concern about agency collusion in *Securities and Exchange Commission v. Bank of America Corporation*, 653 F. Supp. 2d 507, 508-12 (S.D.N.Y. 2009):

> The proposed Consent Judgment in this case suggests a rather cynical relationship between the parties: the S.E.C. gets to claim that it is exposing wrongdoing on the part of the Bank of America in a high-profile merger; the Bank's management gets to claim that they have been coerced into an onerous settlement by overzealous regulators. And all this is done at the expense, not only of the shareholders, but also of the truth.

Neither policy justification for the enactment or enforcement of the rule is a legitimate basis for exacting silence from CFTC targets, let alone a compelling one. Whether CFTC is being overaggressive in its charges or is underenforcing the laws while colluding with its targets at taxpayer expense, purchasing settlements at the price of eternal silence from defendants ill-serves public understanding of the agency and its workings.

In fact, it is hard to imagine a policy better designed to suppress truth about these important matters than the Gag Rule. Securities law professor John Coffee describes these consent settlements as an "artifact": Financial regulatory agencies are "premised on the idea that sunlight is the best disinfectant, and a nontransparent settlement harms the [agency]'s reputation." Z. Goldfarb, *SEC may require more details of wrongdoing to be disclosed in settlements*, WASH. POST, Apr. 1, 2010.

[5] Indeed, Judge Jed Rakoff's influential critiques of the Rule have consistently echoed both concerns. His refusal to approve a consent judgment in one case in part because it contained no admissions of wrongdoing and therefore did not get to the "truth," expressed concerns about the public perception of letting defendants off lightly, or even SEC collusion. *SEC v. Bank of Am. Corp.*, 653 F. Supp. 2d 507, 512 (S.D.N.Y 2009). At the same time, Judge Rakoff has acknowledged that SEC was also likely bringing actions that lacked merit: "Another possibility ... is that no fraud was committed. This possibility should not be discounted." Hon. Jed S. Rakoff, "Why Have No High-Level Executives Been Prosecuted in Connection with the Financial Crisis?" SPEECH, in Corporate Crime Reporter, (Nov. 12, 2013).

If CFTC in 1998 was obtaining settlements when there had been no violation of the securities laws, *it is important for the American public to know that.* By the same token, if CFTC is letting powerful defendants off lightly, or even entering into collusive deals, *it is equally important to shed light on those practices.* The government is institutionally highly unlikely to admit to either practice. Silencing the only other parties to the arrangements with a government enforced muzzle allows the government to act with impunity.

The government has no compelling interest in suppressing speech or suppressing complaints about government regulation and enforcement. The fact that CFTC *systematically* imposes gag orders as a condition of all or nearly all its settlements is profoundly dangerous. Such a practice prevents the public, Congress, courts and policymakers from learning the specifics of how CFTC conducts its enforcement actions. Shielding such an important exercise of government power from oversight and scrutiny prevents lawmakers from knowing when to rein in or unleash CFTC authority and engage in course correction.

By systematically silencing all defendants, the Gag Rule insulates CFTC from criticism by the very people best placed and motivated to expose wrongdoing, over-aggressive prosecutions and/or flawed enforcement policies or practices. Such a restriction "operates to insulate … [government laws] from constitutional scrutiny and … other legal challenges, a condition implicating central First Amendment concerns." *Legal Services v. Velazquez*, 531 U.S. 533, 547 (2001).

In *Overbey v. Mayor and City Council of Baltimore*, No. 17-244, (July 11, 2019), the Fourth Circuit recently held that the City of Baltimore's settlement policy that required a gag order "was contrary to the public's well-established First Amendment interest in 'uninhibited, robust, and wide-open' debate on 'public issues,'" slip op. at 12, that the settling party's First Amendment rights were unwaivable and that the gag order was "unenforceable and void." Slip op. at 8.

Furthermore, the interests protected by the First Amendment are not only the right of the speaker to free expression, but also the right of those *hearing* him to receive information unfettered by any government constraints. As one court stated, "these settlements do not always take adequate account of another interest ordinarily at stake as well: that of the public and its interest in knowing the truth in matters of major public concern." *U.S. Securities and Exchange Comm'n v. CR Intrinsic Investors*, 939 F. Supp. 2d. 431, 443 (S.D.N.Y. 2013) (Marrero, J.). In a 2017 article, Judge Rakoff repeated these concerns: A complaint "which largely consists of unproven allegations" suggests that "very serious misconduct is being alleged [and]… [t]he public … has an obvious interest in knowing whether such serious allegations made by a government agency are true or untrue." That article argues that the "predominance" of the rule utilized by both the SEC and CFTC that this petition seeks to amend,

> in addition to impeding transparency and accountability—also means that wrongly accused parties are incentivized not to prove their innocence if they can get a cheap settlement without admitting anything. By the same token, the SEC can avoid having to litigate questionable cases by the simple expedient of offering a cheap settlement. And to make matters worse, the SEC hides the flimsiness of such cases from the public by imposing a "gag" order that prohibits the settling defendants from contesting the SEC's allegations in the media.

Hon. Jed S. Rakoff, AGAINST: Neither admit nor deny, *Compliance Week*, Sept. 6, 2017.

3. The Gag Rule Is Anything but the Least Restrictive Means

The Gag Rule's sweeping and perpetual speech restriction is far from the least restrictive means of achieving any compelling interest the government may claim. If CFTC believes specific allegations of the complaint or order should be admitted by the defendant, those specific admissions, with the opportunity provided to defendants to truthfully qualify them, can always be negotiated as part of the settlement. As a practical matter, a defendant proclaiming innocence after paying a significant monetary sanction is unlikely to be deemed credible by anyone; the severe industry bans, harsh fines and other penalties imposed by CFTC carry heavy deterrence value and already work to discredit defendants. Furthermore, if, after settling with CFTC, a defendant can show that some or all of the claims brought against him were excessive, or based on legally dubious theories, or simply were not true, that defendant should be free to speak—and the public to learn about it—without the defendant risking renewed prosecution. If a settling party asserts his innocence untruthfully, CFTC need only issue a press release to the contrary, a remedy far preferable and less restrictive than the lifetime ban on the defendant's speech procured under the government's boot and enforced by the threat of renewed prosecution.

As the Second Circuit acknowledged, neither-admit-nor-deny settlements are not about truth, but "are primarily about pragmatism." *Citigroup*, 752 F. 3d. at 296. Given these obvious and judicially acknowledged concerns, a gag order permits an agency that may have overreached or undercharged to do so with impunity—such that no one will be the wiser. There is no possible public interest served by silence on such questions. The relative guilt or innocence of persons prosecuted by government officials requires the utmost transparency and vigilant and enduring scrutiny.

These policy concerns are especially vital, where, as here, one of the parties to the contract is a government agency acting not under a law of Congress but under a rule written and enacted by unelected bureaucrats shielding their own activity from public view.

The Gag Rule is unlimited in time and restricts speech based on its content. It serves no compelling government interest. It conflicts with the important public interest in transparency and agency oversight. And it does all of these things by the most restrictive, unnecessary, and unconstitutional means.

"If the First Amendment means anything, it means that regulating speech must be a last—not first—resort. *Thompson v. Western States Med. Ctr.*, 535 U.S. 357, 373 (2002). CFTC can offer no compelling—or even defensible—state interest in silencing the targets of its administrative proceedings. The First Amendment's core concern with government transparency and the free flow of information about how our government works argues entirely against any rules restraining speech in this context. Thus, both settled constitutional principles and fundamental policy interests forbid gag orders.

C. The Gag Rule Prohibits Truthful Speech

The Rule is also unconstitutional because it forbids true speech just the same as it does false speech. The CFTC's Gag Rule ends with a provision that "lifts" the gag order—and its substantive commands about admissions and denials:

> provided, however, that nothing in this provision shall affect the settling respondent's or defendant's —
>
> i. Testimonial obligation, or
>
> ii. Right to take legal positions in other proceedings to which the Commission is not a party.

17 C.F.R. Appendix A to Part 10 (Exhibit A to this Petition.)

CFTC's "lift" of the speech ban in its consent decrees for later testimonial or other legal proceedings is a tacit concession that the gag order *must* contain an exception where it conflicts with a defendant's obligation to speak the truth under oath. This telling exception is fatal to any defense of the Gag Rule by the Commission because it concedes that defendants' obligations to tell the truth under oath may be at odds with CFTC's "You must admit all allegations; you may deny nothing" diktat. This exception would not be necessary unless CFTC knows that the gag policy otherwise leads to false impressions or even perjury. The 1999 enacting publication expressly admits this: "Appendix A effectively requires an agreement by a settling respondent or defendant not to give testimony in a Commission proceeding that would tend to deny any allegation in the complaint or create an impression that the complaint lacks a factual basis. This restriction has the potential to conflict with the legal obligation of a respondent or defendant to testify truthfully." See Exhibit B to this Petition.

CFTC's self-favoring exemption from the exception—"in which the Commission is not a party"—also disturbingly places CFTC's thumb on the scales of justice in any subsequent proceeding in which the Commission is a party.

The Gag Rule itself creates the false impression that every fact in the complaint or order is accurate, when that is seldom, if ever, the case. Complaints, as noted by Judge Rakoff, consist "largely ... of unproven allegations." Rakoff, AGAINST: Neither admit nor deny, *Compliance Week,* supra, p. 1. Thus, CFTC's original justification for the Gag Rule argues *against* having a rule that gives the false impression that the complaint is completely true.

This "lift" of the ban in testimonial situations appears to be a strategic exception designed to avoid a gag order's coming to the attention of a judge in subsequent judicial proceedings who might well invalidate such a disturbing and unconstitutional speech ban unheard of in normal state or federal judicial settlements or consent decrees.

In any event, this exception is much too parsimonious. The government does not get to decide *when* defendants may speak the truth by carving out a caveat calculated to shield the ban from scrutiny in subsequent judicial or testimonial proceedings while otherwise silencing defendants for life. The statement of the proposition suffices to expose its raw unconstitutionality.

D. The Gag Rule Silences Defendants in Perpetuity

The Gag Rule never expires. The ban is longer even than a criminal sentence would be for the charged violation. The Gag Rule requires a defendant to enter a consent decree that prevents speech forever and without end—a perpetual restriction that cannot be justified under any constitutional precedent. *See FW/PBS, Inc.*, 493 U.S. at 226-7.

E. The Gag Rule Is an Unconstitutional Condition

In *Legal Services v. Velazquez*, 531 U.S. 533 (2001), the Supreme Court held that Congress could not condition aid to public defenders to prohibit them from giving advice or making arguments about the lawfulness or constitutionality of welfare laws. *Velazquez* ruled that Congress is not permitted to restrict the expression of attorneys in courts, as this would be an unconstitutional "distort[ion] of the legal system." *Id.* at 543-44. Likewise, CFTC cannot condition a citizen's ability to settle with the government upon the surrender of his First Amendment rights with respect to the prosecution.

Koontz v. St. Johns River Water Management Dist., 570 U.S. 595 (2013) similarly held that "the government may not deny a benefit to a person because he exercises a constitutional right." *See also Rutan v. Republican Party of Ill.*, 497 U.S. 62, 78 (1990); *Frost & Frost Trucking Co. v. Railroad Comm'n of Cal.*, 271 U.S. 583, 592-593 (1926) (invalidating regulation that required the petitioner to give up a constitutional right "as a condition precedent to the enjoyment of a privilege"); *Southern Pacific Co. v. Denton*, 146 U.S. 202, 207 (1892) (invalidating statute "requiring the corporation, as a condition precedent to obtaining a permit to do business within the State, to surrender a right and privilege secured to it by the Constitution"). In *Perry v. Sindermann*, 408 U.S. 593 (1972), for example, the Court held that a public college would violate a professor's freedom of speech if it declined to renew his contract because he was an outspoken critic of the college's administration. *Accord Pickering v. Board of Ed.*, 391 U.S. 563 (1968). In *Board of Trustees Leland Stanford Jr. Univ. v. Sullivan*, 773 F. Supp. 472 (D.D.C. 1991), the court held that government withdrawal of a contract for a refusal to agree to confidentiality and prior governmental approval to publish was unconstitutional. As the *Koontz* court stated, these "cases reflect an overarching principle, known as the unconstitutional conditions doctrine, that vindicates the Constitution's enumerated rights by preventing the government from coercing people into giving them up." Moreover,

> regardless of whether the government ultimately succeeds in pressuring someone into forfeiting a constitutional right, the unconstitutional conditions doctrine forbids burdening the Constitution's enumerated rights by coercively withholding benefits from those who exercise them.

Koontz, 570 U.S. at 606.

CFTC gag orders require an agreement to not question the merits of the prosecution as a condition precedent to settlement. Further, they impose reopened prosecution as a penalty if a defendant subsequently speaks about his prosecution in a manner that CFTC construes as "creating, or tending to create, the impression that the complaint or the order is without a factual basis." 17 C.F.R. § Pt. 10, App. A. Both "conditions" are impermissible. The unconstitutional conditions doctrine applies regardless of whether the "condition" is a condition precedent or a condition subsequent to the settlement—both of which are presented by the unusual terms of CFTC gag orders, which coercively control defendants' speech in the making of the settlement and forever thereafter.[6] And as in *Velazquez*, the gag orders thus simultaneously abridge a defendant's freedom of speech and distort the legal system by cutting off an avenue of redress against agency abuses.

Nor does it make a difference that the government could have refused to settle at all with the CFTC target. Virtually all unconstitutional conditions cases involve an optional governmental action of some kind. *See, e.g.*, *Perry*, 408 U.S. 593 (non-tenured public employment). As Koontz holds, "we have repeatedly rejected the argument that if the government need not confer a benefit at all, it can withhold the benefit because someone refuses to give up constitutional rights." *E.g.*, *United States v. American Library Assn., Inc.*, 539 U.S. 194, 210 (2003) ("[T]he government may not deny a benefit to a person on a basis that infringes his constitutionally protected ... freedom of speech *even if he has no entitlement to that benefit.*" (emphasis added and

[6] The Supreme Court's "unconstitutional conditions cases have long refused to attach significance to the distinction between conditions precedent and conditions subsequent. *See Frost & Frost Trucking Co. v. Railroad Comm'n of Cal.*, 271 U.S. 583, 592-593 (1926) (invalidating regulation that required the petitioner to give up a constitutional right "upon the condition that it strip itself of ... protection given it by the Federal Constitution"); *Southern Pacific Co. v. Denton*, 146 U.S. 202, 207 (1892) (invalidating statute "requiring the corporation, as a condition precedent to obtaining a permit to do business within the State, to surrender a right and privilege secured to it by the Constitution"). *See also Town of Flower Mound v. Stafford Estates L. P.*, 135 S.W.3d 620, 639 (Texas 2004) ("The government cannot sidestep constitutional protections merely by rephrasing its decision from 'only if' to 'not unless'."). *Koontz*, at 607. The *Koontz* court held that to do so "would effectively render *Nollan* and *Dolan* a dead letter .... [a]s in other unconstitutional conditions cases in which someone refuses to cede a constitutional right in the face of coercive pressure, the impermissible denial of a governmental benefit is a constitutionally cognizable injury." *Koontz*, at 607.

internal quotation marks omitted)); *Wieman v. Updegraff*, 344 U.S. 183, 191 (1952) (explaining in unconstitutional conditions case that to focus on "the facile generalization that there is no constitutionally protected right to public employment is to obscure the issue.") Even if CFTC would have been entirely within its rights in refusing to settle, that greater authority does not imply a "lesser" power to condition the settlement upon defendant's forfeiture of his constitutional rights. *See Nollan v. California Coastal Commission*, 483 U.S. 825, 836-837 (1987). Just as Congress cannot condition its funding "lest the First Amendment be reduced to a simple semantic exercise," *Velazquez* at 547, CFTC cannot condition the benefit of a conclusively settled case on eternal silence by those it prosecutes about the merits of the case.

II. THE GAG RULE VIOLATES DUE PROCESS

A. The Gag Rule Is Unconstitutionally Vague

The Gag Rule is also unconstitutionally vague. It forces those who "enter into consents to agree not to take any action or to make or cause to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis"—a formulation that leaves a party speechless with respect to his prosecution and a reader unable to define any discernible limits in advance on what is prohibited. Such a broad, all-encompassing and impressionistic prohibition fails to provide clear notice of what speech is forbidden or to articulate any limits on the reach of the speech ban. A settling defendant had better stay mum altogether, rather than navigate at his peril what he can say about his own prosecution under the terms of the gag order. In *Connally* v. *General Constr. Co.*, 269 U.S. 385, 391 (1926), the Supreme Court recognized that a penal law "must be sufficiently explicit to inform those who are subject to it what conduct … will render them liable to its penalties … a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at [the law's] meaning and differ as to its application, violates the first essential of due process of law."

"A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012) (citing *Connally v. General Constr. Co.*, 269 U.S. 385, 391 (1926)). Rules that are "impermissibly vague" must be "invalidat[ed]" for failing to satisfy this "requirement of clarity[.]" *Id.* And "[w]hen speech is involved," it is particularly important "to ensure that ambiguity does not chill protected speech." *Id.* at 253-254. The Gag Rule has no limiting principle. The rule forbids a defendant from even creating "an *impression* that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur." 17 C.F.R. § Pt. 10, App. A. This wording places unlimited discretion in the hands of the Commission to decide what future speech is and is not permissible.

Persons who settle with CFTC should not be required to guess at the Rule's scope. "It is one thing to expect regulated parties to conform their conduct to an agency's interpretations once the agency announces them; it is quite another to require regulated parties to divine the agency's interpretations in advance or else be held liable" when the agency interprets it "for the first time in an enforcement proceeding and demands deference." *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 158-59 (2012); *see also Unity08 v. FEC*, 596 F.3d 861, 865 (D.C. Cir. 2010) ("Our reluctance to require parties to subject themselves to enforcement proceedings to challenge agency positions is at its peak where, as here, First Amendment rights are implicated and arguably chilled by a 'credible threat of prosecution.'"); *see also Brown v. Entm't Merchants Ass'n*, 564 U.S. 786, 807 (2011) (Alito, J., concurring) ("Vague laws force potential speakers to steer far wider of the unlawful zone … than if the boundaries of the forbidden areas were clearly marked.") (quotation marks omitted).

Given the breadth and lack of clarity as to the Rule's scope and the attendant chill of First Amendment activity, the Rule is unconstitutionally vague.

B. The Gag Rule Is Void as Against Public Policy

Consent decrees agreed upon by the parties as a compromise to litigation are treated by courts as contracts for enforcement purposes, *Segar v. Mukasey*, 508 F.3d 16, 21-22 (D.C. Cir. 2007), and accordingly "reliance upon certain aids to construction is proper, as with any other contract." *Id.* (citing *United States v. ITT Cont'l Baking Co.*, 420 U.S. 223, 238 (1975)). *See generally* James Valvo, *The CFTC and SEC Are Demanding Unconstitutional Speech Bans in Their Settlement Agreements*, NOTICE & COMMENT, A Blog from Yale J. Reg. and ABA Sec. of Admin. Law & Regulatory Practice, Dec. 4, 2017. When construing and enforcing contracts, courts will not enforce contractual provisions that are void because they violate public policy. *Fomby-Denson v. Dep't of the Army*, 247 F.3d 1366, 1377-78 (Fed. Cir. 2001) (Settlement agreement cannot silence defendant from making a truthful report about plaintiff to authorities.) Courts routinely disfavor unlimited waivers of rights in contracts, for example, refusing to enforce non-compete clauses as unreasonable and unenforceable if they do not contain a time limit. *See, e.g.*, *Diversified Fastening Sys., Inc. v. Rogge*, 786 F. Supp. 1486, 1492 (N.D. Iowa 1991) ("The failure to limit the time period and geographical restriction essentially make the [non-compete] contract one imposing a restrictive covenant of unlimited time and space. Such an unlimited covenant is clearly unreasonable and unenforceable.")

Further, the "consent" at issue here is procured by force in the inducement (it is a non-negotiable condition of settlement) and by force in the enforcement (via a threatened renewed prosecution when CFTC decides it can "vitiate" the settlement). Consequently, the purported consent is a fiction.

CFTC gag orders forbid all speech, even truthful speech by a settling defendant about the merits of his prosecution, and they are unlimited in time. They accordingly violate public policy and are unenforceable and invalid. *Accord Overbey*, *supra*, slip op at 8. (4th Cir. 2019).

III. THE GAG RULE VIOLATES THE FIRST AMENDMENT RIGHT TO PETITION

The First Amendment provides that "Congress shall make no law … abridging … the right of the people … to petition the Government for a redress of grievances." U.S. Const. amend. I. Its protections include the right of petition by defendants or corporations "with respect to the passage and enforcement of laws." *Eastern R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 138 (1961). The First Amendment 'was fashioned to assure unfettered interchange of ideas for the bringing about of political and social changes desired by the people.'" *N. Y. Times Co. v. Sullivan*, 376 U.S. 254, 269 (1964) (quoting *Roth v. United States*, 354 U.S. 476 (1957)). The Gag Rule offends our "profound national commitment to the principle that debate on public issues should be uninhibited, robust, and wide-open." *Snyder v. Phelps*, 562 U.S. 443, 452 (2011) (quotation marks omitted).

The CFTC rule restraining speech which NCLA seeks to amend prohibits targets of an agency enforcement action who settle from ever questioning the merits of the prosecution against them. But history is replete with compelling accounts of prosecutorial abuse of power, including prosecutors who deny their targets access to exculpatory evidence, who engage in misconduct, sharp practice or intimidation tactics that can and have brought defendants or respondents to their knees. The prospect of potentially ruinous costs, crippling time demands, and collateral damage mean that even innocent people may find settling with the government preferable to hazarding a full-fledged prosecution. Consent agreements may well represent either CFTC's failure to make a case when put to its burden of proof or a settling target's guilt—or some combination thereof. Any person who waves the white flag to end the process should not be forever silenced on the topic of his prosecution—*most especially not by the prosecutor!*

"Speech on matters of public concern is at the heart of the First Amendment's protection. *Snyder*, at 451-52 (quotation marks omitted). "That is because speech concerning public affairs is more than self-expression; it is the essence of self-government." *Id.* at 452. Thus, "speech on public issues occupies the highest rung of the hierarchy of First Amendment values and is entitled to special protection." *Id.*

When prosecutors abuse their considerable powers beyond lawful and/or ethical bounds, their targets should be free to tell that story and petition appropriate government bodies for change. When agencies regulate through enforcement, guidance or other legislatively unauthorized means, the persons affected should never be silenced by the regulator. Whether the standards of conduct governing Americans should be set prospectively by lawmakers or retroactively by bureaucrats is a matter of self-evident public concern. There are no better witnesses to testify before a legislative body and no better public advocates than the targets of regulatory (or prosecutorial) overreach. A healthy democratic republic should encourage such self-examination. A constitutional democratic republic requires it.

At bottom, the Gag Rule stifles informed public debate on these matters. It requires defendants to choose between surrendering their constitutional rights to speak freely and petition the government on the one hand and facing the potentially ruinous costs and risks of forgoing settlement with the Commission and contesting the proceedings to the bitter end on the other. Under the Rule, the only way for a defendant to settle an enforcement proceeding is to surrender forever his future First Amendment rights of speech and petition with respect to the government's prosecution of him. Thankfully, our Constitution does not permit that baleful bargain.

IV. CFTC Lacked Statutory Authority to Issue the Gag Rule

Quite apart from the constitutional objections discussed thus far, CFTC issued the Gag Rule without statutory authorization. It is therefore unlawful under the Administrative Procedure Act.

A. Legal Background

No agency has any inherent power to make law. Article I, § 1 of the U.S. Constitution vests "[a]ll legislative powers" in the Congress, and "the lawmaking function belongs to Congress … and may not be conveyed to another branch or entity." *Loving v. United States*, 517 U.S. 748, 758 (1996).

This is a constitutional barrier to an exercise of legislative power by an agency. Further, "an agency literally has no power to act ... unless and until Congress confers power upon it." *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986). Thus, even if an independent agency could constitutionally exercise the legislative power to write a Gag Rule, it cannot purport to bind anyone without congressional authorization, which is utterly lacking here.

B. None of the Statutes Cited by CFTC Gave It Authority to Issue the Gag Rule

The 1999 Federal Register entry announcing the enactment of this rule, claimed authority deriving from Pub. L. 93-463, sec. 101(a)(11), 88 Stat. 1391 and 7 U.S.C. 4a(j).[7] But those regulatory sections —each of which just empowers the agency to make internal housekeeping rules for its own administration—provide no authority whatsoever for agencies to impose a Gag Rule that binds third parties brought before them who decide to settle judicial or administrative proceedings. *None* of the statutes under which CFTC purported to act gave it authority to issue the Gag Rule. Further, CFTC's pronouncement in its enacting publication that "[b]ecause Appendix A constitutes a statement of agency policy, the Commission finds that there is no need to provide the public with an opportunity to submit comments before implementing the above changes ... the Commission has determined to make the changes to Appendix A effective immediately upon publication" is no more than a self-serving statement to justify an emboldened and secretive agency's quest to silence those it regulates through settlements. See Exhibit B.

Congress has not given CFTC—or anyone else, for that matter—any authority to impose additional restrictions on the constitutional rights of persons they prosecute, either in court or administratively. Nor is this surprising, as the First Amendment and the unconstitutional conditions doctrine would forbid it.

[7] Section 11 of the Act to Amend the Commodity Exchange Act of 1974 grants the Commission special powers "to promulgate such rules and regulations as it deems necessary to govern the operating procedures and conduct of the business of the Commission."

C. CFTC Circumvented the APA's Requirement for Notice and Comment

A Gag Rule, binding upon parties brought before CFTC in "any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature" is anything but a rule that "relates only to rules of agency organization, procedure and practice." An agency's *ad hoc* promulgation of a self-protective rule by which CFTC not only seeks to bind private parties with the force of law, but to silence them on the topic of their prosecution is a wholly illegitimate exercise of government power.

Not only does a fair reading of the authorizing statutes reveal that a Gag Rule binding upon third parties whom CFTC prosecutes does not possibly fall within their purview, but the APA would have required notice and comment with respect to CFTC's enactment of any such binding rule. CFTC's disingenuous assertion that publication, notice and comment were not required only strengthens the case for immediate amendment of the rule.

Given the "stinging criticism" of gag rules that has emerged in courts from federal judges and in law journals—*see* D. Rosenfeld, *supra*, p. 3 at 114 --it is fair to assume that a proposed rule giving the agency power to gag its targets as to how regulations have been enforced against them would attract vigorous negative comments if published for notice and comment. We have no record of such public objection here because CFTC chose to view this as a "housekeeping rule" that could bypass APA requirements.

The Gag Rule sets forth a policy that potentially binds anyone brought before the agency who makes the difficult decision to settle the case against them. Rules that bind persons outside the agency are not "housekeeping" rules. They require notice and comment and violate the APA when they are promulgated without it. In this instance, they also exceed any power Congress granted to CFTC in enabling statutes. Thus, in addition to the Gag Rule's fatal constitutional infirmities, it also is unlawful because it was made without statutory authority.

V. THE GAG RULE IS BAD PUBLIC POLICY

A. The Rule Suppresses Information Critical to Agency Oversight

Defendants who enter into plea deals with the Department of Justice are free to criticize any aspect of their prosecution, which is as it should be. Other federal agencies permit defendants to outright deny the government's allegations upon settlement.[8]

Not so with CFTC. The CFTC Gag Rule not only infringes defendants' First Amendment rights, but also shields agencies such as CFTC from public oversight and scrutiny. A defendant charged by an agency may be the single best informed and most well-situated critic of how the agency uses—or abuses—its power. For an agency—not Congress, but an agency—to enact a rule that ensures that anyone who settles an enforcement action will be permanently unable to speak about the process, means that administrative agencies can immunize themselves from criticism and scrutiny of their actions and render their uses of power "unaccountable" in a way a real Article III court would never be allowed to do. The Department of Justice does not presume to be able to issue such broad prior restraints on speech in its consent decrees and settlements. It is presumptuous and lawless for an independent agency to arrogate such powers through rulemaking.

Article III court orders do not require wholesale silence with respect to every allegation of the complaint. No self-respecting U.S. Attorney would dare to insert such a proposed gag order into his settlement agreement. Nor has Congress enacted a gag order statute empowering U.S. Attorneys to request such orders. If Congress should ever try, it would run head-on into the First Amendment's prohibition that "Congress shall make no law … abridging the freedom of speech."

[8] For example, *see In the Matter of Facebook, Inc.*, U.S. Federal Trade Comm'n Docket No. C-4365 (July 27, 2012; *U.S. v. Bank of America Corp., et al.*, No. 120361 (D.D.C. Apr. 4, 2012) (Department of Justice); *In the Matter of Morgan Stanley*, Docket No. 12-015-B-HC (April 2, 2012); *U.S. v. American Electric Power Serv. Corp.*, C.A. No. C2-99-1250 (S.D. Ohio Oct. 9, 2007) (Environmental Protection Agency); *F.D.I.C. v. Killinger et al.*, Docket No. 2:11-cv-00459-MJP, cited in G. Matsko, *SEC "Gag Orders": Does Settling in Silence Advance the Public Interest?*, Washington Legal Foundation Legal Backgrounder, Vol. 29 No. 6, March 28, 2014. *See also* DOJ Release, *Tennessee Fraud Settlement Announced* (July 13, 2011) (settling a civil fraud case for $220K where a defendant 'does not admit liability in the settlement') cited in Reckler & Denton, *Understanding Recent Changes to the SEC's "Neither Admit Nor Deny" Settlement Policy*, Corporate Governance Advisor, Vol. 20, No. 2 (2012).

See, e.g., *Nat'l Ass'n of Mfrs. v. SEC*, 800 F.3d 518, 522 (D.C. Cir. 2015). Agencies do not possess legislative powers denied by the Constitution to *Congress*.

The Gag Rule amounts to a permanent bar on all future speech by defendants or respondents with the temerity to call into question government enforcement actions against them. If a defendant or respondent publicly asserts something the government disagrees with, CFTC is free to issue its own statement, and the public can sort out the truth in the free marketplace of ideas. The government should never be in the business of silencing anyone, particularly persons against whom it has already brought the formidable powers of the state to bear.

One commentator has noted that such gag rules allow CFTC and SEC to pursue weak cases without public scrutiny of the practice: the agencies "'push[] the envelope at times, advancing aggressive and novel legal theories and versions of the facts that, if fully litigated, might not succeed.'" G. Matsko, n. 5 above.[9] Matsko also notes that although the "speech restrictions affect all civil enforcement defendants, they have an especially acute impact on smaller businesses and individuals who may not have the resources for a prolonged, expensive defense, and thus may have to forgo the fight even when frailties in the case might otherwise offer them a viable avenue of defense." *Id.* This insight that the rule falls harder on individuals was confirmed by an empirical study of settlements entered after SEC announced its policy in 2013 that it would require admissions to further public accountability. The data showed that settlements with admissions remained low, and while some admissions were secured in high-profile cases, nearly half of the admissions were in cases with low or no monetary sanctions. V. Winship and Jennifer K. Robbennolt, *Admitting Wrongdoing to the SEC; An Empirical Study of Admissions in SEC Settlements 2011-2017*, Corporate Civil Liability, Deterrence, Enforcement, Enforcement Policy, Sanctions, Securities and Exchange Commission (SEC), Securities Fraud, (NYU, Oct. 24, 2017).

[9] *See* S. Lynch & A. Viswanatha, *Weak trial witnesses hinder a more aggressive SEC*, Reuters, March 10, 2014 (SEC success rate at trial has declined to 58% and SEC explains that the pursuit of challenging cases was a factor.)

A second comprehensive empirical study found the inconsistent application of SEC's admissions policy to be "troubling," remarking that the "lack of clear standards, consistency, and transparency has undermined the fairness and effectiveness of the policy and has bred cynicism that the SEC may be using the threat of a required admission to extract higher penalties in settlements." D. Rosenfeld, *supra*, p. 3 at 117-18. That article sets forth examples where the SEC secured admissions from some defendants, whereas "perpetrators of [a] far more egregious scheme were allowed to settle … on a no-admit/no-deny basis." *Id.* at 155-57. The author, a former SEC lawyer, concluded that if such inconsistency and lack of transparency continue, "the policy should be reconsidered or abandoned altogether." *Id.* at 118. Yet another observer has noted that SEC's new insistence on admissions has led to situations where settling with the SEC could be worse than losing at trial, D. Fisher, *Why Settling With The SEC Can Be Worse Than Losing At Trial*, Forbes.com, Jan. 29, 2014, which no doubt helps explain why the post-2013 SEC policy of requiring admissions has proven such a practical and conceptual failure.

Consider a situation where a defendant may be able to secure a favorable settlement because a government witness had perjured himself or the prosecution was otherwise based on compromised evidence. That defendant should be able to freely call the tainted prosecution to public attention, to ask why CFTC didn't ferret out the perjury itself prior to bringing the prosecution, or question how the agency is selecting the cases it prosecutes. As it now stands, defendants who operate under the CFTC Gag Rule can only buy peace with their enforced silence.

Regulation by enforcement action —rather than statutory authority—is a recognized aspect of administrative agency abuse of power. One SEC Commissioner has described its particularly pernicious reach in the context of settled enforcement actions:

> The practice of attempting to stretch the law is a particular concern when it occurs in *settled* enforcement actions. Often, given the time and costs of enforcement investigations, it is easier for a private party just to settle than to litigate a matter. The private party likely is motivated by its own circumstances, rather than concern about whether the SEC is creating new

> legal precedent. However, the decision made by that party about whether to accede to … SEC's proposed order can have far-reaching effects. Settlements—whether appropriately or not—become precedent for future enforcement actions and are cited within and outside the Commission as a purported basis for the state of the law. Quite simply, a settlement negotiated by someone desperate to end an investigation that is disrupting or destroying her life should not form the basis on which the law applicable to others is based.

SEC Commissioner Hester M. Peirce, *The Why Behind the No*, Remarks at the 50th Annual Rocky Mountain Securities Conference, May 11, 2018 (emphasis added).

Similarly, when CFTC pushes beyond the bounds of its lawful authority and secures a settlement of a claim for which there was no fair notice of illegality, gagging the besieged target means that this form of regulation will have no check; no sunlight will expose it, and it will fester in the dark. It may also prevent adequate notice from reaching other potential targets.

B. The Rule Implicates the Judiciary in Violating the Constitution and Law

Agencies that settle charges with their targets are not just acting under their own power. They have harnessed the machinery of the state, whether a court or an administrative tribunal, and they thereby imperil the livelihood, resources and liberty of defendants. Consent decrees impose injunctive prohibitions and fines enforceable by judicial contempt power. Such applications of judicial power by administrative agencies are "inherently dangerous" as noted by Judge Rakoff and implicate a coordinate branch in the constitutional breach:

> The injunctive power of the judiciary is not a free-roving remedy to be invoked at the whim of a regulatory agency, even with the consent of the regulated. If its deployment does not rest on facts—cold, hard, solid facts, established either by admissions or by trials—it serves no lawful or moral purpose and is simply an engine of oppression ….
>
> [T]here is an overriding public interest in knowing the truth. In much of the world, propaganda reigns, and truth is confined to secretive, fearful whispers. Even in our nation, apologists for suppressing or obscuring the truth may always be found. But the S.E.C., of all agencies, has a duty, inherent in its statutory mission, to see that the truth emerges; and if it fails to do so, this Court must not, in the name of deference or convenience, grant judicial enforcement to the agency's contrivances.

SEC v. Citigroup Global Markets Inc., 827 F. Supp. 2d at 335 (footnotes omitted).

All judges, whether administrative or members of a coordinate branch, have a duty to follow the law of the land and should not be the enforcers of that which they know to be against the law, even though the parties themselves may have agreed to the conditions.

C. The Rule Advances No Legitimate Public Policy

CFTC's contrivance of a power to fashion a gag order out of App. A's "policy" works to suppress truth, oppress defendants, and insulate the agency from public understanding and criticism. It is hard to fathom any policy justification for such suppression of speech. CFTC's notorious industry bans, large monetary sanctions and broad injunctive relief transmit powerful messages to the public that operate to deter like misconduct. That deterrence will not be diminished by a defendant's exercise of free speech.

No matter how uncomfortable later criticism of the agency enforcement may be, if untrue, it is readily corrigible by agency statements. If true—if a target can make a persuasive case for innocence or over-prosecution after the fact—the value of the free flow of information far outweighs such illegitimate "policies" as bureaucratic discomfort with the appearance of over-reaching or underenforcement, which serves solely power's inherent aversion to criticism. Agencies do not have some special grant of power to shield themselves from public scrutiny, a power actual courts, prosecutors and legislatures all lack under well-established law. The Fourth Circuit just resoundingly reaffirmed these principles in *Overbey*.

The Gag Rule violates an impressive array of constitutional doctrines, including infringement of First Amendment Rights to freedom of speech and the press, the right to petition, prior restraint, compelled speech, void-for-vagueness, void as against public policy, and unconstitutional conditions. It also ignores statutory constraints on agency power and basic requirements of the APA. Any rule that racks up a list of constitutional and legal violations that lengthy compels the conclusion that some fundamental tenet of our constitutional republic has been violated by the offending provisions of the rule this Petition seeks to amend.

VI. The Proposed Amended Rule

NCLA's proposed amended rule, set forth below, removes the offending language used by CFTC in securing gag orders in its consents, and provides instead that defendants or respondents may admit, deny, or neither admit nor deny the allegations against them in any settlement with the agency:

> The Commission has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, a defendant or respondent may consent to a judgment or order in which he admits, denies, or states that he neither admits nor denies the allegations in the complaint or order for proceedings.

By providing for admissions, denials, or no-admit-no-deny for specific allegations of the charges against defendants, the proposed amended rule allows CFTC to bargain for admissions when it has a clear-cut case of specific wrongdoing, allows defendants to specifically deny erroneous or overreaching charges against them, and leaves intact the pragmatic no-admit-no-deny approach that the Second Circuit has recognized as a useful approach from all perspectives. This amended rule is designed to secure to all parties maximum freedom in negotiating fair, truthful and transparent settlements and to secure the blessings of liberty—including the free exercise of speech—forever after.

CONCLUSION

Because "[f]ragile First Amendment rights are often lost or prejudiced by delay," *Bernard v. Gulf Oil Co.*, 619 F.2d 459, 470 (5th Cir. 1980), NCLA requests prompt determination of this Petition to Amend the CFTC Rule under which the agency has been unconstitutionally silencing persons who enter into consents with CFTC. The Gag Rule is unconstitutional, unauthorized, unjustified and operates to shield the government from criticism and reform, contrary to the First Amendment's guarantees of freedom of speech, of the press and of the right of petition.

Respectfully submitted,
/s/Margaret A. Little
Margaret A. Little
Mark Chenoweth
NEW CIVIL LIBERTIES
ALLIANCE
1225 19th St. NW, Suite 450
Washington, DC 20036
202-869-5212
peggy.little@ncla.legal

Counsel for Petitioner New Civil Liberties Alliance

July 18, 2019

EXHIBIT A

Current Rule, Proposed Rule

CURRENT RULE:

Code of Federal Regulations

Title 17 - Commodity and Securities Exchanges

APPENDIX A TO PART 10—COMMISSION POLICY RELATING TO THE ACCEPTANCE OF SETTLEMENTS IN ADMINISTRATIVE AND CIVIL PROCEEDINGS

It is the policy of the Commission not to accept any offer of settlement submitted by any respondent or defendant in an administrative or civil proceeding, if the settling respondent or defendant wishes to continue to deny the allegations of the complaint or the findings of fact or conclusions of law to be made in the settlement order entered by the Commission or a court. In accepting a settlement and entering an order finding violations of the Act and/or regulations promulgated under the Act, the Commission makes uncontested findings of fact and conclusions of law. Similarly, in settling a civil proceeding with a defendant the Commission invites the federal court to make conclusions of law and, in some instances, findings of fact. The Commission does not believe it would be appropriate for it to be making or inviting a court to make such uncontested findings of violations if the party against whom the findings and conclusions are to be entered is continuing to deny the alleged misconduct.

The refusal of a settling respondent or defendant to admit the allegations in a Commission-instituted complaint or the findings of fact or conclusions of law in the settlement order entered by the Commission or a court shall be treated as a denial, unless the party states that he or she neither admits nor denies the allegations or the findings and conclusions. In that event, the proposed offer of settlement, consent or consent order must include a provision stating that, by neither admitting nor denying the allegations, findings or conclusions, the settling respondent or defendant agrees that neither he or she nor any of his or her agents or employees under his authority or control shall take any action or make any public statement denying, directly or indirectly, any allegation in the complaint or findings or conclusions in the order, or creating, or tending to create, the impression that the complaint or the order is without a factual basis; provided, however, that nothing in this provision shall affect the settling respondent's or defendant's—

i. Testimonial obligation, or

ii. Right to take legal positions in other proceedings to which the Commission is not a party.

PROPOSED AMENDED RULE:

Code of Federal Regulations

Title 17 - Commodity and Securities Exchanges

APPENDIX A TO PART 10—COMMISSION POLICY RELATING TO THE ACCEPTANCE OF SETTLEMENTS IN ADMINISTRATIVE AND CIVIL PROCEEDINGS

The Commission has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, a defendant or respondent may consent to a judgment or order in which he admits, denies, or states that he neither admits nor denies the allegations in the complaint or order for proceedings.

EXHIBIT B

1999 Enacting Publication of Gag Rule in Federal Register

(64 Fed. Reg. 30,902)
Title 17-COMMODITY AND SECURITIES EXCHANGES
Chapter I-Commodity Futures Trading Commission

PART 202-INFORMAL AND OTHER PROCEDURES
Consent Decrees in Judicial or Administrative Proceedings

On October 19, 1998, the Commission published its final amended Rules of Practice. This was the first major revision of the Rules in over 20 years. Appendix A was added to the Rules to set out the Commission's policy relating to the acceptance of settlements in Commission enforcement proceedings, specifically, that the Commission will not enter into a settlement if the defendant or respondent wishes to continue to deny the allegations in the complaint. The proposed changes to Appendix A are intended to clarify two points related to this policy. First, in its current form, Appendix A requires an agreement from defendants and respondents as a condition of settlement that they will not deny the allegations in a complaint, but does not address directly a respondent's or defendant's ability to deny the findings of fact or conclusions of law in settlement order entered by the Commission or a court. The proposed changed make clear that settling defendants and respondents cannot continue to deny either the allegations in the complaint or the findings of fact or conclusions of law in a settlement order that is entered by the Commission or a court.

Second, the proposed changes to Appendix A clarify that Commission settlement agreements do not affect defendants' or respondents' testimonial obligations in proceedings to which the Commission is a party or in any other proceeding. In its current form, Appendix A effectively requires an agreement by a settling respondent or defendant not to give testimony in a Commission proceeding that would tend to deny any allegation in the complaint or create an impression that the complaint lacks a factual basis. This restriction has the potential to conflict with the legal obligation of a respondent or defendant to testify truthfully. Accordingly, the Commission is making technical changes to Appendix A to clarify that a Commission settlement agreement does not affect a settling respondent's or defendant's subsequent testimonial obligations in any proceeding in which the Commission is not a party or in any other proceeding. This change will not affect the Commission's ability to protect against respondents or defendants making later statements that are inconsistent with statements upon which the Commission relies in entering into a settlement. In such circumstances, the Commission can condition the settlement upon the truthfulness of such statements and can vitiate the settlement in the event that the respondent or defendant subsequently provides testimony that is inconsistent with the statements. Moreover, the Commission will continue to prohibit settling respondents and defendants from taking legal positions in proceedings to which the Commission is a party that would tend to deny the allegations in the complaint or the findings of fact and conclusions of law in the settlement order or would tend to create the impression that the complaint or order is without a factual basis.

Because Appendix A constitutes a statement of agency policy, the Commission finds that there is no need to provide the public with an opportunity to submit comments before implementing the above changes. 5 U.S.C. 553(b)(A). For the same reason the Commission has determined to make the changes to Appendix A effective immediately upon publication. 5 U.S.C. 553(b)(2). All of the remaining changes to the Rules correct publication errors. Accordingly, the Commission also finds good cause to make these corrections effective immediately upon publication in the Federal Register. 5 U.S.C. 553(b)(B), 553(d)(3).

COMMISSION ACTION

Appendix A to Part 10 is revised to read as follows:

Appendix A to Part 10—Commission Policy Relating to the Acceptance of Settlements in Administrative and Civil Proceedings

It is the policy of the Commission not to accept any offer of settlement submitted by any respondent or defendant in an administrative or civil proceeding, if the settling respondent or defendant wishes to continue to deny the allegations of the complaint or the findings of fact or conclusions of law to be made in the settlement order entered by the Commission or a court. In accepting a settlement and entering an order finding violations of the Act and/or regulations promulgated under the Act, the Commission makes uncontested findings of fact and conclusions of law. Similarly, in settling a civil proceeding with a defendant the Commission invites the federal court to make conclusions of law and, in some instances, findings of fact. The Commission does not believe it would be appropriate for it to be making or inviting a court to make such uncontested findings of violations if the party against whom the findings and conclusions are to be entered is continuing to deny the alleged misconduct.

The refusal of a settling respondent or defendant to admit the allegations in a Commission-instituted complaint or the findings of fact or conclusions of law in the settlement order entered by the Commission or a court shall be treated as a denial, unless the party states that he or she neither admits nor denies the allegations or the findings and conclusions. In that event, the proposed offer of settlement, consent or consent order must include a provision stating that, by neither admitting nor denying the allegations, findings or conclusions, the settling respondent or defendant agrees that neither he or she nor any of his or her agents or employees under his authority or control shall take any action or make any public statement denying, directly or indirectly, any allegation in the complaint or findings or conclusions in the order, or creating, or tending to create, the impression that the complaint or the order is without a factual basis; provided, however, that nothing in this provision shall affect the settling respondent's or defendant's—

i. Testimonial obligation, or

ii. Right to take legal positions in other proceedings to which the Commission is not a party.

Issued in Washington, DC on June 1, 1999, by the Commission.

Jean A. Webb,
Secretary of the Commission.

[FR Doc. 99-14370 Filed 6-8-99; 8:45 am]

CERTIFICATE OF SERVICE

I hereby certify that on July 18, 2019, I served the foregoing Petition to Amend by hand delivery to the U.S. Commodity Futures Trading Commission to:

Chris Kirkpatrick, Secretary
Office of the Secretariat
CFTC Headquarters
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20549

/s/ Margaret A. Little

OneChicago

141 West Jackson Blvd.
Suite 2240
Chicago, IL 60604
Writer's direct tel: 312.424.8519

August 1, 2008

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 ^{2}1st Street, N.W.
Washington, D.C. 20581

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington DC 20549

Re: Request for a Joint CFTC and SEC Rulemaking to Amend CFTC Rule 41.45(b) and SEC Rule 403(b) Relating to Customer Margin Levels for Security Futures Products

Dear Mr. Stawick and Ms. Morris:

On behalf of OneChicago, LLC, ("OCX") we hereby petition both the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC") (together the "Commissions") for a joint rulemaking amending the minimum 20% customer margin level established in CFTC Rule 41.45(b) and SEC Rule 403(b) to 15%. OCX believes 15% customer margin is consistent with Section 7(c)(2) of the Securities Exchange Act of 1934 ("Exchange Act") in that this margin is consistent with margin on comparable option contracts traded on options exchanges.[1] Accordingly, it is appropriate for the CFTC and SEC to jointly enter into rulemaking to amend CFTC Rule 41.45(b)(1) and SEC Rule 403(b)(1) by reducing the minimum margin levels for security futures positions to 15%. A copy of rule change proposed by OCX to CFTC Rule 41.45(b)(1) and SEC Rule 403(b)(1) are Attachments A and B respectively.

[1] 15 USC 78g(c)(2).

On August 14, 2002, the Commissions jointly adopted margin rules for security futures.[2] Both CFTC Rule 41.45(b)(1) and SEC Rule 403(b)(1) state that:

> *General rule. The required margin for each long or short position in a security future shall be twenty (20) percent of the current value of each security future.*[3]

The Commissions determined that this minimum margin level of 20% satisfied the comparability standard of section 7(c)(2) of the Exchange Act,[4] which requires that the customer margin for security futures be consistent with customer margin on comparable exchange-traded options contracts.[5]

On December 12, 2006, the SEC approved a proposed rule change to the margin rules of the Chicago Board Options Exchange Incorporated ("CBOE") permitting, among other things, "...a broker-dealer to calculate customer margin requirement by grouping all products in an account that are based on the same index or issuer into a single portfolio."[6] This amendment, in effect, reduced the margin on listed options products from 20% to 15% if the positions are carried in a securities account or sub-account. However, because of operational issues at the securities firms, almost all security futures positions are carried in a futures account regulated by the CFTC and not in a securities account. Therefore, margin relief comparable to that for listed options is de-facto unavailable for most security futures customers. The proposed joint rulemaking would permit customers carrying security futures in futures accounts to receive margin treatment consistent with that permitted under the margining provisions of CBOE.

The present margin differential essentially eliminates competition between financial products and thus unnecessarily restricts the diversity of products and hedging tools available to the public. It is in the public interest and consistent with the protection of customers/investors to provide competitive financial products and risk management instruments to customers/investors.

[2] 67 FR 53146 (August 14, 2002).

[3] 17 CFR 41.45(b)(1) and 17 CFR 242.403(b)(1).

[4] 15 USC 78g(c)(2).

[5] Id. at 53157.

[6] Securities Exchange Act of 1934 Release No. 54919 (December 12, 2006) (SR-CBOE-2006-14), 71 FR 75781, 75782 (December 18, 2006).

Therefore, OCX hereby requests a joint rulemaking by the CFTC and SEC amending the present margin rules, CFTC Rule 41.45(b) and SEC Rule 403(b). If you have any questions, please contact the undersigned at 312-424-8519 or dhorwitz@onechicago.com.

Sincerely,

Donald L. Horwitz

Managing Director and General Counsel

Attachment A

CFTC Regulation § 41.45   Required margin.

(a) **No Change** .

(b) *Required margin* —(1) *General rule.* The required margin for each long or short position in a security future shall be fifteen (15) ~~twenty (20)~~ percent of the current market value of such security future.

(2) **No Change**.

(c) **No Change**.

Attachment B

SEC Rule 403 Required margin.

(a) **No Change.**

(b) *Required margin.*—(1) *General rule.*
The required margin for each long or short position n a security future shall be fifteen (15) [twenty (20)] percent of the current market value of such security future.

(2) **No Change.**

(c) **No Change.**

TAC 21-1

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521

COMMODITY FUTURES TRADING COMMISSION 1975

OFFICE OF THE
SECRETARIAT

October 2, 1996

Mr. Gary Goldberg
President
American Corn Growers Association
Rt. 1, Box 229
Kearney, NE 68848

Dear Mr. Goldberg:

By letter dated September 25, 1996, you requested on behalf of the American Corn Growers Association that the Commission consider a petition for issuance of a proposed rule. This is to acknowledge receipt of the petition and to inform you that the petition has been referred to the Commission for such action the Commission deems appropriate. I will inform you of any action taken by the Commission on the petition.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

19960055

SEP 27 9 44 AM '96

American Corn Growers Association

P.O. Box 18157 • Washington, DC 20036 • 202-835-0330 • Fax: 202-429-3741

September 25, 1996

Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition For Issuance Of A Rule

To The Secretariat:

Enclosed is a Petition For Issuance Of A Rule for review by the Commission. Please address all correspondence to:

Gary Goldberg
President, American Corn Growers Association
Rt. 1, Box 229
Kearney, NE 68848

Thank you for your consideration of the issues presented in the petition.

Sincerely,

Gary Goldberg

Gary Goldberg
President

cc: Petition For Issuance Of A Rule

COMMODITY FUTURES TRADING COMMISSION

To:
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

From:
Gary Goldberg, Petitioner
President, American Corn Growers Association
Rt. 1, Box 229
Kearney, NE 68848

PETITION FOR ISSUANCE OF A RULE

I, Gary Goldberg, a corn producer and the President of the American Corn Producers Association, respectfully petition the Commodity Futures Trading Commission (Commission) to issue the following proposed rule in accordance with 17 CFR, Section 13.2.

TEXT OF PROPOSED RULE

Petitioner submits the following rule for consideration by the Commission:

> Any person, including individuals, associations, partnerships, corporations, and trusts, who publishes crop information or gives general circulation of letters, circulars, telegrams or reports, which concerns crop information that affects or tends to affect the price of any commodity, shall be prohibited from owning or holding any futures or options position in any commodity.

NATURE OF PETITIONER'S INTEREST

Petitioner is a corn producer who regularly markets his grain through commodity cash markets.

The value of petitioner's corn is affected by the level of corn supplies and the buying and selling of commodity futures positions.

Crop forecasts have historically and recently affected the cash market price for corn that petitioner owns. In recent months, crop forecasts have been released which appear to have moved the cash market price for corn downward to petitioner's detriment.

Petitioner and similarly situated commodity producers depend on fair and efficient commodity cash and futures markets for their livelihoods.

ARGUMENTS IN SUPPORT OF ISSUANCE OF PROPOSED RULE

1) The proposed rule would protect the integrity and appearance of fairness in both commodity cash and futures markets.

To preserve the appearance of fairness in the commodity cash and futures markets, any person, including commission merchants, members of a contract market, or publishers, who publishes or circulates crop forecasts, should not own or hold positions on commodities futures contracts.

Farmers are reporting that during the last year-- a period which has experienced volatile grain market and futures prices-- futures trading houses and farm publications have made widely disparate crop forecasts. Many farmers suspect that certain individuals and entities who own positions in the grain futures market are benefitting from their own forecasts, causing hesitance to participate in the commodity futures market.

There are reports of instances where particular crop forecasts preceded pronounced shifts in market and futures prices.

Taken together, commodity producers and others are more reluctant to engage in futures trading because of suspicions that commission merchants, members of a contract market, or publishers who publish crop forecasts, could possibly be trading on positions based on prior knowledge of crop forecasts.

The proposed rule would increase confidence in commodity cash and futures markets and reduce suspicions by producers of the role of crop forecasts in moving commodity cash and futures prices.

2) The proposed rule would prevent possible manipulation by persons who trade in futures grain contracts with prior knowledge of the contents of crop forecasts.

The current rules allow for the possible manipulation of crop reports by individuals and entities who also own positions in commodity futures markets. With no restrictions on persons, including commission merchants, members of a contract market, or publishers who publish crop forecasts, from holding futures positions, the situation exists where forecasters can manipulate crop information to fit their own positions in the futures market.

The proposed rule would make it impossible for crop information to be used improperly in that way.

3) The proposed rule would make commodity cash and futures markets more efficient and prevent swings in cash and futures markets that often decrease the value of crops owned by commodity producers at the time the crop information is announced.

There are recent instances where corn crop reports released by commission companies contained surprisingly high crop estimates. The resulting movement of futures positions may have resulted in a marked decrease in the commodity cash prices that followed. As a result, the value of corn held by producers decreased.

The proposed rule would address the problem of cash and futures price shifts based on crop forecasts. The rule would make cash and futures commodity markets more efficient and prevent crop information from independently driving the value of commodities held by producers downward.

CONCLUSION

In order to protect the integrity of futures markets, to prevent market manipulation and to attain fair commodity cash and futures prices, I respectfully petition the Commission to issue the proposed rule submitted herein.

Date: September 25, 1996

Gary Goldberg, Petitioner

TAC 15-10

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521

OFFICE OF THE
SECRETARIAT

February 4, 1997

Ms. Diana Klemme
Chair
NGFA Risk Management Committee
National Grain and Feed Association
1201 New York Avenue, N.W., Suite 830
Washington, D.C. 20005

Dear Ms. Klemme:

By letter dated January 30, 1997, you requested on behalf of the National Grain and Feed Association that the Commission consider a petition for amendment of Commission rules concerning trade options to permit trade options in agricultural commodities. This is to acknowledge receipt of the petition and to inform you that the petition has been referred to the Commission for such action the Commission deems appropriate. I will inform you of any action taken by the Commission on the petition.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

COMMODITY FUTURES
TRADING COMMISSION
RECEIVED
OFFICE OF THE
SECRETARIAT

JAN 30 4 05 PM '97

National Grain and Feed Association

January 30, 1997

Mrs. Jean Webb
CFTC Secretary
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Amendment of Commission Rules Concerning Trade Options To Permit Trade Options In Agricultural Commodities

Dear Secretary Webb:

The National Grain and Feed Association (NGFA®) hereby petitions the Commodity Futures Trading Commission, pursuant to 17 C.F.R. § 13.2, for amendment of Commission regulations to permit trade options, and other options determined by the Commission not to be contrary to the public interest, on agricultural commodities to the same extent as other commodities. The NGFA submits that the Commission should grant this petition by adopting Commission-proposed amendments previously subject to public notice and comment as more fully set out below.

Nature of Interest

The NGFA is the national nonprofit trade association for approximately 1,000 grain, feed and processing firms comprising 5,000 facilities that store, handle, merchandise, mill, process and export more than two-thirds of all U.S. grains and oilseeds utilized in domestic and export markets. Founded in 1896, the NGFA's members include country, terminal, and export elevators; feed mills; cash grain and feed merchandisers; commodity futures brokers and commission merchants; processors; millers; and allied industries. The NGFA also consists of 37 affiliated state and regional grain and feed associations whose members include more than 10,000 grain and feed companies nationwide. NGFA's country elevator, terminal elevator and processor members are the primary buyers of grain from producers.

Exemption Background

While Commission regulations permit off-exchange trade options on non-agricultural commodities, the regulations prohibit the use of off-exchange trade options involving agricultural commodities. The Commission proposed amendments to 17 C.F.R. Part 32 in September 1991 [56 *Federal Register* 43560-65 (Sept. 3, 1991)]. That notice contained a detailed explanation of the Commission's authority to grant the proposed amendments and the history of the present rules.

The Commodity Exchange Act does not expressly define the term "trade option." The Commission and the courts, however, have developed guidelines. Generally, the "buyer" of an option including a "trade option" can choose to walk away from the delivery aspect of the contract. The following characteristics generally describe a "trade option":

1) The purchaser has the right, but not the obligation, to make or take delivery of the physical commodity;

2) The initial charge for an option is normally a non-refundable premium covering the grantor's commissions, costs and profits; and

3) The purchaser's maximum potential losses on an option normally are limited to the premium.

Extending the current trade options exemption on non-agricultural commodities to agricultural commodities would, for example, authorize the following off-exchange transaction between a producer and a grain buyer:

> "The contract establishes a minimum contract price determined when the contract is written, and a premium is collected, either at the initiation of the contract, during the life of the contract or, together with the interest accumulated over the life of the contract, at the time of settlement. In return for the premium, the producer has the right to require the merchant to accept delivery of and pay a minimum contract price for the crop. However, the producer may forfeit the premium and seek a higher price for, and deliver, the crop elsewhere."[1]

It has also been suggested that extending the trade options exemption to agricultural commodities would clarify that so-called revenue assurance contracts can be utilized by producers and grain buyers in the cash marketplace. We urge the Commission, if it agrees to

[1] Example contained in: ***Characteristics Distinguishing Cash and Forward Contracts and "Trade" Options***, 50 Fed. Reg. 39656, 39660 (Sept. 30, 1985).

a lifting of the current ban on agricultural trade options, to clarify that such revenue-based contracts would be permitted under the amended regulations.

Proposed Exemption

The NGFA requests that the following amendments proposed by the Commission in 1991 be adopted [new material underlined; deleted material struck-through]:

I. It is proposed that 17 C.F.R. § 32.1 be revised as follows:

§ 32.1 Scope of part 32; definitions.

* * * *

(b) *Definitions.* As used in this part:

(1) *Commodity option transaction* and *commodity option* each means any transaction or agreement in interstate commerce which is or is held out to be of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty" involving any commodity regulated under the Act ~~other than wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, onions, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, peanuts, soybeans, soybean meal, livestock, livestock products and frozen concentrated orange juice~~;

II. It is proposed that 17 C.F.R. § 32.2 be removed in its entirety and reserved. The amended and deleted provision is as follows:

§ 32.2 ~~Prohibited transactions.~~ [Removed and reserved]

~~No person may offer to enter into, enter into, confirm the execution of, or maintain a position in, any transaction in interstate commerce involving wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, onions, solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, livestock, livestock products and frozen concentrated orange juice if the transaction is or is held out to be of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guarantee", or "decline guarantee".~~

III. It is proposed that 17 C.F.R. § 32.4 be revised as follows:

§ 32.4 Exemptions.

(a) Except for the provisions of §§ ~~32.2,~~ 32.8 and 32.9, which shall in any event apply to all commodity option transactions, the provisions of this part shall not apply to a commodity option offered by a person which has a reasonable basis to believe that the option is offered to a producer, processor, or commercial user of, or a merchant handling, the commodity which is the subject of the commodity option transaction, or the products or by-products thereof, and that such producer, processor, commercial user or merchant is offered or enters into the commodity option transaction solely for purposes related to its business as such.

(b) The Commission may, by order, upon written request or upon its own motion, exempt any other person, either unconditionally or on a temporary or other conditional basis, from any provisions of this part, other than §§ ~~32.2,~~ 32.8 and 32.9, if it finds, in its discretion, that it would not be contrary to the public interest to grant such exemption.

Rationale for Commission To Act Now

Agriculture truly has entered a new era. With changes enacted in the 1996 farm act now being implemented, today's producers need flexibility and a wide range of alternatives to manage risk and market their production. The NGFA believes that today's producers are increasingly sophisticated with regard to using an array of marketing and risk management vehicles, ranging from crop insurance to cash grain contracts to exchange-traded futures and options. In this changed farm policy environment, producers will need to seek a greater share of income from the marketplace while managing the risks arising from price volatility. Lifting the agricultural trade options ban would facilitate these goals. That necessity also has been recognized by various producer groups that have supported lifting the agricultural trade options ban.

Further, lifting the ban would put agriculture on an equivalent footing with other commodities that have been exempt from such a ban for years -- currently, agriculture is the only industry subject to such a ban. The NGFA believes that a ban only on agriculture puts producers and other market participants at a disadvantage when seeking means to manage risk. U.S. agriculture has many competitive advantages, not the least of which is its highly efficient risk management system. While there is considerable creativity in the marketplace today, even with a trade options ban in place, unfettering agriculture from governmental restraints undoubtedly would enhance potential gains in marketing efficiency.

There is another element to the agricultural trade options debate which recently has surfaced. Crop insurance companies and the Federal Crop Insurance Commission have designed hybrid insurance products designed to protect producers against volatility in both commodity prices and yields. Such vehicles essentially guarantee a certain level of revenue to the producer. These products generally are underwritten or reinsured by the U.S. government at substantial expense to the U.S. taxpayer.

Many cash grain market participants would like to offer products in the private marketplace with similar revenue assurance coverage, at no cost to government. However, under current regulation, they are precluded from doing so by the agricultural trade options ban. The NGFA believes that, in the interest of fairness, the Commission should allow offerors of cash grain contracts to offer producers similar risk management strategies in the private marketplace. The issue of federal subsidization of revenue assurance instruments issued by crop insurance companies or agents competing against private, unsubsidized products is an issue that will need to be addressed but is beyond the scope of this discussion.

Some have argued that existing cash grain contracts or revenue assurance instruments that might be offered if the ban is lifted would compete against -- some would say, serve as a substitute for -- exchange-traded instruments. The NGFA believes this is an incorrect and short-sighted objection to lifting the ban. Without a doubt, those offering hybrid cash grain contracts today, and potentially offering revenue assurance products if the ban is lifted, must hedge their own (sometimes substantially increased) risk. The NGFA believes that greater flexibility will increase the need for exchange-traded instruments, thereby increasing volume on commodity exchanges.

Further, to those who would argue against lifting the ban for fear that agricultural producers lack the sophistication to deal with such instruments and need protection, the NGFA disagrees strongly. Today's producers are increasingly sophisticated businessmen and women. In addition, this exemption, if granted, would do nothing to diminish the CFTC's ability to investigate and enforce its regulations in those rare cases where fraud or unlawful representations may occur. The Commission would retain its authority over those matters as set forth in 17 C.F.R. §§ 32.8 and 32.9. Likewise, the Commission would retain authority to determine whether a particular transaction fits within the exemption.

In the entire area of risk management, the NGFA consistently has maintained that education -- of producers, grain elevators, market advisors, lenders, extension economists, and all market participants -- is a critically important element. The availability of more sophisticated risk management and marketing strategies will serve little useful purpose if such strategies are not well understood by all parties. NGFA will continue to provide education to the industry as new developments occur in this area.

The Commission has gathered extensive information and testimony on the subject of the agricultural trade options ban. In addition to the 1991 proposed rule, a ***Chairman's Roundtable on the Prohibition of Agricultural Trade Options*** was conducted by the Commission on December 19, 1995, during which extensive testimony was taken. The NGFA is hopeful that, given the substantial record already compiled on lifting the ban, this proceeding can move ahead and be implemented quickly.

As related at the 1995 roundtable, the NGFA has a policy goal of "strengthening and enhancing an efficient marketing infrastructure, risk management tools and transportation capacity, all at world market-competitive costs." Lifting the agricultural trade options ban is consistent with that policy goal and would enhance the ability of the cash grain industry to offer producers additional pricing and risk management tools.

Sincerely,

Diana Klemme

Diana Klemme, Chair
NGFA Risk Management Committee

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
Facsimile: (202) 418-5521

May 1, 1997

Mr. Frank Taucher
Suite 190
8210 East 71st Street
Tulsa, Oklahoma 74133

Re: Petition for Amendment of Commission Rule 4.13(a)(2)

Dear Mr. Taucher:

This is in response to your letter dated April 7, 1997 in which you petitioned the Commission for the amendment of Rules 4.13(a)(2)(i) and 4.13(a)(2)(ii) (hereinafter referred to collectively as Rule 4.13(a)(2)).[1]

Commission Rule 4.13(a)(2) provides that a person is not required to register under the Commodity Exchange Act (CEAct) as a commodity pool operator (CPO) if: (1) the total gross capital contributions which the person receives for units of participation in all of the pools that the person operates or intends to operate do not in the aggregate exceed $200,000; and (ii) none of the pools operated by the person has more than 15 participants at any time.[2] In your petition, you requested that the Commission increase the dollar amount in the rule from $200,000 to $1,000,000,000 and the number of participants from 15 to 10,000.

As the Commission indicated in its April 3, 1997 response to your previous petition to repeal Commission Rule 4.13(a)(2), your request, in substance, is for repeal of the statutory requirement for CPO registration. Section 4m(1) of the CEAct[3] provides that

[1] Commission Rule 13.2 provides that "[a]ny person may file a petition with the Secretary of the Commission for the issuance, amendment, or repeal of a rule of general application." Commission rules referred to herein are found at 17 C.F.R. Ch. I (1996).

[2] In computing the number of paraticipants, the following persons may be excluded: the CPO, any commodity trading advisor (CTA) for the pools, and principals of either the CPO or CTA, as well as any relative, spouse or relative of such spouse living in the same household as another paraticipant.

[3] 7 U.S.C. § 6m(1) (1994).

it is unlawful for a CPO to use the mails or any means or instrumentality of interstate commerce in connection with his or her business as a CPO unless registered as such under the CEAct. If the Commission were to adopt your suggested amendments, virtually no person would be required to register as a CPO since only a handful of persons currently or at any time in the past have operated pools with total gross capital contributions exceeding $1 billion or more than 10,000 participants. You have not provided any additional information concerning this issue beyond what you set forth in your February 26, 1997 letter and to which the Commission responded in its April 3, 1997 letter by denying your previous petition to repeal Rule 4.13(a)(2).

In light of the foregoing, we find that you have not provided a sufficient basis for modification of Rule 4.13(a)(2). Accordingly, the Commission has determined to deny your petition to amend Rule 4.13(a)(2).

In your April 7, 1997 letter, you also raised certain issues concerning the National Futures Association (NFA). In numbered paragraph 3, you inquired about the original par value of NFA's stock, its stockholders, the number of shares issued and the compensation of these stockholders. NFA does not issue stock and has no stockholders. As Article IV of NFA's Articles of Incorporation, under the heading "Form of Organization", states in full:

> NFA shall be a membership corporation and shall have no capital stock. NFA is not organized and shall not be conducted for profit, and no part of its revenues or earnings shall inure to be the benefit of any Member except for the repayment of bona fide loans or other credit extended by a Member to NFA.

In numbered paragraph 3 and at the end of your letter, you refer to NFA as a "monopoly" and NFA Bylaw 1101 as "draconian" in requiring that NFA members only engage in business with other NFA members. As was stated in the letter to you from the Commission's Division of Trading and Markets (Division) dated April 3, 1997, under the Commodity Exchange Act, there may be multiple registered futures associations. Indeed, NFA recognizes this in its Bylaw 1101 by providing that NFA members may do business with a non-member if such non-member of NFA is a member of another registered futures association. Thus, contrary to your assertion, NFA Bylaw 1101 does not require that NFA members only engage in commerce with other NFA members.

As to the NFA per-transaction fee, that issue was discussed in the Division's April 3, 1997 letter. As you requested, we are enclosing a copy of the Commission's September 22, 1981 order granting NFA registration as a futures association. The second reference in the Division's April 3 letter was to page 7 of that order; only one order, not two as you stated in your April 7 letter, was referred to in the Division's letter.

If you have any questions concerning these issues, please contact Division Chief Counsel Susan C. Ervin or Associate Chief Counsel Lawrence B. Patent at (202) 418-5450.

For the Commission,

Jean A. Webb

Jean A. Webb
Secretary of the Commission

Enclosure

cc: Daniel J. Roth, NFA (w/o enclosure)

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of the Application of the National Futures Association	ORDER GRANTING REGISTRATION AND APPROVING RULES

I. Introduction

The National Futures Association ("NFA") submitted an application to the Commodity Futures Trading Commission ("Commission") for registration as a registered futures association under Section 17 of the Commodity Exchange Act ("Act"), 7 U.S.C. §21 (Supp. III 1979), on March 16, 1981. The Commission published notice of the application in the Federal Register, requested public comment and announced the Commission's intention to hold a public hearing regarding the application.[1] In recognition of their prior interest in the Commission's consideration of issues relating to registration of futures associations, the Commission also expressly solicited the views of the Securities and Exchange Commission ("SEC"), the Antitrust Division of the Department of Justice ("Justice"), and the National Association of Securities Dealers, Inc. ("NASD").[2]

On June 4, 1981, the Commission held the public hearing announced in the Federal Register notice. Twelve individuals representing various segments of the

[1] 46 FR 23101 (April 23, 1981). The Commission initially afforded the public sixty days to submit comments, but upon request of a number of interested persons, the Commission extended the comment period to July 2, 1981. 46 FR 35140 (July 7, 1981). In considering NFA's application, the Commission also took into account views expressed in comment letters received after July 2, 1981.

[2] Letters dated April 22, 1981, from Theodore W. Urban, Deputy Director, Division of Trading and Markets, to George A. Fitzsimmons, Secretary, SEC; Stanley M. Gorinson, Chief, Special Regulated Industries Section, Justice; and Gordon Macklin, President, NASD.

commodities industry, as well as the Director of the SEC's Division of Market Regulation testified at the hearing.[3] The Commission received 22 written comments, many of which commented upon issues raised at the hearing or by other commentators.[4]

[3] In the order of their appearance, the following people testified: Leo Melamed, President of the NFA; William Bagley, former Chairman of the Commission; David H. Morgan, President of MidAmerica Commodity Exchange; Robert L. Isaacson, Co-Chairman of the National Association of Futures Trading Advisors ("NAFTA"); Donald M. Mennel, Chairman of Mennel Milling Company and the Millers' National Federation Committee on Agriculture; Stewart Siebens of Kohl Lane Siebens & Company; Douglas Scarff, Director of the SEC's Division of Market Regulation; David T. Johnston, Senior Vice President of E.F. Hutton and Company Inc.; Robert K. Wilmouth, President of the Board of Trade of the City of Chicago ("CBT"); John F. Sandner, Chairman of the Chicago Mercantile Exchange ("CME"); Howard A. Stotler, Chairman of the Futures Industry Association, Inc. ("FIA"); Michael D. Weiner, Managing Partner of Filler, Weiner, Zaner & Associates; and Lee G. Magnussen, Financial Vice President of Heinold Commodities, Inc. (hereinafter cited as "Prepared Statements" or "Testimony . . . NFA Hearing Transcript").

[4] The Commission received the following comment letters: dated May 18 and August 25, 1981, from E.W. Kimball on behalf of Kimball Associates ("Kimball Associates"); dated May 27, 1981, from Leslie A. Blau, General Counsel, Maduff & Sons, Inc. ("Maduff"); dated June 1, 1981, from Charles P. Nastro, Senior Vice President and Counsel to the Commodity Division, Shearson Loeb Rhoades, Inc. ("Shearson"); dated June 2, 1981, from William F. Brooks, President and General Counsel, National Grain Trade Council; dated June 17, 1981, from Lee H. Berendt, President, Commodity Exchange, Inc.; dated June 19, 1981, from Frederick F. Horn, Senior Vice President, Bache Halsey Stuart Shields Incorporated ("Bache"); dated June 19, 1981, from Keith S. Wellin, Executive Vice President, Dean Witter Reynolds Inc. ("Dean Witter"); dated June 20, 1981, from Bennett J. Corn, President, Coffee, Sugar & Cocoa Exchange, Inc.; dated June 22, 1981, from John J. Giovannone, of Memel, Jacobs, Pierno & Gersh, Counsel to Monex International, Ltd. ("Monex"); dated June 22, 1981, from Theodore Thomte, President, Thomte & Co., Inc. ("Thomte"); dated June 24, 1981, from Margaret R. Sandridge, Vice President and Commodity Counsel, Paine Webber Jackson & Curtis, Incorporated ("Paine Webber"); dated June 26, 1981, from Gerald D. Beyer, In-House Counsel, CME; dated June 26, 1981, from the Honorable Richard G. Lugar, United States Senate; dated June 30, 1981, from Terrence F. Kelly on behalf of A.G. Becker Incorporated ("A.G. Becker"); dated July 1, 1981, from Gordon S. Macklin, President, NASD; dated July 2, 1981, from Lawrence H. Hunt, Jr., of Sidley & Austin, Counsel to ContiCommodity Services, Inc. and Heinold Commodities, Inc. ("Conti and Heinold"); dated July 2, 1981, from Justice; dated July 16, 1981, from Joseph H. Spiegel, representing Spiegel and Fain, Ltd., General Counsel for Dillon-Gage, Inc. and other non-member FCMs ("Spiegel and Fain"); undated (received August 10, 1981) from Mr. Isaacson and William A. Dunn, Co-Chairmen, NAFTA; dated August 27, 1981, from David R. Ganis, Senior Vice President, Paine Webber; and dated August 28, 1981, from E.G. Burton III, Associate General Counsel, Clayton Brokerage Co. of St. Louis, Inc. ("Clayton").

In addition to inviting public comment on the NFA application, the Commission, through its staff, requested clarification of certain provisions of the NFA application. By letter dated May 15, 1981 ("Comment Letter"), the Division of Trading and Markets ("Division") provided its comments and questions to the NFA on various aspects of the application.[5] The Division identified specific concerns and requested further justification on a number of the proposed articles of incorporation, bylaws and rules. In a July 9, 1981 letter to the NFA, the Division advised that it also would be appropriate and of assistance to the Commission and its staff for the NFA to address some of the issues raised by the public comment letters which the Commission had received.[6] Finally, on August 27, 1981, the Division transmitted to the NFA a memorandum which set forth certain concerns of the Commission's Office of General Counsel concerning the NFA's application.[7]

The NFA submitted a response to the Division's Comment Letter on July 22, 1981 ("Response I").[8] The NFA included in that response comprehensive justifications for various features of the proposal, as well as several amendments to its articles of incorporation, bylaws and rules. In a subsequent letter dated August 10, 1981 ("Response II"), the NFA responded to the Division's July 9 letter.[9] The NFA stated it had taken into account the testimony at the hearing, as well as the written comments from the public, when preparing its July 22 response. Nevertheless, the NFA indicated that it had made some additional changes in its rules and

[5] Letter from John L. Manley, Director of the Division, to Mahlon M. Frankhauser, Kirkland & Ellis, Counsel to the NFA.

[6] Letter from Mr. Manley to John H. Stassen, Secretary of the NFA.

[7] Letter from Mr. Manley to Mr. Frankhauser.

[8] Letter from Mr. Melamed to Mr. Manley.

[9] Letter from Mr. Stassen to Mr. Manley.

addressed certain other issues raised by the public comments. Finally, in a letter dated September 11, 1981 ("Response III"), the NFA responded to various concerns raised by the memorandum from the Commission's Office of General Counsel.[10/] The NFA also responded specifically to a comment letter submitted by Justice.[11/]

II. Overview of NFA Application

A. Structure of NFA

NFA is organized as a non-profit membership corporation.[12/] Membership in NFA generally will be open to all persons engaged in a business related to the commodity futures industry, unless they are explicitly excluded by Commission rule or a rule of the NFA approved by the Commission.[13/] Specifically, Article VI provides that contract markets, agents of futures commission merchants ("FCMs"), and persons registered with, or designated as eligible by, the Commission may become NFA members. Commission registrants include FCMs and their associated persons ("APs"), commodity trading advisors ("CTAs"), commodity pool operators ("CPOs") and floor brokers.[14/]

The NFA has determined that in order for it to exercise its regulatory authority effectively, membership in NFA or another Title III organization should

[10/] Letter from Mr. Stassen to Mr. Manley. The NFA also submitted a final technical amendment to Article XVII; Letter from Mr. Frankhauser to Mr. Urban dated September 18, 1981.

[11/] Reply from Mr. Frankhauser to the Comments of Justice, dated July 16, 1981 ("NFA Reply to Justice").

[12/] Article IV of the NFA's proposed Articles of Incorporation (hereinafter referred to as "Articles" or by a particular Article number).

[13/] Article VI.

[14/] *See* Section 8a(1) of the Act, 7 U.S.C. §12a(1) (Supp. III 1979).

be compulsory for FCMs and their agents, CPOs, and CTAs. The rules do not explicitly compel such membership, but proposed Bylaw 1101 would prohibit NFA members from carrying accounts, accepting orders, or handling accounts for or on behalf of any suspended or non-member of the NFA who is not a member of another registered futures association, unless such person is exempted from the provisions of Bylaw 1101 by the NFA Appeals Committee or by resolution of the NFA Board of Directors ("Board"). In addition, Bylaw 301 would require APs of FCMs to register with the NFA as "associates." Consequently, each step in the order-handling process leading to execution by a floor broker (floor brokers will not be subject to the compulsory membership provision) would have to be effected through an NFA member or a person subject to NFA regulation.[15/]

The NFA will be governed by a forty-member Board.[16/] Section 2 of Article VII describes the Board's composition as follows: (a) each exchange will select a director to serve as its representative, except that every contract market having more than 20 percent of the previous calendar year's volume on all exchanges will have two directors each;[17/] (b) FCMs with more than 50 branch offices will be represented by a total of six directors, while FCMs with 16-50 branch offices will be allocated four directors, as will FCMs with fewer than 16 branch offices; (c) CPOs, CTAs and commercial members ("Industry Participants") will be represented by a total of ten directors — two directors each for CPOs and

[15/] NFA has stated that the effectiveness of this provision rests upon the presumption that all contract markets will require their FCM members to join NFA. See the NFA Registration Statement ("Registration Statement") at 8 n. 1.

[16/] Article VII; Bylaw 501.

[17/] The total number of contract markets that may be represented on the Board has been limited to the current eleven. Should another board of trade apply for and receive designation as a contract market, the eleven contract markets with the greatest transaction volume would be represented on the Board.

commercial banks and three directors each for CTAs and commercial firms;[18] and (d) three directors will have no direct association with any commodities business ("Public Representatives").

In view of the Board's size, management of NFA's daily affairs is vested in a nine-member Executive Committee. The Committee will include the President of NFA, one director representing those contract markets with two Board members each, one director representing the other contract markets, three directors representing the FCMs, two directors representing Industry Participants and one Public Representative director.[19]

The Executive Committee's activities will focus on the management and administration of routine matters. To this end, it may exercise all of the Board's powers, except the following: the adoption, amendment or repeal of any bylaw or the ratification of any proposal to change the Articles; the establishment of major plans, including those regarding the expenditure of NFA funds except when specifically authorized by the Board; the election, appointment or removal of directors, officers or committee members; the approval of statements to be presented to governmental bodies as official positions of the NFA; the adoption of a plan of merger, consolidation or the distribution of assets; the sale, lease, exchange or mortgage of NFA property; the voluntary dissolution of the NFA or the revocation of any such dissolution proceedings; or the amendment or repeal of any Board resolution which specifically prohibits these actions by the Executive Committee.[20] In

[18] Certain restrictions in Article VII will prevent regional concentration of Board members in the FCM and Industry Participant categories. Article V establishes three regions -- Eastern, Central and Western -- and sets forth the states which comprise each region.

[19] Article VIII, Section 3. There are regional limitations concerning Executive Committee members similar to those prescribed for Board representatives.

[20] Article VIII, Section 2.

addition, the Committee may not exercise any of the Board's powers while the Board is in session, nor may it take action upon any matter included in a notice of a pending Board meeting.[21]

Funds necessary to support NFA's daily operations will be derived from membership dues and assessments.[22] Member contract markets will be assessed two cents per round-turn transaction, with a minimum mandatory annual payment of $25,000 and a maximum of $300,000.[23] FCMs also will be assessed on a round-turn basis; however, the NFA has not yet determined the amount that will be charged on each transaction.[24] FCMs must invoice the transactional assessment to their customers and remit to NFA the customers' assessment plus an additional sum equal to 10% of the total amount invoiced to all of its customers. Every FCM also must pay annual dues of $1,000. CPOs and CTAs will pay to the NFA membership dues of $500 during their first year of registration with the Commission and $1,000 annually thereafter.[25] Agents will pay $500 in annual dues and all other members will pay $1,000, unless the Board waives or establishes lower dues.[26]

B. Functions

As described in Article III, the NFA's fundamental purposes include implementation of comprehensive regulatory programs with respect to the commodities industry. The NFA expects that its implementation of these programs will relieve the Commission of a substantial portion of its direct regulation of CPOs, CTAs,

[21] Id.

[22] Article XV, Section 3.

[23] Bylaw 1301(a).

[24] Bylaw 1301(b).

[25] Bylaw 1301(c).

[26] Bylaw 1301(b) and (c).

ar-d FCMs, and their APs and agents. The NFA recognizes that instituting all of the contemplated programs at once would not be feasible. Rather, the NFA plans to phase in those functions and, thus, its rules as they apply to each membership category.[27/]

The NFA estimates that its offices and staff will be organized within the first six months following its registration. Thereafter, it will begin implementing the FCM and AP programs, i.e., qualification screening and registration. Within the second six months, as administrative and enforcement staff are added, auditing and surveillance pursuant to the Financial Requirements will be undertaken. At that time, Bylaw 1101, which prohibits NFA members from dealing with non-NFA members, will become effective as to FCMs. The NFA expects that a similar phase-in of CTA and CPO registration, surveillance and compliance with Bylaw 1101 by CTAs and CPOs will occur in the second year of the NFA's existence.

The NFA initially will screen applicants for membership and registration as associates to determine whether they meet the qualifications prescribed in Bylaw 301 and, if they are qualified, grant them membership or registration.[28/] The NFA has indicated, however, that it intends to develop fitness standards and administer proficiency examinations for associates.[29/] Thus, while the NFA initially may grandfather APs registered with the Commission, unrestricted continuing registration by the NFA may be conditioned upon subsequent passage of such an examination.[30/]

[27/] See Registration Statement at 15; Article XII, Section 6; testimony of Mr. Melamed, NFA Hearing Transcript at 19 and 27; and Response II at 4.

[28/] See Response I at 24-25; Bylaw 302. The NFA has indicated that in all likelihood it will "grandfather" applicants currently registered with the Commission.

[29/] Article III, Section 1(d).

[30/] See Response I at 24.

The NFA has proposed several rules designed to protect against the insolvency, bankruptcy or unsound financial condition of its FCM members. Notwithstanding Article III, Section 2(a), NFA has stated explicitly that it has the authority, concurrently with the contract markets, to impose those financial requirements.[31] Contract markets will continue to be responsible for auditing and reviewing the financial condition of their members. The NFA will assume responsibility for auditing non-exchange FCMs which are NFA members and anticipates that the auditing of exchange member FCMs will continue to be conducted by the contract market that has been delegated primary financial responsibility for the NFA member pursuant to a "Delegation Plan" of the NFA and the contract markets.[32] Of course, the exchanges will be free to delegate their own auditing responsibilities to the NFA as they see fit under any such Delegation Plan. Clearing organizations, exchanges and the NFA all will have the responsibility to enforce compliance with their own financial rules.

Another fundamental purpose the NFA will seek to fulfill is the protection of customers of FCMs (their APs and agents), CPOs and CTAs through the adoption of uniform, industry-wide sales practice standards.[33] Failure to observe ethical standards of conduct or violation of any of the specific prohibitions or mandates will be grounds for disciplinary action. The proposed compliance procedures establish a compliance office, which, in conjunction with the Regional

[31] Id. at 9-10.

[32] See Financial Requirements, Section 2. The NFA has indicated that it anticipates its auditing program will be under way within one year following the grant of registration by the Commission. See Response I at 19. Within that time, any delegation plan which the NFA and the contract markets enter into will be subject to Commission review.

[33] Article III, Section 1(e).

Business Conduct Committees,[34] will conduct investigations and take any necessary actions against NFA members.[35]

An additional function of the NFA will be to administer an arbitration procedure for the voluntary settlement of customers' claims up to $15,000 against members, their employees or associates.[36] Toward this end, the NFA has proposed a Code of Arbitration, which will govern the conduct of such proceedings. Moreover, other arbitrable claims between or among customers, members or associates may, in the President's discretion, be settled through the same procedures.[37]

This overview touches upon only the central features of the NFA proposal. These and other provisions which relate directly to NFA's compliance with Section 17 of the Act and Part 170 of the Commission regulations are analyzed below only to the extent that they raise significant issues under the Act and Commission regulations.

III. History of Title III

In considering the NFA's application for registration, the Commission was aware of the legislative history underlying the adoption of Section 17 of the Act. The Commission's promulgation of rules setting forth the minimum requirements with which applicants must comply in order to fulfill the public interest requirements of Section 17 reflects that legislative history. A brief

[34] There will be a committee composed of nine Board-appointed members for each of the three regions. Bylaw 704.

[35] *See* Article III, Section 1(e) and Compliance Rule 2-1.

[36] "Customer" is defined to exclude FCMs, floor brokers, members and associates. Code of Arbitration, Section 2(a)(1)(i)(A).

[37] Code of Arbitration, Section 2(b).

discussion of that legislative history, NFA's earlier draft proposal under Section 17 of the Act, and the Commission's adoption of regulations under Section 17 outlines the context within which the Commission considered NFA's application.

A. Legislative History: 1974

During the Congressional deliberations which culminated in the Commodity Futures Trading Commission Act of 1974,[38] a consistent theme of the legislative hearings was a concern that the existing self-regulatory framework no longer adequately served the broad public interests involved in the nation's rapidly expanding futures markets.[39] As a result, the Commission was created and armed with new and enhanced oversight and enforcement powers to regulate the commodity futures markets. In addition, the 1974 amendments brought three classes of commodity professionals under the Commission's regulation for the first time: CTAs, CPOs and APs of FCMs. Unlike floor brokers and FCMs, most of which were also contract market members and thus subject to self-regulation under the Act, those three newly regulated categories of industry participants had not been subject to any self-regulatory oversight.

To accommodate the Commission's increased regulatory responsibilities, the Act specifically empowered the Commission to impose regulatory requirements on those industry participants that are not contract market members.[40] In addition, Congress authorized the registration of futures associations under Title III of

[38] Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. §1389, et seq. (1974).

[39] See, e.g., H.R. Rep. No. 975, 93d Cong., 2d Sess. 44-48 (1974); and S. Rep. No. 1131, 93d Cong., 2d Sess. 18-19 (1974).

[40] Section 8a(8) of the Act, 7 U.S.C. §12a(8) (1976).

the Act[41] as a means of complementing, through self-regulation, Commission regulation of all commodity professionals.

In hearings before the House Committee on Agriculture and the Senate Committee on Agriculture and Forestry on the legislation to amend the Commodity Exchange Act, many witnesses addressed the propriety of authorizing the creation of futures associations as a new form of self-regulation for the industry.[42] Proponents of futures associations believed that such organizations, like the NASD, could complement the regulatory efforts of the Federal agency overseeing the industry and assist in improving the caliber of commodity professionals who deal with the public.[43]

The House Committee on Agriculture, in adopting the bill which authorized the creation of registered futures associations,[44] explained that the legislation:

> . . . provides enabling authority at the discretion of the Commission for persons registered under the Act and in the commodity trading business to establish a voluntary futures association or associations which would have authority to regulate the practices of its members in the public interest. Such an association would register with the Commission and establish a uniform code of professional conduct for those in the commodities business and have disciplinary authority over

[41] 7 U.S.C. §21 (1976).

[42] See Hearings Before the House Committee on Agriculture Concerning Review of the Commodity Exchange Act and Discussion of Possible Changes, 93d Cong., 1st Sess. 94 (1973) (hereinafter cited as "October House Hearings"); Hearings Before the House Committee on Agriculture on H.R. 11195, 93d Cong., 2d Sess. 18-19, 101-102, 116, 127 and 262 (1974) (hereinafter cited as "January House Hearings"); and Hearings Before the Senate Committee on Agriculture and Forestry on S. 2485, S. 2578, S. 2837 and H.R. 13113, 93d Cong., 2d Sess. 510, 542-543, 548-549, 718-721, 729 and 739-740 (1974) (hereinafter cited as "Senate Hearings").

[43] See October House Hearings at 94; and January House Hearings at 328. See also Senate Hearings at 718-719 and 721.

[44] 120 Cong. Rec. 10769 (April 11, 1974).

> its members. . . . Association activity would serve solely as a complement rather than a displacement to the authority of the new Commission. 45/

The Conference Committee generally accepted the House provisions,[46/] which, as accepted, were enacted and signed into law as Title III of the Commodity Futures Trading Commission Act of 1974.

The architects of Title III envisioned that members of the futures industry would generate proposals for the formation of futures associations. Moreover, the Commission was expected to assist this process by establishing appropriate standards and a procedural framework so that organizations could apply for registration and the Commission could determine whether to register particular applicants. In addition, Section 17 vested in the Commission statutory power that would allow the Commission to act as a catalyst for the formation of futures associations.[47/]

B. NFA's Initial Proposal

On January 31, 1977, NFA's organizing committee presented to the Commission an outline proposal for a national association that would bring within its self-regulatory purview all firms and individuals engaged in commodity futures activities with the public.[48/] This informal proposal had been adopted by

[45/] H.R. Rep. No. 975, 93d Cong., 2d Sess. 4 (1974).

[46/] 120 Cong. Rec. 33043 (September 30, 1974). See also H.R. Rep. No. 1393, 93 Cong., 2d Sess. 39 (1974); and S. Rep. No. 1194, accompanying H.R. 13113, 93d Cong., 2d Sess. 39 (1974).

[47/] See H.R. Rep. No. 975, 93d Cong., 2d Sess. 16 and 17 (1974).

[48/] The NFA organizing committee's presentation included draft articles of incorporation, a document entitled "Points of Agreement - With Committee Intent" (an agreement among industry organizers), and a memorandum to the organizing committee from its Counsel. The FIA previously submitted an outline proposal to the Commission in 1976, which applied to FCMs, CTAs and CPOs, and focused its regulatory efforts on retailing activities and member financial responsibility. After learning of the efforts underway to organize NFA's broadly based association, the FIA organizers agreed to support the draft proposal that was presented to the Commission in 1977. See Prepared Statement of Mr. Melamed at 4-10.

the organizing committee, all of the then existing contract markets and the FIA. It was placed before the Commission in order to facilitate and encourage discussion of certain issues involved in registering futures associations.[49/]

Following a public meeting on February 10, 1977, the Commission issued a statement of guidance that reflected its preliminary reaction to the NFA draft proposal.[50/] In that statement the Commission endorsed the concept of cooperative regulation and announced that it considered "the NFA proposal to be a valuable first step toward implementing the purposes of Title III."[51/] The Commission stated, however, that there were certain aspects of the proposal that required further study, including incentives to membership and fair representation. Nevertheless, the Commission emphasized that it stood ready to work with NFA representatives to assist it in finding solutions to these problems and to seek alternatives where required.

During the ensuing months, Commission staff and NFA representatives corresponded and met to discuss the informal proposal. At a meeting held on June 7, 1977, the Commission, recognizing that a formal registration application had not been filed, approved as a matter of policy the concept of "uniform required membership" as proposed by the NFA organizing committee.[52/] NFA

[49/] *Id.* at 6-7.

[50/] CFTC Advisory to the Media, February 15, 1977.

[51/] *Id.*

[52/] The Commission's policy approval in 1977 was stated "in the abstract," applicable to any applicant futures association. Nevertheless, this policy was intended to be a basis for the proposed NFA structure, subject to the Commission's "continuing powers and processes . . . in further structuring and implementing" NFA's proposal. *See* CFTC Press Release No. 297-77, June 7, 1977; and official minutes of the open Commission meeting held on June 7, 1977.

submitted a revised version of its draft articles of incorporation on July 20, 1977, along with a revised "Points of Agreement" setting forth the organizing committee's intent.[53] The revised draft contained a modified manner for selecting a board of directors.

Justice subsequently commented on the informal proposal, expressing its opinion that NFA's mandatory membership requirement, in particular, posed an unconstitutional delegation of agency authority and was not, as required by Section 15 of the Act, the least anticompetitive means available to the Commission to achieve the objectives of the Act.[54] The Commission then afforded NFA an opportunity to respond to Justice's comments.[55] In addition, the Public Interest Economic Center, under contract with the Commission, undertook a study of the competitive aspects of the futures trading industry and expressed some reservations about the NFA proposal which are discussed below.[56] The NFA draft application thereafter was not formally submitted to the Commission and, accordingly, the Commission deferred any further consideration of the NFA's draft proposal. The concerns which Justice raised were addressed explicitly by Congress in 1978.

C. 1978 Reauthorization: Section 17(m)

During the Commission's 1978 reauthorization hearings, subcommittees of both the House Committee on Agriculture and the Senate Committee on Agriculture,

[53] Letter from Philip F. Johnson, then Counsel for the NFA organizing committee, to Richard E. Nathan, then Acting General Counsel, dated July 20, 1977.

[54] 7 U.S.C. §19 (1976). See In the Matter of the National Futures Association, Comments of October 7, 1977, from Justice to the Commission (hereinafter cited as "1977 Justice Comments").

[55] Response of the National Futures Association to Objections to its Preliminary Proposal, January 31, 1978.

[56] See Jones, N. and Ferguson, A., Competition and Efficiency in the Commodity Futures Markets (May 1978). See also pp. 30-32 infra.

Nutrition and Forestry heard testimony from many witnesses expressing their opinion that a futures association should be created.[57] The Senate Subcommittee considered that:

> [t]he industry has worked to develop a regulatory organization which would apply to the CFTC for approval . . . . This title III organization is designed to regulate all FCM's taking over the responsibility in this area formerly carried out by the exchanges, whereby the exchanges will regulate all activities at the exchange level, such as floor trading practices, contract details, financial integrity of clearinghouse members, et cetera.
>
> Thus, the industry would be regulated through the exchanges concerning exchange operations, and through the title III organization concerning FCMs and their contacts with the public. [58]

During the Senate floor debate on the legislation, Senator Patrick J. Leahy stated that the proposed amendments to Title III were being offered in order:

> to speed the establishment of these associations and to allow them to assume some of the duties currently being conducted by the Commission. These associations could free Commission personnel to engage in other activities. [59]

Most significantly, the committees adopted new Section 17(m), which expressly allows the Commission to approve rules of a futures association that

[57] See Hearings on H.R. 10285 Before the Subcommittee on Conservation and Credit of the House Committee on Agriculture, 95th Cong., 2d Sess. (pp. VIII-IX for summary of testimony) (1978) (hereinafter cited as "1978 House Hearings"); Hearings on the Reauthorization of the Commodity Futures Trading Commission Before the Subcommittee on Agricultural Research and General Legislation of the Senate Committee on Agriculture, Nutrition, and Forestry, 95th Cong., 2d Sess. pt. II at 12, 13, 26, 27, 29, 30, 47, 48, 50, 51, 68, 116, 119, 121, 122, 136, 137, 186, 190 and 191 (1978) (hereinafter cited as "1978 Senate Hearings").

[58] Testimony of David T. Johnston, then Vice President, E.F. Hutton Inc., 1978 Senate Hearings at 121.

[59] See 124 Cong. Rec. S10535 (daily ed. July 12, 1978). See also remarks of Rep. Foley, 124 Cong. Rec. H7206 (July 24, 1978); and S. Rep. No. 850, accompanying S. 2391, 95th Cong., 2d Sess. 30 (1978).

would make membership in at least one futures association mandatory for persons eligible for membership.[60] The House Committee commented that:

> [u]se of the authority of this amendment would be completely discretionary with the Commission. The committee was persuaded that such discretion may be useful to the Commission if it should decide that such a provision is necessary for an effective self-regulation program and is otherwise in the interest of the objectives of section 17. [61]

The Conference Committee of the Senate and House agreed to adopt the House amendment, thereby explicitly permitting the Commission to approve mandatory membership rules of any futures association. The conferees also adopted provisions that increased the limit on the amount in controversy in futures association customer arbitration proceedings to $15,000 and authorized the Commission to delegate to a registered association certain aspects of the Commission's registration functions for APs.[62]

D. Adoption of Part 170; The NFA Application

In furtherance of its statutory mandate under Section 17 of the Act, the Commission adopted, effective April 10, 1979, regulations governing applications for registration submitted under Title III and specifying standards with which such applications must comply.[63] The Commission's regulations expanded upon the

[60] The Senate Committee's mandatory membership amendment to Section 17 would have granted the Commission the authority to approve mandatory membership rules of either a Title III association or a contract market for persons eligible for membership. See S. Rep. No. 850, 95th Cong., 2d Sess. 31 (1978).

[61] H.R. Rep. No. 1181, 95th Cong., 2d Sess. 20 (1978).

[62] See 124 Cong. Rec. H10685, H10687, H10691 (September 25, 1978).

[63] The Commission adopted Part 170 of its regulations (17 CFR Part 170 (1981)). See 44 FR 20649 (April 6, 1979), [1977-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,795. When proposing the registration standards,

(footnote continued)

requirements set forth in Section 17 of the Act and, in particular, Section 17(b), which enumerates the findings the Commission must make in order to register a futures association and empowers the Commission to establish specific requirements to which an association's rules must conform. The Commission did not determine that any particular form of futures association was necessary or would be in the public interest, but noted that any such determination could be made only after considering the issues involved in registering a futures association in the context of specific applications received.

Following the 1978 reauthorization of the Commission and the Commission's adoption of specific guidelines governing prospective futures associations, the NFA organizing committee resumed its attempts to present the Commission with a workable futures association which, if registered, could effectively comply with its responsibilities under the Act. These renewed efforts culminated in the submission, on March 16, 1981, of a formal application for registration under Section 17 of the Act. Supporters of the proposal now before the Commission believe it represents a practical compromise of inherently conflicting industry interests.[64] It incorporates a regulatory framework upon which the functions of the Title III organization may be implemented, but does not purport to describe or detail all of the self-regulatory functions that the NFA necessarily will

Footnote continued

the Commission also requested public comment on certain policy questions concerning the benefit of having a registered futures association, the structure such associations should take, the role of various segments in the futures industry in the associations and the consequences of mandatory membership. See 43 FR 46039 (October 5, 1978), [1977-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,679.

[64] See Prepared Statements of Messrs. Melamed, Morgan, Isaacson, Wilmouth, Stotler, Weiner and Magnussen at 9-11, 13, 2, 2, 3, 2 and 1-3, respectively. See also NFA Hearing Transcript at 137-138 and 155; and comment letter from Senator Lugar.

implement. Rather, in seeking registration as currently structured and formulated, the NFA would commence operations with responsibility for certain core self-regulatory functions and thereafter, subject to further Commission review, evolve in a practical manner to fulfill additional objectives of the Act and Commission regulations thereunder.

IV. Analysis of the NFA Application

The NFA application addresses each of the mandatory requirements for registration set forth in Section 17(b) of the Act and Part 170 of the Commission's regulations. The cumulative effect of the NFA's rules and the regulatory functions which it will assume is to demonstrate that the Commission's registration of the NFA will benefit the public interest. The discussion which follows analyzes the nature of the public interest to be served by the NFA's registration and its specific compliance with each provision of Section 17(b) of the Act and the Commission's regulations thereunder.

A. Section 17(b)(1): Public Interest

Section 17(b)(1) prohibits the Commission from registering the NFA unless it is able to find that the NFA "is in the public interest and that it will be able to comply with the provisions of this section and the rules and regulations thereunder and to carry out the purposes of this section."[65/] Commission regulations 170.1 and 170.9 reiterate the statutory standard and 170.9 in particular provides that an applicant association must "conduct its affairs consistent with the public interest to be protected by the antitrust laws."[66/]

[65/] 7 U.S.C. §21(b)(1) (1976).

[66/] Commission regulation 170.9, 17 CFR §170.9 (1981). See alsó pp. 77-80 infra.

In evaluating whether registration of the NFA would be in the public interest, the Commission considered whether a need for additional regulation of the commodities industry exists. Concluding that a regulatory gap exists and that coordination is lacking with respect to industry regulation of participants' financial responsibility and sales practices, the Commission then analyzed whether the role of a comprehensive futures association such as the NFA could serve the public interest by assuming self-regulatory responsibilities where a need has been identified. In this regard, the Commission examined the extent to which the NFA could more effectively or efficiently perform regulatory functions currently exercised by the Commission. In addition, the Commission considered the experience of the SEC with respect to its program to regulate broker-dealers that are not NASD or securities exchange members ("SECO program") as well as the SEC's reliance upon the NASD to perform certain self-regulatory functions similar to those proposed by the NFA.

1. Need for Effective Customer Protection

The NFA and others have asserted that the NFA's approach is the most practical and effective means to achieve a comprehensive self-regulatory program, and that its program is designed to fill a gap that currently exists in commodities self-regulation.[67] The approach is not intended to replace the Commission's customer protection responsibilities, but to complement those duties by providing a vehicle through which commodity firms and professionals handling customer accounts will be subject to binding, uniform ethical and financial standards.[68]

[67] See Prepared Statements of Messrs. Morgan, Sandner, Weiner and Magnussen at 5, 2-3, 2-3 and 6, 1-2, and 3-4, respectively. See also comment letters from the CME and Maduff.

[68] See, e.g., Prepared Statement of Mr. Melamed at 16.

The NFA approach will impose professional standards on industry participants not currently subject to self-regulatory ethical and financial rules. Many firms and individuals conducting customer-related commodities businesses are not regulated by a contract market and, therefore, not subject to the audit programs or disciplinary rules imposed on contract market members. For instance, 35 percent of the 376 FCMs registered with the Commission as of May 29, 1981, were not members of a contract market; neither were 99.24 percent of the 1,961 Commission-registered CTAs nor 98.83 percent of the 1,110 registered CPOs.[69/] Further, the number of contract market member FCMs remained relatively constant (declining from 217 to 205) during the period of August 1979 through August 1980, while the number of FCMs which were not members of any contract market increased by approximately 40 percent (from 108 to 149).[70/]

a. Financial Monitoring

Those FCMs which are not regulated by a contract market have been the cause of disproportionate compliance problems that might have been avoided

[69/] As of May 29, 1981, there were 32 firms that were registered as both CTAs and FCMs under the same name. Seventeen of those CTA/FCMs were not members of any contract market. Similarly, there were 19 CPOs that were also registered as FCMs, and 13 of those dual registrants were not contract market members.

[70/] In the ten years since 1970, the average volume of funds in segregation per firm (exchange member and non-exchange member) increased 4,000 percent from $.2 million in 1970 to $8.7 million in 1980, as shown in the following chart:

YEAR	AVERAGE FCM SEGREGATION	$ CHANGE	% CHANGE FROM PRECEDING YEAR
1970 *	$ 213,517		
1971 *	459,209	$ 245,692	115%
1976 *	2,105,809	1,646,600	359%
1979	4,950,000	2,844,191	135%
1980	8,737,286	3,787,286	77%

* See 42 FR 27167 (May 26, 1977).

through greater self-regulatory monitoring.[71] For instance, in 1980 alone, the financial problems of five FCMs, none of which was a member of any contract market, placed in jeopardy a total of approximately $8 million of customer funds.[72]

Nor has the loss of customer funds been confined to non-member FCMs. A number of CPOs and CTAs have experienced compliance problems that have resulted in financial difficulties. For instance, there have been major commodity pool and trading advisor failures.[73] The activities of these CPOs and CTAs have largely been beyond the jurisdiction of the existing self-regulatory organizations. There have also been several failures of firms dealing in leverage transactions and in illegal futures and options.[74]

b. Sales Practice Regulation

The problems which the Commission has identified with respect to the financial responsibility of non-member FCMs, CPOs and CTAs may well reflect even more serious problems regarding the sales practices of these industry participants. In particular, it has been the Commission's experience that in

[71] See Prepared Statements of Messrs. Weiner and Sandner at 3 and 3-4, respectively.

[72] Three firms filed in bankruptcy: Incomco, Inc. ($2 million in customer funds); Chicago Discount Commodity Brokers, Inc. ($3.8 million or more); and Bengal Trading Corp. ($1.8 million). One firm was placed in receivership: Pyne Commodities Corp. ($400,000). These dollar figures reflect the total exposure of customer funds threatened by the FCMs' financial difficulties. The actual amount of customer losses, however, may be less, because the bankruptcy trustees are endeavoring to recover funds that may be distributed ultimately to customers.

[73] Three CPOs were placed in receivership in 1980 and two in 1981. Two CTAs were placed in receivership in 1981.

[74] Approximately 15 such firms either were placed in receivership or filed in bankruptcy during 1980.

many of the instances where financial difficulties have forced non-member FCMs or CPOs into bankruptcy proceedings, the financial failure frequently has been the result of, or coupled with, the misuse of customer funds.[75/] While routine financial auditing of such firms and periodic examination of their sales practice, supervisory and back office procedures would not serve as a guarantee against the loss of customer funds through fraud, such routine surveillance could serve as a means of early warning against improper financial or sales practices and thereby prevent or at least mitigate potential losses.

With respect to the need for a futures association to assume regulatory responsibility for commodities sales practices, the Commission notes that the problem is not one which is confined to non-contract market member firms. The contract markets themselves either do not currently have rules and programs for conducting retail sales audits of their members or, if they do have such rules and programs, do not conduct retail audits routinely.[76/] To remedy this regulatory deficiency, the eleven exchanges each could be required to adopt and enforce individual rules and programs focusing on customer protection. The burden upon many firms to comply with as many as eleven separate sales practice programs,[77/] however, led many commentators to object to provisions in the NFA's Articles and rules which would preempt the effectiveness of NFA sales practice rules where any member contract market had adopted rules governing the same conduct.[78/]

[75/] See pp. 27-28 infra.

[76/] Testimony of Messrs. Wilmouth, Sandner and Johnston, NFA Hearing Transcript at 135, 147-48, and 121-23, respectively.

[77/] See, e.g., CBT Rule 423.01 and CME Rules 442 and 443. CBT members and employees thereof are prohibited from soliciting discretionary accounts through advertisements, while CME members and their employees may advertise if within the bounds of "truth and good taste" and their publications are filed with the CME Public Information and Marketing Department.

[78/] See Article III, Section 2 and Compliance Rule 2-1.

In response to those objections, NFA amended these provisions to assure that its regulatory program with respect to sales practices would not be preempted by any conflicting contract market rules and that NFA could enforce its rules against all NFA members.[79] Indeed, the desire to eliminate or avoid duplicative regulatory requirements has been a motivating factor underlying the NFA's development and application from its inception.[80] In addition, from the Commission's viewpoint, the practical task of overseeing eleven exchange programs, each reflecting individual self-interests, would impose a more time-consuming burden on the Commission than registering and overseeing an association whose principal purpose is to regulate the retail activities of its members uniformly under rules that satisfy Commission standards.

The incidence of financial problems among non-member FCMs, CPOs and CTAs, the uniform lack of adequate sales practice regulation, and the recognized desire of industry participants to avoid the burdens of duplicative and conflicting regulations all demonstrate that a need exists for both broadening the scope of existing regulation and, where appropriate, seeking to lend uniformity to the framework of self-regulation.[81] The NFA's application is responsive to these regulatory needs and, upon implementation of its programs, would appear to represent a significant contribution to furthering the public interest in effective and efficient regulation of the commodities industry.

[79] Response I at 7-10 and Response II at 1-2.

[80] Prepared Statements of Messrs. Melamed, Sandner, Stotler and Weiner at 8, 5, 2 and 2, respectively. *See also* comment letters from A.G. Becker, the CME, and Bache.

[81] Justice raised a concern that registration of the NFA was not an appropriate means of protecting the public interest unless the Commission could demonstrate that a "market failure" had occurred. Under its statutory interpretation, however, Justice would have the Commission add a new registration requirement for futures associations which does

(footnote continued)

2. Registration of the NFA is a Reasonable Response to a Demonstrated Need for Regulation

While the Commission believes that the NFA and those commenting upon its application have demonstrated that a legitimate need for changes in the current regulatory framework exists, the Commission also has considered whether approaches other than registration of the NFA might better serve the public interest. As discussed below, the Commission does not believe that it is possible to demonstrate that another regulatory approach would necessarily be more effective, or less anticompetitive, in serving the public interest than registration of the NFA.

a. Direct Commission Regulation

The Commission has primary oversight responsibility under the Act for the prevention of abusive practices and the protection of the public engaged in commodity futures trading. In fiscal 1980, the Commission regulated the activities of over 3,000 contract market members, 360 FCMs, more than 38,000 Commission-registered industry salespeople and nearly 2,600 CTAs and CPOs.[82/] The Commission,

Footnote continued

not exist in the Act or regulations, or would require the Commission to substitute Justice's narrow view of the public interest for the independent judgement of the Commission, which Congress in this instance recognized as the final arbiter of any preceived conflicts between the public interest and the antitrust laws. Justice's argument, however, seems to be premised on its view that registration of the NFA would have anticompetitive consequences. As discussed in the Commission's Section 15 analysis infra, the Commission is not convinced that, on balance, registration of the NFA will be accompanied by any anticompetitive effects. To the extent that any such effects are evidenced, the Commission believes that the factors discussed above illustrate market deficiencies which would warrant registration of the NFA. While these deficiencies may not be considered a "market failure" in a purely economic sense (i.e., the marketplace does not provide the most efficient allocation of resources), the Commission believes that the NFA and the commentators have identified substantial gaps in the current self-regulatory framework (e.g., lack of adequate sales practice regulation) and unnecessary duplication of regulatory functions that have resulted in a failure of the marketplace efficiently and effectively to thwart financial failures and the misuse of customer funds.

[82/] See the Commission's 1980 Annual Report at 12.

in its efforts to provide the needed level of customer protection, has devoted enormous staff resources to audit and enforce its customer protection and segregation rules and minimum net capital requirements.[83/] The Commission's staff conducted 313 audits of commodity firms handling customer funds during fiscal 1980[84/] and, to assure the maintenance of contract market rule enforcement programs consistent with the requirements of Commission regulations 1.51 and 1.52,[85/] conducted 14 rule enforcement reviews of exchange programs for both financial and trade practice rule enforcement compliance.[86/]

The Commission's regulatory duties also include the review of new applications for designation as a contract market under Section 6 of the Act and the review of contract market rule submissions pursuant to Section 5a(12) of the Act.[87/] In this regard, the Commission notes that it recently adopted rules under Section 4c(c) of the Act which will authorize a three-year pilot program for the trading of options on designated futures contracts.[88/] The Commission anticipates that,

[83/] In fiscal 1980, 41 members of the Commission's professional staff expended over 60 thousand hours (approximately 35 percent of the Division of Trading and Markets' total working hours) monitoring the financial and customer business practices of FCMs, CTAs and CPOs at a cost of nearly $1 million. In comparison, during the first eleven months of fiscal 1981, over 59 thousand hours were expended by 37 staff professionals monitoring those activities at a cost of over $900 thousand. Nearly 13,000 of those hours were spent auditing non-contract market-member FCMs for compliance with the Commission's customer protection and financial rules, at a cost of almost $200 thousand.

[84/] See the Commission's 1980 Annual Report at 124.

[85/] 17 CFR §§1.51 and 1.52 (1981).

[86/] See the Commission's 1980 Annual Report at 120.

[87/] Id. at 117.

[88/] The Commission adopted the regulations authorizing the options pilot program at a public meeting on September 8, 1981. Under Section 4c(c) of the Act, the Commission's rules cannot become effective until the expiration of thirty calendar days of continuous session of Congress after the date of transmittal to Congress of such rules and documentation of the Commission's ability to regulate successfully these options transactions.

under its pilot program, the Commission's regulatory duties with respect to applications for designations as contract markets to trade commodity options and the submission of related contract market rules will increase considerably.

The Commission notes that along with the significant increase in the number of commodity firms and persons registered with the Commission,[89] there has been a significant expansion of public participants in the futures markets. With increased customer participation, more complaints have been filed with the Commission's reparations staff. While 540 complaints were filed in 1977, this figure increased to 1,401 in 1980.[90] It is also noted that customers often make complaints to the contract markets or the commodity firms themselves, in which case it appears that a large number of possible actions go unreported to the Commission.

Where the Commission identified or became aware of compliance deficiencies by regulated entities, it brought nine preliminary and permanent injunctive actions against firms for conducting illegal commodity options and off-exchange

[89] The number of Commission registrants in the following categories has increased significantly during the six-year period of September 1, 1976, through August 31, 1981, as shown in the following table:

	FCMs	CTAs	CPOs	APs
8/31/81	380	1,602*	815*	43,376
8/31/80	360	1,194	697	37,585
8/31/76	274	463	375	23,825
% increase 1976-1981	39%	246%	117%	82%

Between 1980 and 1981 alone the number of CTAs registered with the Commission increased by 34 percent and the number of APs increased by 15 percent.

* The Commission notes that the number of CTAs and CPOs registered as of May 29, 1981 (see p. 21 supra), was greater than the numbers reflected here, as of August 31, 1981, the most recent date available. This discrepancy occurs annually as a result of late renewals of such registrations, which must be renewed each year by June 30. The Commission has no reason to expect that, upon receipt of late renewals, the number of registrants in these categories will decline.

[90] See the Commission's 1980 Annual Report at 28.

futures trading in fiscal 1980.[91] The Commission also instituted actions against five CPOs[92] and three FCMs, none of which was a member of any contract market during fiscal 1980, and filed four complaints alleging fraud and misappropriation of customer funds.[93] The Commission also argued appeals of eleven cases involving unlawful futures contracts and commodity options on appeal during fiscal 1980.

Notwithstanding the significant commitment of resources and public funds which these regulatory and enforcement functions entail, Justice in its comments suggests that direct Commission regulation of potential NFA members may be more appropriate than registration of the NFA for such purpose. The Commission strongly disagrees.

The Commission believes that the commodities industry is not only prepared to assume, and capable of exercising, self-regulatory responsibility with respect to the activities of industry participants, but also better equipped to devote the resources necessary to reduce significantly the considerable number of customer abuses which have occurred in the absence of effective self-regulation. Moreover, inasmuch as the industry as a whole may benefit from self-regulation of those industry segments currently subject only to the limited oversight permitted by limited Commission resources, the Commission believes it is appropriate in the public interest to assess the costs of such regulation directly upon the industry and customer beneficiaries of NFA regulation, rather than on the general public through direct Commission regulation. The effectiveness of this approach, how-

[91] In seven of the nine actions, firms have been placed in receivership. In total the Commission opened 777 and closed 689 investigative matters during fiscal 1980. Of the 36 administrative proceedings and 19 injunctive actions that were initiated, thirty of those cases were closed. See Commission's 1980 Annual Report at 94-100.

[92] Id. at 100-103.

[93] Id. at 103-105.

ever, would be jeopardized if the NFA did not have provisions which, in effect, compel NFA membership by industry participants.

While the Commission has statutory discretion to register a futures association which requires membership by all potential regulatees, it also has authority to regulate those persons and firms that do not wish to be members of any voluntary futures association.[94/] Thus, the Commission itself could directly impose and enforce business conduct and financial standards on those industry participants transacting customer business that are not association members. The Commission believes, however, that this approach would be less effective than a self-regulatory approach and that it would restrict the time which the Commission and its staff could devote to other statutory responsibilities that the Commission must fulfill, including those noted above.[95/] The Commission believes, therefore, that the NFA approach should be a more effective method of ensuring adequate customer protection and offers the means to provide a level of customer protection responsive to the needs identified above. Moreover, in light of the NFA proposal and the clear statutory mandate favoring self-regulation by a registered futures association, the Commission believes its reliance solely on direct Commission regulation of potential NFA members would be inappropriate.

In this regard, the Commission expects that, as the NFA implements its regulatory programs, the Commission will be able to reallocate portions of its staff resources from the direct auditing functions which it now performs to other priorities (e.g., oversight of the exchange-traded options pilot program, greater scrutiny of existing self-regulatory programs, review of contract market

[94/] See 7 U.S.C. §§21(d) and (e) (1976).

[95/] See Prepared Statements of Messrs. Melamed, Morgan, Isaacson, Siebens and Weiner at 13-14, 11-12, 3, 5, and 2, respectively. See also comment letters from the CME, NAFTA, and Thomte.

rule proposals and applications for designation) and to more vigilant enforcement against all fraudulent activities, whether conducted on or off the commodity exchanges. The Commission believes that the direct regulation of retail sales practices and financial activities by both the Commission and a futures association necessarily would result in duplicative regulatory efforts.[96/] It would result neither in cost efficiencies nor allow the Commission's staff the necessary time to develop other Commission programs that could enhance fair, competitive and efficient commodity futures trading.[97/]

b. Compulsory Contract Market Membership

The Commission also has considered whether the present structure of commodity self-regulation is effective to correct retail sales abuses.[98/] In particular, the Commission examined whether it should require the contract markets to undertake the direct regulation of all FCMs, CPOs and CTAs by compelling all industry

[96/] To provide biennial reviews of retail sales activities of every FCM, CPO and CTA, it is projected that the Commission would need to place at least 40 additional auditors into the regional field offices and increase its Washington staff by six attorneys and supervisors. The Commission, however, has no realistic expectation that such additional resources might be made available to it for these purposes.

[97/] Justice also questioned in its comments whether an industry-wide insurance program might be a more effective means of providing customer protection against industry participant financial and sales practice abuses. Justice comments at 28. The Commission believes, however, that the value of such an insurance program as an alternative to self-regulation is questionable. In this regard, the Commission agrees with the NFA's observation that the NFA's program "is intended as a preventative program, unlike insurance, for example, which only comes into play after a loss occurs." Response III at 11. Moreover, the NFA also raises valid concerns as to whether "insurance premiums, absent an organization such as NFA, could be sufficiently low for smaller FCMs so as not to be a serious burden on competition." Id.

[98/] See, e.g., Prepared Statement of Mr. Morgan at 5. Cf. Justice comment letter at 3-4, in which Justice asserts that the existing regulatory structure is adequate to regulate the industry and maximize consumer welfare.

participants conducting customer business to join a contract market. The Commission considered this alternative in light of a 1978 study by the Public Interest Economic Center, which concluded that a superior alternative to registering a compulsory membership futures association would be to require all participants transacting customer business to join a contract market.[99] The Commission believes, however, that such an approach would be impractical, less effective and could impose significant competitive burdens on industry participants.

The Commission notes that the contract markets have not been inclined to expand their self-regulatory functions to include industry participants otherwise subject to what have been the traditional areas of contract market self-regulation. Moreover, to realize programs comparable to that proposed by the NFA, each contract market would have to develop programs for conducting retail sales audits of its members and routinely conduct such audits.[100] In connection with such programs, the contract markets would have to adopt and enforce more extensive rules relating to customer protection. The contract markets also would be required to regulate new categories of industry participants -- CPOs and CTAs -- in which the exchanges have had no prior direct regulatory experience. The responsibility to review contract markets' multiple rules and programs would impose a more time-consuming burden on the Commission than registering one or more associations whose principal purposes are to regulate the retail activities of specified categories of members.

[99] See Competition and Efficiency in the Commodity Futures Markets at 304-306.

[100] See, p. 23 supra.

Finally, the contract market customer protection rules that currently exist and which might be adopted by each contract market could vary from exchange to exchange. Those industry participants that are members of two or more contract markets would often face conflicting exchange rules governing their customer-related activities as well as duplicative self-regulatory burdens.[101] By granting the NFA (or other futures associations) responsibility to regulate the retail sale practices and financial responsibility of specific categories of commodity firms and professionals directly, the Commission believes that the NFA will not only reduce conflicting and duplicative regulatory burdens on industry participants, but will also allow the Commission and the contract markets to reallocate more efficiently their resources to other regulatory programs.

c. Benefits of Self-Regulation by a Registered Futures Association

The Commission believes that its reliance upon the self-regulatory approach of a futures association will enable the industry to consolidate the expertise and experience of various industry segments, thereby allowing NFA readily to identify and solve industry regulatory problems. The opportunity for members to share their knowledge of developing sales practice or financial problems with a common self-regulator should encourage a response to such problems before they require Commission intervention. In this regard, the NFA will impose early warning financial reporting requirements on FCMs that are not members of any contract market. Thus, each FCM must notify, in addition to the Commission, either the NFA or its affiliated designated self-regulatory organization ("DSRO") (*i.e.*, a

[101] Prepared Statements of Messrs. Melamed, Sandner, Stotler and Weiner at 8, 4, 2 and 2, respectively. *See also* comment letters from A.G. Becker, the CME and Bache.

contract market) when its adjusted net capital at any time is less than the appropriate dollar amount.[102/] In this manner the NFA should be readily aware of any potential financial problems that could adversely affect any industry participant's dealings with a financially insecure firm. The ready availability of information concerning both financial and sales practice abuses from the NFA should improve the Commission's ability to take appropriate action where necessary to ensure that customers' funds are secure.

This reliance on industry knowledge and expertise, therefore, can benefit both the industry and customers. As one market user stated during the Commission hearing on NFA:

> Those intimately involved through market participation know potential conflict areas where irregularities may exist, symptoms of abuse will show more clearly to those experts, the intelligence network will work more quickly as a result, and surveillance will be enhanced by this first hand monitoring as will enforcement. The fact that all sectors related to market transactions are represented in NFA membership will further enhance the self-policing aspect. [103/]

Although it is difficult to measure the benefit to be derived from NFA's customer protection and financial responsibility programs, which encompass all industry participants handling customer accounts, the Commission expects that NFA will allow the Commission to decrease its staff's day-to-day monitoring activities and, therefore, reduce those costs that the Commission now incurs

[102/] See parenthetical note at Financial Requirements, Section 6. Under Commission regulation 1.12(b), 17 CFR §1.12(b) (1981), every FCM or applicant FCM that knows or should know that its adjusted net capital has fallen below the early warning dollar amount must file a notice with the Commission and its DSRO (as well as with the SEC if the applicant or registrant is also a securities broker-dealer) within five business days of such event.

[103/] Prepared Statement of Mr. Mennel at 4. See also Prepared Statements of Messrs. Isaacson, Siebens and Weiner at 5, 5 and 7, respectively; and testimony of John T. Gelderman, then President of the FIA, 1978 House Hearings at 268.

while concurrently improving customer protection. Although the Commission, in its oversight capacity, will incur some costs in overseeing NFA activities, the Commission expects that its staff will expend significantly less time and expense inspecting NFA compliance activities than it currently expends conducting field inspections and other audits of FCMs, CPOs and CTAs. Moreover, under NFA's mandatory membership approach, the Commission will not need to implement a program similar to the SEC's SECO program, and thus will be able to avoid expending substantial time on direct regulatory efforts that would merely duplicate efforts performed by NFA.

Finally, through the NFA's regulatory efforts that focus specifically on customer protection and financial responsibility, the Commission believes that NFA can effectively deter, if not reduce, the number of firms that have engaged in abusive retail and financial practices which have ultimately resulted in bankruptcy or receivership and the loss of customer funds. The Commission expects that the dedication of NFA resources to conduct full compliance reviews of FCM, CPO and CTA customer activity will have a significant prophylactic value, and that further loss of customer funds may be reduced.

d. SEC Experience

As mentioned above, Title III was adopted in contemplation that registered futures associations would act as industry self-regulatory bodies comparable to the NASD.[104] The provisions of Section 17 of the Act were modeled closely after Section 15A of the Securities Exchange Act of 1934 ("Exchange Act"), which authorizes the SEC to register national securities associations.[105] Indeed, Congress adopted some of the language of Section 15A of the Exchange Act verbatim when it drafted Section 17.

[104] See text at note 43 supra.

[105] 15 U.S.C. §78o-3 (1976).

The Commission, in considering alternatives to the self-regulatory approach offered by the NFA, examined the SEC's experience with the NASD and with those securities firms which are registered only with the SEC and are not members of any self-regulatory organization. While recognizing that "some tension necessarily exists between the vigorous regulatory pursuit of customer abuse and the legitimate business desire to avoid undue government intrusion," the SEC asserted in its testimony that based on its experience, "the self-regulatory model appears to offer the optimum vehicle" for advancing customer protection and financial responsibility, particularly in view of increasing customer participation in the commodities markets.[106]

In this regard, the SEC provided the Commission with some indication of the resources employed by that agency in supervising those parts of the industry which it regulates directly, as opposed to those industry segments that are regulated by one or more self-regulatory organizations. The SEC estimates that approximately nine staff members (approximately 15,800 working hours) are required to perform examinations and inspections of the 450 broker-dealers that have not chosen to join the NASD and instead are regulated by the SEC ("SECO broker-dealers") and another seven persons (approximately 12,000 working hours) to review financial and other reports of these SECO broker-dealers.[107] In addition, the full time equivalent of 70 persons (approximately 122,000 working hours) were involved in inspection and compliance activities regarding 1,500 investment companies and 4,000 investment advisors.

[106] Prepared Statement of Mr. Scarff at 1.

[107] This information and that which follows are based on data generated during the first two quarters of this fiscal year through the SEC's staff time and activity tracking system. See letter from Mr. Scarff to the Commission dated July 27, 1981.

In comparison to the number of Commission working hours budgeted to regulate the 2,700 commodity participants that were not subject to exchange jurisdiction in fiscal 1981, the SEC projected that it expends nearly three times as many hours in its direct regulation of 5,950 securities industry participants that are not regulated by any self-regulatory organization.[108/] In terms of staffing commitments, the Commission, when compared to the SEC's direct regulatory efforts, is unable to dedicate the resources necessary to provide customer protection and financial responsibility programs staffed at a level comparable to those of the SEC.

Moreover, at the Commission hearing on the NFA, the SEC pointed out that the SECO program is the most difficult of its regulatory programs to administer and, in the absence of any examination program other than that of self-regulatory organizations, the public relies entirely on the SEC's scrutiny. As a result of diminishing SEC resources and other factors, it was Mr. Scarff's belief that the SECO program does not extend "the kind of public protection benefits" that it should to meet its goal under the Exchange Act.[109/]

Predicated on the performance of the NASD for the more than forty years of its existence, the SEC experience indicates that there are a number of advantages resulting from reliance on self-regulatory organizations to establish effective regulation.[110/] Those advantages include a practical and effective alternative to

[108/] It is estimated that the SEC expends approximately 150,000 hours directly regulating 5,950 securities participants (25 hours per firm), while the Commission expended approximately 38,000 hours to regulate 126 FCMs and nearly 2,600 CPOs and CTAs that were not contract market members (nine hours per firm) in fiscal 1980. In addition, the SEC also employs 34 persons (approximately 63,000 working hours) to perform examinations, inspections and compliance activities on an oversight basis for the over 3,000 broker-dealers that are NASD members. Id.

[109/] See testimony of Mr. Scarff, NFA Hearing Transcript at 97.

[110/] See Prepared Statement of Mr. Scarff at 2. See also Prepared Statement of Mr. Morgan at 6; and comment letter from the CME. The SEC also pointed out that NASD did not emerge mature at birth, but developed in an evolutionary manner over a period of years.

attempting direct government regulation on a wide scale and the ability to "bring industry knowledge and experience to bear on regulatory problems, thus fostering sensible, as well as effective, solutions to those problems."[111] In addition, self-regulation permits participation in the development process by those firms and persons that will be subject to the regulation, "with the object of harnessing industry involvement to establish industry-defined standards that may, where appropriate, go beyond the requirements imposed by a governmental body."[112]

* * *

On the basis of the demonstrated need for greater regulatory involvement with the activities of both contract market member and non-member FCMs, as well as CPOs and CTAs not currently subject to self-regulation, the lack of adequate Commission resources to devote to direct regulation of such persons, the benefits to be realized by self-regulation, and the Commission's appreciation of the SEC's experience with self-regulation by the NASD, the Commission believes that there is an established need to register a futures association which can demonstrate its ability to comply with the public interest standard of Section 17(b)(1) of the Act.

B. Sections 17(b)(2), (3) and (4): Eligibility, Statutory Disqualification and Qualification Standards for NFA Membership

Section 17(b)(2) of the Act[113] states that the Commission shall not register a futures association unless the association has promulgated rules which permit

[111] Prepared Statement of Mr. Scarff at 2-3.

[112] Id. at 3. The SEC also advised the Commission that a potential disadvantage exists in that an "industry group will act in an anticompetitive manner, or that it may be less diligent in enforcing standards that it adopts. . . ." Id. In this regard, the Commission concurs with the SEC in its belief that government oversight can address those concerns when they arise and thereby assure effective self-regulation.

[113] 7 U.S.C. §21(b)(2) (1976).

(1) any person registered under the Act, (2) contract markets, or (3) any other person designated as eligible by the Commission to become a member, unless excluded by Sections 17(b)(3) and (4)[114] or a rule of the association which the Commission has approved. Section 17(b)(2) further authorizes the establishment of a restrictive membership system which could allow for eligibility to be determined by the nature of the potential registrant's business activity or such other basis approved by the Commission. In regulation 170.2,[115] the Commission indicated that an association could restrict membership, among other things, by categories of persons registered in particular capacities with the Commission or doing business in particular geographic regions.

Article III, Section 1 of the NFA application construes the potential scope of the NFA membership by reciting as the organization's general purpose its intent " . . . to promote the improvement of business conditions and the common business interests of persons engaged in commodity futures activity. . . ." NFA has chosen to include contract markets, FCMs, agents of FCMs,[116] CTAs, CPOs and APs as those eligible for membership. In defining the scope of the organization and the universe of its potential members, the NFA considered whether persons

[114] 7 U.S.C. §21(b)(3) and (4) (Supp. III 1979).

[115] 17 CFR §170.2 (1981).

[116] As defined under NFA Article XVIII(c), "agent" means any person required to be named by an FCM on its application for FCM registration with the Commission. While the Commission notes that one commentator expressed concern that the terms "agent" and "correspondent" are not defined in the Act or regulations (see comment letter from A.G. Becker), the Commission believes that the term "agent" has a commonly accepted meaning that is within the common usage of the trade and, therefore, that a separate definition for this purpose is unnecessary. APs, however, would be excluded from the NFA's definition of agent. See Section 4k of the Act, 7 U.S.C. §6k (Supp. III 1979), and 45 FR 80485, 80486 n. 7 (December 5, 1980). See also NFA Article XVIII(d), which defines "associates" to include APs.

participating in the offer and sale of leverage contracts and dealer options also should be included.

The NFA has determined to limit its oversight to the more traditional areas of commodity futures contracts traded on designated contract markets as well as to any exchange-traded options which the Commission may permit and to exclude from its membership those persons who engage solely in the offer and sale of leverage contracts or dealer options. Nevertheless, because the Commission has suggested that it might determine to regulate leverage contracts as futures contracts,[117] the NFA would include those participants as eligible for membership if the Commission adopts the regulatory framework for leverage contracts which has been proposed.[118] In this regard, the NFA points out that its current Articles do not preclude a broader regulatory role in the future, and that persons involved in the offer and sale of leverage contracts and dealer options could be admitted to its membership.[119]

Section 17(b)(3) requires an applicant futures association to adopt rules which provide for the mandatory disqualification of certain persons seeking membership. The Act states that the registered association's rules must indicate that a person is ineligible for membership if he (1) has been suspended or expelled from a registered futures association or contract market for conduct "inconsistent with just and equitable principles of trade," (2) is subject to a Commission order denying, revoking or suspending his registration or suspending, expelling or barring him from a registered futures association or contract

[117] See 45 FR 13494 (March 12, 1979).

[118] Response I at 5.

[119] At least one leverage dealer has indicated a preference for being included in NFA. See comment letter from Monex.

market, (3) was the cause of any such action or (4) is associated with any person who, in the exercise of reasonable care, should be known to him to be ineligible for membership in the association. The NFA has promulgated standards in Bylaw 301(b) listing the circumstances under which a person may be disqualified from membership. The NFA Bylaw generally mirrors Section 17(b)(3) of the Act in its enumeration of those circumstances under which no person shall become a member or when suspension or expulsion from membership in the futures association would be warranted.

In addition, the NFA generally has incorporated a Commission interpretation concerning the Commission's standards for denial of registration into its non-statutory disqualifications.[120] That interpretation includes, among other things, convictions within the preceding ten years involving transactions or advice concerning commodities or securities, injunctions from certain activities related to commodities or securities and willful violations of the Act or of several securities statutes.

Although NFA's standards of exclusion are similar to those promulgated in the Act, there are instances in which NFA goes further than mandated by Section 17 and in which those standards differ from the Commission's standards. In particular, Bylaw 301(b)(iii) would permit a party to become a member even if the party otherwise would be ineligible if the Membership Committee finds that the reason for the ineligibility "does not cause the party to pose a threat to Members, Associates or customers." Inasmuch as the Act does not require exact duplication of Commission standards, the reasons for differing do not violate the Act or the purposes of Section 17, and Section 17(b)(3) provides for exceptions with the approval or at the direction of the Commission in cases where

[120] 17 CFR Part I, Appendix A (1981).

the Commission determines that such exception would be in the public interest, the Commission finds that NFA's bylaws concerning registration comport with Section 17(b)(3) of the Act.

Through Section 17(b)(4), the Act also requires that a proposed futures association adopt rules which establish standards with respect to training, experience, and such other qualifications as the association finds necessary or desirable for members and their associates. Under Bylaw 301 the NFA has provided for the promulgation of qualification standards, although initially the NFA will limit its qualification testing to the registration of associates.[121] With respect to associated persons, the NFA represents that it eventually may assume the Commission's responsibilities in this area and perform all registration functions. However, such action is not intended to occur immediately but rather after the NFA has placed its associate registration and testing programs into full operation.[122]

Finally, the NFA has suggested that it may use the authority contained in Bylaw 302 to "grandfather" those NFA applicants who currently are registered with

[121] See Response I at 21. The Commission, pursuant to Section 4p of the Act, is authorized to adopt such standards and written proficiency examinations for applicants for certain kinds of registration. The Commission is further empowered, pursuant to Sections 4p and 4k(3), to delegate the authority to require testing of applicants for registration to a registered futures association. The NFA intends to assume much of the clerical burden of registration and testing of associated persons, as expressly authorized under Section 4k(3) of the Act. The Commission notes that the assumption of such functions under Section 4k will require the NFA, where relevant, to follow precisely any Commission regulations concerning testing. For proposed rules concerning proficiency examinations for associated persons, see 46 FR 20679, 20681 (April 7, 1981).

[122] The Commission questioned the apparent limitation placed on NFA in the Articles, as implemented in Bylaw 301(b)(ii), to adopt standards in the form of written proficiency examinations solely with respect to associates of FCMs. NFA did note, however, that the current Articles do not preclude the association undertaking a broader regulatory role in the future. Response I at 21-22.

the Commission.[123] Certainly in the initial registration of members and associates, this procedure would expedite the required processing time.

In conclusion, NFA's proposed rules pertaining to the requirements and restrictions for registration generally comport with Sections 17(b)(2), (3) and (4) of the Act, although there are some procedures concerning registration and qualification standards which still remain to be adopted. The Commission will, of course, review such rules when proposed by NFA.

C. Section 17(b)(5): Fair Representation

Section 17(b)(5) of the Act and Commission regulation 170.3 require that the rules of a registered futures association assure fair and equitable representation of the views and interests of all of its members in adopting or amending its rules, in its procedures for selecting officers and directors and in all other phases of its affairs and activities.[124] The regulation also provides that "[n]o single group or class . . . shall dominate or otherwise exercise disproportionate influence on any governing board . . . or on any disciplinary or membership panel . . . ." The membership structure of the NFA, as well as the manner in which certain categories of its membership may exercise power through its Board, raise certain questions in light of the statutory language and the Commission's regulations adopted thereunder.

The membership will be divided into three categories -- contract markets, FCMs, and Industry Participants. Those categorical divisions pervade the NFA's Articles, Bylaws and Rules and form the basis for the composition of the Board,

[123] Response I at 24.

[124] 7 U.S.C. § 21(b)(5) (1976); 17 CFR § 170.3 (1981).

the Executive Committee and the Nominating Committee. Each of the eleven contract markets which comprise the first category will select an individual to serve on the Board. In addition, those contract markets which captured more than 20 percent of the previous year's total volume on all contract markets will be entitled to an additional representative. At the present time, two contract markets meet this test; thus, there will be a total of thirteen contract market directors. The second category will be composed of all FCMs, contract market as well as non-contract market members, who will elect a total of fourteen Board members. FCMs with more than 50 branch offices will be represented by six directors, FCMS with 16-50 offices will fill four directorships, and FCMs with 1-15 offices also will have four Board representatives. The third category, Industry Participants, will encompass all other NFA members, with ten Board seats allocated among CPOs (two directors), CTAs (three directors), commercial banks (two directors), and commercial firms (three directors). There also will be three Public Representatives on the Board.

The nine-member Executive Committee will be made up of the NFA's President, one contract market director from among those having one Board seat and one from a contract market allocated two Board directorships, three FCM directors, two Industry Participant directors and one Public Representative director. The Nominating Committee will be composed of five subcommittees -- FCMs, CPOs, CTAs, commercial firms and commercial banks — each having three members. Each FCM member will be drawn from a different size subcategory, i.e., one from the 1-15 offices group, one from the 16-50 offices group and one from the over 50 offices group.

Given the structure and comprehensive authority of the Board and Executive Committee, the Commission considered whether the interests of the members comprising each category will be equitably represented. In particular, the Commission and commentators raised essentially three issues with respect to the provisions governing contract market representation. The first is whether contract markets should be entitled to have any voice in the NFA's government since, as separate entities, they will not be subject to the NFA's regulations.[125] Further, inasmuch as contract markets are a composite of other groups (FCMs, CPOs, CTAs) which will have their own representatives and the only components of contract markets which will not be separately represented are floor brokers and floor traders (who will not, in any case, be regulated by the NFA), the Commission also considered whether the representation of contract markets was consistent with the requirements of fair representation under the Act.[126]

The second issue relates to the degree of representation allocated contract markets in comparison to other categories.[127] Exchanges will be represented on a one member, one vote basis, as well as on a proportional basis (those with greater volume, i.e., larger exchanges, will fill two directorships).[128] FCMs and Industry Participants, on the other hand, have not been allocated Board seats in a directly proportional manner -- there is no consistent relation in the number of members in each category or subcategory to the number of directors they will elect.

[125] See Comment Letter, Articles at 9. See also comment letter from the CME; and Prepared Statements of Messrs. Melamed and Morgan at 17-20 and 7-11, respectively.

[126] See, e.g., comment letter from Spiegel and Fain and Prepared Statement of Mr. Morgan at 7-8.

[127] See comment letters from Dean Witter, the NASD, Conti and Heinold, Justice, Spiegel and Fain, NAFTA and Clayton. See also Prepared Statements of Messrs. Morgan, Weiner and Magnussen at 8, 7-9 and 5, respectively.

[128] If one or more new boards of trade are designated as contract markets, however, only those eleven contract markets with the greatest annual volume will be represented on the NFA Board. Article VII, Section 2(a).

Third, some comments addressed whether the provisions of Article XVII comport with the fair representation requirements of Section 17(b)(5) of the Act and Commission regulation 170.3.[129] That Article requires ratification by two-thirds of the contract market directors, but only a majority of the directors in the other categories, before proposed changes in the Articles may be presented for full membership vote. Commission staff and commentators questioned the purpose of the provision, given the potential for as few as three contract markets to veto a proposal which the remainder of the Board as well as a majority of the NFA members may favor.[130]

Additional issues concerned the lack of distinction between exchange and non-exchange member FCMs and the absence of any direct voice on the Board for FCM agents and associates. Commentators questioned whether non-member FCMs would be equitably represented unless they were assigned a specific number or proportion of the directorships allotted to the FCM category.[131] Similarly, questions were raised with respect to the fairness of compelling agents to be members and pay dues, requiring APs to register as associates and subjecting both agents and associates to the NFA's rules, without affording them the opportunity to participate in the NFA's decision-making processes.[132]

The NFA organizers maintain that the NFA's application recognizes that a system of fair government is imperative not only for the NFA to gain registration, but also to gain credibility within the industry and thereby operate in a

[129] See Comment Letter, Articles at 9; and comment letters from Conti and Heinold, Paine Webber (August 27) and Clayton.

[130] See, e.g., comment letters from Paine Webber (August 27) and Clayton.

[131] See Comment Letter, Articles at 6; and comment letters from A.G. Becker, Clayton and Spiegel and Fain. See also Prepared Statements of Messrs. Siebens and Weiner at 3 and 7, respectively.

[132] See Comment Letter, Articles at 7; and comment letter from A.G. Becker.

viable manner. The NFA's initial draftsmen and its organizing committee consistently have maintained that the participation of the contract markets would provide a valuable resource. They also believed that any private organization which would regulate those who trade commodity futures should permit contract markets, where all transactions are executed and which ultimately would be affected by those regulations, to become members.[133/]

Moreover, the organizers believed that if the NFA was to maximize its goal of regulatory efficiency, full contract market participation would be essential. If contract markets were to relinquish some of their oversight roles in favor of the assumption of those tasks by the NFA, they would have to have a voice in the matter. Otherwise, the organizers believed that duplicative regulations would not be eliminated and contract markets would not be inclined to require their member FCMs to join the NFA.[134/]

Finally, the organizers stated that the industry leadership, which traditionally has been found at the contract markets, is vital to the NFA's stability and vitality. In that vein, contract market representatives have devoted considerable time and effort and contributed substantial capital in anticipation of the central role they will have in aiding the NFA's development. Indeed, although the NFA eventually may have been organized without exchange leadership, the exchanges and other industry officials provided the impetus necessary to organize this broad-based futures association and proceed with its application for registration.

The Commission acknowledges that contract market participation in decision making was an issue crucial to the NFA's formation. The Commission also recognizes that contract markets have considerable interests at stake in NFA in terms

[133/] See Prepared Statement of Mr. Melamed at 6.

[134/] See n. 15 supra.

of the financial contributions they have made and will continue to make and in terms of the responsibilities they will relinquish to the NFA. However, the Commission must also examine the continuing role of the contract markets in the governance of the NFA from the perspective of those who will be subject to NFA regulation.

In this regard, the Commission reviewed the appropriateness of the NFA providing contract markets with a voice in the conduct of its affairs. The absence of NFA regulation over contract market functions raises the issue of why contract markets and major portions of their memberships (floor brokers and floor traders), which also will not be subject to NFA regulation,[135] should be participating in the governance of non-contract market members which are subject to NFA regulation. Further, to the extent that contract market members are subject to NFA regulation (e.g., FCMs) they are assured an independent voice in the NFA's governance. Accordingly, at least one commentator has questioned whether the provision of Board representation of contract markets is duplicative and therefore unnecessary.[136]

In response to this concern, commentators as well as the NFA point to the experience of contract markets in developing and maintaining effective self-

[135] The NFA preempts itself from adopting, administering or enforcing any rule or procedure which would purport to govern the conduct of business on any contract market's trading floor. Article III, Section 2(b)(v). The NFA notes that "[f]loor brokers are regulated by the contract market where they conduct business, and not by NFA. Thus, floor brokers are not compelled to join NFA in order to accept futures orders for execution." Registration Statement at 8. See also Article III, Section 2(a).

[136] Spiegel and Fain commented that Board actions will be in the interests of contract market members since "[i]t would appear that there is no difference between the membership make-up of the contract markets and the members themselves . . . ."

regulatory bodies.[137/] The NFA contends that contract markets are the organizations most representative of the industry as a whole.[138/] Furthermore, the NFA asserts that since contract markets eventually will withdraw from certain areas of regulation, they should be able to participate actively in the decisions which pertain to whether the NFA is better suited to assume regulatory responsibilities which the contract markets previously have exercised.[139/]

The Commission believes it is appropriate for the NFA to recognize the stake that contract markets have and the insight they can offer in the development of the NFA's rules. The Commission finds merit in the argument advanced by the NFA and others that the expertise of contract markets will be a valuable resource to the fledgling organization. Particularly in its formative stages, the NFA will gain the benefit of the contract markets' experience with self-regulation. This may assist the NFA in overcoming unanticipated hurdles which are more than familiar to contract markets. The Commission believes, however, that as the lines of responsibility between the NFA and the contract markets become more particularly defined and as the NFA institutes its regulatory programs and becomes comfortable in their operation, the NFA should reexamine the structure of its government, particularly the further need for the current level of representation of the contract markets.[140/] In short, while the Commission does not believe that contract market representation is essential to the functioning of the NFA, it also believes that there is sufficient flexibility in the Act and regulations to allow for NFA's proposed representative structure.

[137/] See comment letters from the CME and NAFTA.

[138/] See Response I at 12.

[139/] Id. at 11.

[140/] See Prepared Statement of Mr. Morgan at 9.

Having concluded that contract market representation is not inappropriate, the Commission also considered whether the number of contract market directorships is acceptable in relation to those allotted to the other industry segments. There will be eleven contract market members in the NFA and thirteen directors on the Board to represent them. In contrast, 360 FCM members will be represented by 14 directors on the Board, and Industry Participants, including some 2,000 CTAs, 1,100 CPOs and an undetermined number of commercial firms and commercial banks, will have a total of ten directors to represent them. These figures reflect that representation (at least currently) will be on basically a one member, one vote basis for exchanges,[141] but not for FCMs or the subcategories of Industry Participants.[142]

The Commission recognizes that strict representative government (one member, one vote) is not required by the Act or regulations. Rather, all that is necessary is that the system be fair and equitable. The NFA maintains that contract market representation, in the form prescribed, is essential to ensure that duplicative regulation is avoided (i.e., each contract market must be able to present its views regarding how it can eliminate rules that overlap those of the NFA) and to provide base funding.[143] Indeed, contract markets have already invested considerable time and financing and will be a substantial source of funds under the dues structure established by the Bylaws.

[141] In this regard, however, the Commission notes that exchange representation itself is at best an approximate attempt at providing exchanges as a group with a voice in the governance of the NFA. In fact, at present each exchange will be provided at least one Board representative regardless of whether that exchange is merely designated as a contract market in a single commodity or trades actively in a significant number of designated contracts.

[142] Dean Witter, Conti and Heinold and Justice cite this numerical imbalance as evidence of potential contract market dominance, which Justice argues may have anticompetitive effects.

[143] See Response I at 11-12.

The Commission also notes that the provision of thirteen Board directorships and two Executive Committee memberships does not per se confer dominance upon contract markets. Nor does the provision for two directors for each of the "larger" contract markets mean that they will automatically dominate the other contract markets. The NFA has established a large Board in order to mitigate the influence any particular segment might have on a smaller governing board.[144/] Even if a two-thirds majority of the contract market directors collaborate and garner the support of a majority of the other categories' directors to ratify a proposed change in the Articles, approval by a majority of the members themselves in each category also is required. That approval will serve as an intrinsic mechanism to protect against the attempts of any group of directors to effect changes which are not in the best interests of the general membership.

Moreover, the Commission expects that the contract markets will exercise good faith and not attempt to use their positions on the Board for their individual purposes rather than for the collective goals of the NFA. In any event, the Commission must approve all NFA rule changes prior to their effectiveness and, in this regard, will monitor the activities of the Board in order to assure that no segment or group of members attempts to restrict NFA development or to promote individual interests to the detriment of the NFA, in contravention of the requirements of Section 17 of the Act or the public interest considerations of Section 15 of the Act.

The third issue concerning contract markets also warrants further discussion. Article XVII, which sets forth the requirements for adopting, amending or repealing the Articles, provides that all such proposed changes must be

[144/] Earlier informal proposals of the NFA included Boards composed of 15 and 17 members, with approximately the same proportionate representation.

ratified by two-thirds of the contract market directors, but by only a majority of the directors in the Industry Participant and FCM categories before they may be presented for full membership vote. In practice, this would give the CBT and the CME in conjunction with one other contract market, or any other combination of five of the thirteen contract market directors, the power to veto proposals which could affect the entire industry.[145/] A two-thirds vote of approval is not required for any other membership category, and there is no apparent reason for the distinction.[146/]

The NFA insists that "[t]his safeguard is important to assure that changes in the Charter -- to alter the scope or mission or basic structure of NFA . . . -- will occur only if there is a broad-based industry consensus. This consensus is best reflected through the representatives of the exchanges . . . . The present requirement assures in particular that no single regional or product grouping of interests can dominate."[147/]

Although the Commission believes that amendment of the provision at some time in the future may prove necessary, the Commission is willing to approve the Article, at least for the present, for several reasons. First, the voting structure prescribed is limited to the adoption, amendment or repeal of any of the Articles. Thus, the day-to-day activities and requirements, as well as the implementation of the NFA's functions, will be unaffected. Moreover, the Commission

[145/] The CBT and CME, the two largest exchanges, together will have four of the thirteen contract market directors. Thus, only one more vote would be necessary to constitute the one-third needed for a veto.

[146/] Conti and Heinold raised this point in its comment letter and proffered an amended version of Article XVII calling for ratification of proposed changes in the Articles by a straight majority of the Board.

[147/] Response II at 2-3 (emphasis supplied).

will monitor and closely scrutinize the voting that occurs pursuant to those procedures. If the Commission determines that contract markets are exercising disproportionate influence, it will not hesitate to take action pursuant to Section 17(k) of the Act.[148] Thus, the Commission has a means to control any abusive dominance which may arise.

Finally, the Commission has determined that there is an overwhelming public interest in seeing the NFA assume its intended regulatory functions. With the safeguards available to the Commission and the internal limitation that the procedure concerns only the preliminary ratification, before the membership vote, of proposed Article changes, the Commission has determined to approve Article XVII.

Both the Commission and Justice also remarked upon the distribution of Board directorships among CPOs and CTAs as compared to those allocated to contract markets and FCMs.[149] Those groups will have the greatest number of members -- there are 1,961 CTAs and 1,110 CPOs registered with the Commission -- yet CTAs will elect three and CPOs will elect two individuals to serve as their spokesmen. Together, they will comprise only one-half of the Board representatives in the Industry Participant category. Thus, they will have to share their voting strength with commercial firms and commercial banks whose interests may vary considerably from those of CTAs and CPOs. Even in combination, their category will be entitled to only ten votes, in comparison with fourteen votes for the 376 FCMs and thirteen votes for the eleven contract markets.

The NFA's replies to these concerns assert that the representative scheme with respect to CPOs and CTAs is fair and equitable.[150] The NFA contends that the

[148] 7 U.S.C. §21(k) (1976).

[149] *See* Comment Letter at 7, 8; and comment letter from Justice at 20-21, 22-23.

[150] *See* Response I at 13; and NFA Reply to Justice at 16-19.

contract markets and FCMs have greater levels of business activity than do Industry Participants.[151] Moreover, the NFA maintains that the two former categories will bear a significantly greater proportion of the burden of funding than the latter category.[152]

The Commission believes that the Act and regulations are not so narrowly drawn that CPOs and CTAs must have more directors than the Articles currently provide simply because their aggregate membership will be numerically greater than other NFA constituents. The basic principle underlying the NFA's governing structure is to provide each membership constituency with an equitable opportunity to voice its concerns and provide its imput into the NFA's overall development and operation. The NFA's determination to base such representation on such factors as the concentration of commodity activity and its sources of funding, among other things, does not appear to be inconsistent with principles of fair and equitable representation. Moreover, any actions taken by the Board are reviewable by the Commission, which will monitor those activities to assure that all categories of membership are represented fairly.

The Commission and commentators also observed that, for purposes of Board or Executive Committee representation, no distinction is made in the NFA proposal between FCMs that are members of contract markets and those that are not.[153] This was seen by some commentators as a potential source of inequity, particularly because non-contract market members will be compelled to adhere to an initial

[151] See Response I at 13; and NFA Reply to Justice at 18.

[152] Id.

[153] See Comment Letter, Articles at 6; and comment letters from Spiegel and Fain and A.G. Becker. See also Prepared Statements of Messrs. Siebens and Weiner at 3 and 7, respectively.

system of rules which they had no voice in fashioning. Contract market member FCMs, on the other hand, are accustomed to observing equivalent standards of the contract markets and representatives of some of those FCMs participated in the formulation of the NFA's initial rules. Non-contract market member FCMs did not participate in the initial adoption of NFA rules and are not explicitly guaranteed an avenue to express their views regarding the ways in which certain NFA regulations or policy decisions may affect them differently from contract market member FCMs.

In analyzing this issue as well as all others raised by the application, the Commission carefully considered the views of those who testified and submitted comments. Specifically, one witness testified at the hearing that a directorship allocated specifically to non-member FCMs could be meaningless. He stated that "no one non-member can really represent fairly other non-members" because non-contract market member FCMs do not necessarily share common interests.[154]

Nevertheless, the Commission expects that the FCM subcommittee of the Nominating Committee[155] will be cognizant of the need for non-member FCM representation when it selects candidates for election to the Board and subsequent Nominating Committees.[156] If the slate presented by the Nominating Committee proves to be unsatisfactory, non-members could nominate one or more of their constituency for directorships by petition.[157] Since a large percentage of FCMs having fewer

[154] See Prepared Statement of Mr. Weiner at 7. Mr. Weiner spoke on behalf of Filler, Weiner, Zaner & Associates, a non-member FCM and a CPO, and not as a spokesman for non-member FCMs generally.

[155] See Article X.

[156] See Prepared Statement of Mr. Siebens at 3.

[157] Article VII, Section 3(b).

than 15 offices are not members of a contract market, it is likely that through the Nominating Committee or, if necessary, by petition, non-exchange member FCMs will have an opportunity for direct representation on the Board.

Similar arguments have been advanced regarding the lack of direct representation for FCM agents and associated persons.[158] While they too are required to be members or registered as associates, respectively, they have no spokesperson on the Board to represent their collective interests. Yet, agents will be obligated to pay annual dues, and both agents and associates will be subject to the NFA's oversight.

The NFA justifies its determination not to allocate Board seats specifically to agents and associates by pointing out that their FCM principals or employers will serve as their representatives.[159] In addition, the Board will consult with various advisory committees[160] in which the NFA anticipates agents and associates will participate directly.[161] Moreover, as the NFA has observed, the successful self-regulatory history of the NASD has been based on a representational structure which does not include direct representation of agents or associates, notwithstanding equally rigorous requirements for fair representation under the Exchange Act.[162]

The Commission, again, is aware that Section 17(b)(5) and regulation 170.3 do not mandate a one member, one vote system of government. Since agents and

[158] See Comment Letter, Articles at 7; comment letters of A.G. Becker and Justice at 3 and 19, respectively.

[159] Response I at 14.

[160] See Bylaw 703.

[161] Response I at 14.

[162] See Exchange Act §15A(b)(4), 17 U.S.C. §78o-3(b)(4). See also Response III at 4.

associates are retained in those capacities at the pleasure of their FCM principals, it is reasonable to expect that FCMs will represent the interests of their agents and APs. The advisory committees also should prove to be a valuable source of input for the Board, as well as a means for agents and associates to voice their opinions regarding regulations which affect them. Thus, the Commission believes that the views and interests of agents and associates will be represented fairly and equitably.

* * *

The Commission recognizes that the issues of fair representation likely present the most controversial questions which the NFA has been required to address and which the Commission has been required to review. While concerns as to the appropriate degree of representation of each category of participants in a broadly based governmental organization may well be inevitable, the Commission believes that, on balance, the NFA's approach reflects a deliberate and reasoned response to the concerns of all industry participants. The Commission also recognizes, however, that the most valid test of the NFA's representational structure will be its operation as the NFA proceeds to develop into a fully operational self-regulatory organization. As that organization gains operational experience, the Commission fully expects the NFA to address any aspects of its representational structure which may deter its full effectiveness or otherwise operate in an anticompetitive manner.

D. Section 17(b)(6): Equitable Allocation of Dues and Fees

Section 17(b)(6) of the Act and Regulation 170.4, promulgated thereunder, require that the rules of a futures association furnish a revenue collecting method which provides for the equitable allocation of dues among its members in order to defray reasonable expenses of administration.[163] It may not be structured in a manner constituting a barrier to entry for any person desiring to engage in commodity-related business activities.

In compliance with Section 17, the NFA's application contains proposed Article XV. Section 3 of that Article provides that different rates or amounts of dues, fees, assessments and other charges shall be levied for various categories or subcategories of members.[164] The determination to prescribe different amounts of dues for different categories is intended to reflect the expected differences in the financial burden to be borne by the applicant in carrying out programs for each category or sub-category of members. By requiring different fee rates among the different member categories, the NFA has endeavored to ensure that the revenue collecting structure will equitably allocate the burden of satisfying administrative expenses. Otherwise, if uniform rates were charged without regard to the respective financial burdens imposed on the NFA with its particular regulatory programs, the revenue structure might be inequitable.[165]

There are numerous intrinsic difficulties in devising a method of equitably assessing dues and fees among an association's members. The Commission did not interpret Section 17 as expressing a Congressional intent that the only available financing mechanism for a futures associaton was the imposition of dues as that term is generally understood.[166] As a consequence, the NFA drafted Chapter 13 of the Bylaws in part to propose a non-specified open fee structure for assessing FCM annual dues. According to this proposal, FCM members will be assessed dues

[163] 7 U.S.C. §21(b)(6) (1976); 17 CFR §170.4 (1981).

[164] Response I at 28-29.

[165] _See_, _e.g._, Response I at 29.

[166] 44 FR 20649, 20650 (April 6, 1979).

of $1,000 plus a percentage of the NFA transaction charge as well as the transaction charge itself.

One concern with the NFA's plan to collect from each FCM a transaction charge which the FCM will levy against its customers is that such charges by FCMs may, in effect, be construed as a tax and as such may be unconstitutional.[167/] The NFA argued, however, that the proposed "transaction fee" is not contrary, either directly or indirectly, to Congress' exclusive power under Article I, Section 8, Clause 1 of the Constitution to lay and collect taxes.[168/] The NFA also stated that the transaction fee is designed to provide financing of NFA directly by market users and, as such, has no resemblence to the exercise of the public taxing power.[169/] Rather, since the NFA is proposing to assume the substantive and costly function of regulating FCM members and their agents for the protection of customers against unfair practices, the transaction charge is designed merely to distribute proportionately the administrative expenses of NFA among the consumers for whom the NFA's regulatory functions will be implemented.

The transaction fee is also designed to distribute the reasonable expenses of administration among FCM members, with regard to whom NFA will assume substantial and costly regulatory burdens, including the supervision of their agents and associates.[170/] The NFA bases the measure of FCM fees on volume, which it claims will equitably distribute the cost of the self-regulatory body among the FCMs while not unfairly disadvantaging or barring

[167/] See the 1977 Justice comment letter at 59-66.

[168/] Letter from Mr. Stassen to Mr. Nathan, dated March 11, 1977.

[169/] Letter from Mr. Johnson to the Commission, dated January 31, 1978.

[170/] See Response I at 29.

any small or moderately sized FCM from entry into the commodity industry. One commentator expressed concern that this proposed dues structure might subject large FCMs to excessive fee assessments.[171] The NFA notes, however, that pursuant to Bylaw 1301(b), the transaction-based assessments shall be suspended by the Board during any fiscal year when the Board believes the NFA's budget goals for that fiscal year have been met.

The transaction fee, as originally proposed in the application, would have subjected certain non-exchange member FCMs to a greater than equitable portion of the organization's eventual operating expenses.[172] In recognition of this issue, the NFA organizers amended the language in Bylaw 1301(b) to provide an exemption for non-member FCMs who operate omnibus accounts with member firms. This amendment was added by the NFA to assure that each FCM would be levied only one assessment with respect to its direct customer relationships. Bylaw 1301 also provides that each agent shall pay to the NFA annual dues of $500. The NFA represents that this amount should be considered nominal by any realistic standard.[173]

A traditional schedule of dues is also proposed under Bylaw 1301(c) for CPOs, CTAs and other commodity participants eligible for membership under the proposal. For instance, a CPO or CTA will be assessed $500 as annual dues for the first year that it is registered with the Commission and $1,000

[171] Comment letter from Dean Witter.

[172] Bylaw 1301(b) originally required that a transaction charge for each round turn be assessed against all FCMs without providing an exemption for non-contract market member FCMs who handle omnibus accounts with member firms. Without an appropriate exemption, a non-member FCM handling an omnibus account would be required to pay the transaction charge twice. See comment letter from Spiegel and Fain.

[173] Response I at 29.

annually thereafter.[174] The NFA represents that this yearly fee is a modest assessment considering the extensive regulatory program to be imposed upon these membership categories. Further, the NFA has provided in Bylaw 1302 a provision which permits the Board, by resolution, to waive certain dues and assessments which a CPO or CTA would have to pay by virtue of dual registration with the Commission.[175] With regard to other members such as commercial firms and banks, the Board is afforded broad discretion subject to limitations on the maximum amount which may be charged.[176]

Pursuant to Bylaw 1301(a), each contract market member shall pay to the NFA an assessment calculated on the basis of each contract executed on the contract market. In recognition of the fact that contract markets do not represent a burden to the association and that their assessments are in the nature of grants, a cap is placed on the amount of assessments which may be charged these members.

[174] Kimball Associates commented in its May 18 letter that the annual dues assessed CTAs would impose a hardship on small businesses. Consequently, in lieu of the currently suggested flat fee, a sliding scale based on gross sales was suggested as a means of determining a trading advisor's annual dues. The NFA represents that subsequent dues assessed CPOs and CTAs can be reduced by a vote of the full Board. The Association further represents that the Board is in the best position to fairly evaluate the overall funding needs of the NFA and to determine how those needs can most equitably be met. Response III at 7.

[175] Response I at 30. The issue of dues assessed dual registrants can also arise in the context of FCMs which are registered as CTAs and CPOs. See comment letter from Thomte. The NFA represents that the full Board is in the best position to determine the overall regulatory costs of the NFA and how those needs are best met within the organization. Determinations as to dues for dual registrants will be based on an analysis of income and budget projections and a realistic assessment of anticipated or actual costs to NFA of conducting its regulatory programs with respect to such dual registrants. Response III at 8.

[176] Response I at 30.

The Commission's interpretation of the requirements in Section 17 of the Act has paralleled the position taken by the SEC with respect to similar provisions in Section 15A of the Exchange Act. Nevertheless, funding has been a sensitive issue throughout the development of this Title III organization. Without studied deliberation by the organizers of NFA, this issue might have been a stumbling block to the acquisition and maintenance of the broad-based industry support which the NFA has enjoyed. The Commission believes that the outcome represents a fair and balanced fee structure which is consistent with the requirements of Section 17(b)(6) of the Act. Further Board determinations concerning the fee structure and its specific implementation will, of course, be subject to prior Commission review.

E. Section 17(b)(7): Prevention of Fraudulent and Manipulative Practices

Section 17(b)(7) of the Act requires each registered futures association to establish rules "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, in general, to protect the public interest, and to remove impediments to and perfect the mechanism of free and open trading."[177] Commission regulation 170.5 necessitates the establishment and maintenance of a customer protection program, including the adoption of rules to protect customers and customer funds and to promote fair dealings with the public. In response to these requirements, the NFA has adopted a package of compliance rules which establish standards for the business conduct of its members and will form the basis of the NFA's substantive regulation of its members.

[177] 7 U.S.C. §21(b)(7) (Supp. III 1979).

Compliance Rule 2-2 forms the core of the NFA's compliance rules, much of which follows the principal antifraud section of the Act, Section 4b.[178] Other paragraphs of the Rule are modeled on definitions of unlawful or improper practices set forth in Sections 5(c), 5(d), 6(b) and 9(b) of the Act.[179] With the exception of certain culpability standards discussed below, the rule generally tracks the language of those sections of the Act by prohibiting members from cheating, defrauding or willfully deceiving their commodity customers, in prohibiting bucketing of customer's orders and bucket shops, and in making it unlawful willfully to make a materially false report to a customer or willfully to enter a materially false record (Rule 2-2(a)-(c)). The NFA further prohibits the willful dissemination of materially false or misleading information, or a knowingly inaccurate report that affects or tends to affect the price of any commodity futures contract (Rule 2-2(d)), as well as the manipulation or attempted manipulation of commodity prices (Rule 2-2(e)).

In addition, the NFA, following the principle of Section 6(b) of the Act, prohibits the willful submission of materially false or misleading information to the NFA or its agents (Rule 2-2(f)). Further, NFA members and associates may not effect trades on a contract market for any person who is prohibited by the Commission from trading on the contract market, unless the member or associate did not know or have reason to know of the prohibition (Rule 2-2(g)).

The final provision of Rule 2-2 prohibits the conversion of customer funds or other assets (Rule 2-2(h)). This section adopts much of the language, except that dealing with criminal sanctions, described in Section 9(a) of the Act.[180] The

[178] 7 U.S.C. §6b (1976).

[179] 7 U.S.C. §§7(c), 7(d), 9(b) and 13(b) (1976 and Supp. III 1979).

[180] 7 U.S.C. §13(a) (1976).

rule also comports with Commission regulation 170.5 in that the NFA has adopted requirements designed to protect customer funds.

Commission regulation 170.1 requires the NFA to demonstrate "that it will require its members to adhere to regulatory requirements governing their business practices at least as stringent as those imposed by the Commission."[181] While the Commission has stated that a futures association need not adopt requirements identical to those of the Commission, certain proposed compliance standards in Rule 2-2 seem less stringent than those of the Act since they qualify the prohibitions under the Act by inclusion of a "materiality" or "willfullness" standard, e.g., Compliance Rules 2-2(c) and 2-2(d). Furthermore, Rule 2-2 generally prohibits conduct done "willfully" or "knowingly," and thus is more limited than the analogous provisions of Section 4o of the Act,[182] which prohibits CPOs and CTAs generally from engaging in fraudulent or deceitful practices.

The NFA, however, contends that its Compliance Rules "simply reflect accepted standards of culpability which must be demonstrated before it is fair or appropriate to impose sanction . . . ."[183] The NFA has not conformed its rules to

[181] 17 CFR §170.1 (1981).

[182] See 7 U.S.C. §6o (Supp. III 1979).

[183] See Response I at 33. In this regard, the Commission notes that courts have interpreted a "willful" standard to include a violation where a person charged with a violation intentionally committed the act which constitutes the violation. Such person need not be aware that he is violating the Act, a Commission regulation or, in this instance, an NFA rule. See Tager v. Securities and Exchange Commission, 344 F.2d 5 (2d Cir. 1965); Nees v. Securities and Exchange Commission, 414 F.2d 211 9th Cir. 1969). Moreover, with respect to its regulation of CPOs and CTAs under Section 4o of the Act and the regulation of any person in connection with any commodity option transaction, under Commission regulation 32.9, the Commission understands that "accepted standards of culpability" do not require proof of scienter to establish violations of these provisions. See Commodity Futures Trading Commission v. Savage, 611 F.2d 270 (9th Cir. 1979); Commodity Futures Trading Commission and State of Georgia v. Sterling Company, et al, Comm. Fut. L. Rep. (CCH) ¶21, 170 at 24,788 (N.D. Ga. 1981). Accordingly, where the NFA brings actions against its members for any violations of its rules, the Commission understands that the NFA will apply these standards of culpability.

the requirements of Section 4b(B) of the Act, which unlike Rule 2-2(c) does not limit its application to the "materially" standard expressed by the NFA nor eliminated its variance from Section 5(c) of the Act by use of a "willfullness" standard in Rule 2-2(c). The NFA also has not addressed its failure to provide an analogous provision to Section 4o of the Act. Although the Commission believes approval of the NFA rules as submitted is consistent with the requirements of Section 17 of the Act, it notes that it would be reluctant to confer upon the NFA responsibility for exercising the Commission's registration authority or for the regulation of prospective participants in any exchange-traded commodity options program until such time as changes which explicitly conform these rules to the appropriate sections of the Act and Commission regulations are made.

The NFA Compliance Rules also address a number of miscellaneous areas not previously discussed under its business conduct section. These areas include sharing in profits (Rule 2-3), just and equitable principles of trade (Rule 2-4), cooperation in NFA investigations and proceedings (Rule 2-5), treatment of suspended members or associates (Rule 2-6), discretionary accounts (Rule 2-8), supervision (Rule 2-9), recordkeeping (Rule 2-10) and compliance jurisdiction (Rule 2-11). These rules comport with the appropriate standards set forth in the Act and the Commission regulations or otherwise are not contrary to the Act or regulations.

The Commission also notes that, as originally submitted, Compliance Rule 2-1 provided that the NFA would not charge a member with an offense if the specific conduct alleged to constitute the offense was governed by the rules of a contract market, regardless of whether the contract market was taking or had taken disciplinary action. The Commission believed that the NFA's determination to waive enforcement of its rules against NFA members or associates who are subject to similar contract market rules was inconsistent with the required maintenance of an effective rule enforcement program. In response to these concerns, the NFA amended its proposed rule to give explicit jurisdiction to the NFA where a contract market has expressly delegated enforcement responsibility to it or if the offense under these Rules is a violation of the NFA financial standards or customer protection requirements. The Commission believes that this provision, as amended, is consistent with the requirements of Section 17 of the Act and the Commission's regulations thereunder.

With respect to its enforcement capability, Commission regulation 170.5 requires a futures association to "establish and maintain a customer protection program" by which to enforce compliance with those rules.[184/] The NFA rules provide that an Office of Compliance ("Compliance Office") managed by the Director of Compliance ("Director") will be established as the investigatory arm of the NFA to conduct audits and examinations and investigate violations of NFA rules as well as to prepare reports and conduct prosecutions. The Compliance Office will conduct investigations on the Director's own initiative, at the Commission's direction, and upon information received by the NFA, such as complaints from customers or members. The Director has the authority to compel members and associates to give testimony and produce records in response to questions concerning violations of NFA rules (Rule 3-1). The Director and employees or agents of the Compliance Office are prohibited from having any connection with members and associates without the President's approval. They are further prohibited, unless they obtain the President's approval, from trading, directly or indirectly, in commodity futures, commodity options, or leverage contracts (Rule 3-1(b)).

The Commission notes, however, that although the NFA has not found it feasible to make financial and employment commitments at this time, it has represented to the Commission that the office will be staffed adequately.[185/] The

[184/] 17 CFR §170.5 (1981).

[185/] See Registration Statement at 71.

Commission will monitor the NFA's development to ensure that the NFA has adequate staffing and develops an effective regulatory program. If the Commission is not satisfied with the NFA program or staffing, it will take appropriate action to enforce compliance by the NFA with the requirements of Section 17 of the Act or otherwise assure that the NFA rectifies any deficiency in its programs.

Accordingly, the Commission finds that the rules of NFA "are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, in general, to protect the public interest, and to remove impediments to and perfect the mechanism of free and open trading" as required by Section 17(b)(7) of the Act.

F. Sections 17(b)(8) and (9): Disciplinary Proceedings and Membership Denials

Sections 17(b)(8) and (9)[186] of the Act and Commission regulations 170.6 and 170.7[187] provide that the rules of a futures association must provide for appropriate discipline for rule violations and that any such discipline be imposed pursuant to a "fair and orderly procedure." Section 17(b)(9) also includes certain minimum procedural safeguards which the association's rules must provide. Specifically, that section requires a futures association to provide in its rules that specific charges be provided and notice be given to respondents, an opportunity to defend against such charges be provided, a record of the proceeding be kept. In addition, the determination must set forth any acts or practices in which the member or associate was found to have engaged or omitted, the specific rules of the futures association deemed to be violated, whether the conduct is deemed to be inconsistent with just and equitable principles of trade, and the penalty imposed. Many of these requirements also apply to determinations concerning membership denials.

[186] 7 U.S.C. §21(b)(8) and (9) (1976).

[187] 17 CFR §§170.6 and 170.7 (1981).

The NFA's Compliance Rules 3-12 and 3-13, which govern the procedures for disciplinary actions -- from initiation of the investigation through appeals -- substantively replicate the disciplinary procedure listed in Part 8 and applicable portions of Part 9 of the Commission's regulations.[188] The Commission believes that its establishment of standards for disciplinary procedures in Parts 8 and 9 reflect appropriate standards not only for contract markets, but also for registered futures associations. In fact, the NFA has largely modeled its rules on Parts 8 and 9, although a number of the NFA rules governing disciplinary actions contain additions to or deviations from the corresponding Commission regulations.

The NFA also has established its procedures for denial and revocation of membership or registration in Bylaw 301(d). This bylaw provides procedural safeguards for applicants and existing members or associates who do not meet the qualifications to become or continue as members or associates. The procedural safeguards also apply if a person faces denial or revocation for the alleged intentional submission of an incomplete, inaccurate or otherwise false application for membership or registration. The bylaw comports with Section 17(b)(9) of the Act in that it requires, inter alia, notice setting forth the specific grounds for the determination, both initial and final, and an opportunity for hearing, as well as the maintenance of records relevant to that proceeding.[189]

To implement the requisite procedures, pursuant to Sections 17(b)(8) and (9) of the Act, the NFA has established three Regional Business Conduct

[188] 17 CFR Parts 8 and 9 (1981).

[189] Unlike the NFA disciplinary rules, the membership denial procedures were not modeled after the Commission's regulations since specific procedures for such denials have not yet been promulgated.

Committees ("BCC" or "Committee"), each consisting of nine members. Each Regional Committee will have jurisdiction over those compliance matters arising in its respective geographic region. This bylaw closely parallels Commission regulation 8.08,[190] which directs each contract market to establish at least one disciplinary committee authorized to determine whether violations have been committed, to accept offers of settlement and to set and impose appropriate penalties (Bylaw 704).

The NFA also has designated the Appeals Committee as a nine member disciplinary body to hear and decide appeals from, and review decisions of disciplinary cases by any Regional BCC in accordance with the Compliance Rules (Bylaw 702). The Appeals Committee should assure the maintenance of the procedural safeguards envisioned under Section 17(b)(9) of the Act.

The Commission believes that the disciplinary bodies established by these rules will be sufficient to carry out the NFA's obligations under Commission regulations 170.5 and 170.6. Upon staffing the Compliance Office and selecting the members of the Regional BCCs and Appeals Committee according to the terms of these rules and Commission regulations, the NFA should be in a position to take effective disciplinary actions in an equitable and expeditious manner. The Commission will, however, oversee the NFA's disciplinary, membership and registration actions to determine, among other things, whether the NFA maintains equivalent requirements and standards as those enunciated in Parts 8 and 9 of the Commission's regulations.[191]

[190] See 17 CFR 8.08 (1981).

[191] Section 17(h) of the Act, 7 U.S.C. §21(h) (1976), provides for Commission review of any disciplinary action or membership denial by a registered futures association either upon application by the person aggrieved or

(footnote continued)

Based upon the above discussion, the Commission finds, pursuant to Sections 17(b)(8) and (9), that the rules of the NFA provide for appropriate discipline of members and persons affiliated with members upon any violation of the NFA's rules, and that such discipline or any denial of membership to any person seeking membership in NFA or barring of any person from being associated with a member, will be imposed pursuant to fair and orderly procedures.

G. Section 17(b)(10): Code of Arbitration

Futures associations also must demonstrate that their rules provide for a fair and equitable procedure for the voluntary settlement of customer claims of $15,000 or less through arbitration or otherwise against association members and employees thereof.[192] These requirements are reiterated in Commission regulation 170.8[193] which further provides that an association seeking registration must demonstrate that its customer dispute resolution rules are consistent with Part 180 of the Commission's regulations.[194] Part 180 reflects

Footnote continued

sua sponte. Moreover, Section 17(h) specifically provides that application for Commission review or the institution of such review by the Commission "shall operate as a stay of such action until an order is issued upon such review . . . unless the Commission otherwise orders, after notice and opportunity for hearing on the question of a stay." In this regard, a person registered by the Commission who is denied membership by the NFA or expelled or suspended from membership in, or association with a member of, the NFA, will be able, if the NFA action is appealed or reviewed sua sponte by the Commission, to continue to do business with NFA members, notwithstanding NFA Bylaw 1101, until the Commission has had an opportunity to review the NFA action or orders that a stay shall not take effect. Otherwise, such actions by the NFA would operate to deny the Commission registrant the privileges of such registration without the opportunity for Commission review.

[192] Section 17(b)(10), 7 U.S.C. §21(b)(10) (Supp. III 1979).

[193] 17 CFR §170.8 (1981).

[194] 17 CFR Part 180 (1981).

the Commission's determination of minimum requirements for arbitration or other dispute resolution procedures which must be incorporated in contract market rules under Section 5a(11) of the Act.[195] By analogy, the Commission had determined when adopting registration standards for futures associations that the contract market arbitration standards also would be applicable to association rules governing customer dispute resolution procedures.

The NFA has adopted a comprehensive body of rules governing arbitration procedures for the settlement of customer and NFA-member claims against NFA members, employees thereof and associates. Under the NFA's complaint resolution procedures, arbitrators will hear any dispute that involves commodity futures contracts, including options traded on contract markets,[196] either (1) upon the application of a customer against any NFA member, its employees or any associate, if a claim is $15,000 or less,[197] or (2) upon delegation to the NFA by a contract market under Section 5a(11).[198] The arbitration rules require any NFA member, employee thereof or associate to submit to arbitration proceedings whenever arbitration is invoked by a customer with a claim less than $15,000. Under the mandatory arbitration procedures, counterclaims against the customer involving the same events will also be heard, up to the same dollar level.

[195] 7 U.S.C. §7a(11) (Supp. III 1979).

[196] See Response I at 39.

[197] Two commentators expressed concern that the $15,000 limit on customer claims should be increased or deleted. See comment letters from Shearson and Monex. The Commission believes that any change should be undertaken by Congress and suggests that interested persons raise this issue during the Commission's 1982 Congressional reauthorization hearings.

[198] Code of Arbitration, Section 2(a)(1) and (2).

Other disputes, including customer claims exceeding $15,000 or disputes between NFA members, may be arbitrated under NFA's discretionary arbitration provisions, if the parties agree or have agreed to arbitrate.[199] Counterclaims also will be heard in discretionary proceedings if agreed upon by the parties.

Arbitration will be heard by panels composed of three persons connected with NFA and appointed by the President.[200] However, customers with claims less than $15,000 may elect a panel that will include both a chairman and one other person who are not connected with the NFA or any member (*i.e.*, a mixed panel) to hear disputes.

All parties in any NFA arbitration proceeding will have the right to be represented by counsel,[201] and to be promptly notified of the place and time of the hearing[202] and of the names of the appointed arbitrators.[203] Furthermore, each party may appear personally to testify, produce evidence and examine any other

[199] Code of Arbitration, Section 2(b). Among the factors that will be considered when determining if other disputes will be heard are whether the dispute is more suitable for litigation (*e.g.*, availability of witnesses and need for extensive discovery), the availability of arbitrators (particulary whether the mandatory arbitration program might be adversely affected), and the availability of other arbitration forums. *See* Response I at 40-41.

[200] Code of Arbitration, Section 4(a). Those persons who may be appointed to an arbitration panel include employees, officers and partners of NFA members and other individuals who, on the specific facts, the President deems to include. *See* Response I at 42. Each candidate for appointment and appointee is required to disclose to the President any circumstance that might prevent the arbitrator from acting impartially. Code of Arbitration, Sections 4(b) and 6(g).

[201] Code of Arbitration, Section 7.

[202] Code of Arbitration, Section 8. Parties also will be notified of the amount of fees and costs when they inform the NFA Secretary of their intent to arbitrate. Code of Arbitration Sections 6(b), 10 and 11.

[203] Code of Arbitration, Section 6(g).

party.[204] A verbatim record will be made of the hearing, but no party will be required to bear the costs of making the record unless a party requests a transcript, in which case the transcript must be furnished.[205]

The arbitration award must be rendered in writing within thirty days after conclusion of the hearing and must be promptly served on each party or its representative.[206] The award will be binding on all parties and final with no right to appeal except as provided under applicable law.[207] Judgment on the award may be entered in any court of competent jurisdiction. Moreover, any NFA member, employee thereof, or associate who fails to comply with an award may be subject to disciplinary action under the NFA's compliance rules.[208]

These safeguards are consistent with the Commission's standards under Part 180 of its regulations. Accordingly, the Commission believes that the NFA has made a sufficient showing that its rules provide a fair and equitable forum for the resolution of customer complaints, thereby meeting the standards of Section 17(b)(10) of the Act and regulation §170.8. The Commission further believes that arbitration through the NFA may centralize the customer arbitration programs presently implemented by each contract market as contemplated by Congress under Sections 5a(11) and 17 of the Act[209] and, therefore, relieve the contract markets of

[204] Code of Arbitration, Section 8(b).

[205] Id.

[206] Code of Arbitration, Section 9(a).

[207] The award, however, may be modified within 20 days at a party's request, if, inter alia, it is discovered that the award was the result of fraud or perjury committed during the arbitration. Code of Arbitration, Section 9(c), (d) and (e). See also Response I at 43-44.

[208] Code of Arbitration, Section 12 and Compliance Rule 2-11.

[209] See remarks of Rep. Foley, 120 Cong. Rec. H7206 (July 24, 1978).

the expense of maintaining separate arbitration facilities.[210] Moreover, by providing customers with an additional forum for the resolution of their commodity claims, the Commission anticipates that customers' reliance upon the Commission's reparation proceedings may be reduced and the pending backlog of such cases alleviated.

H. Section 17(m): Compulsory Membership

Section 17(m) authorizes the Commission to approve futures association rules requiring -- whether directly or indirectly -- all eligible persons to become members of at least one registered futures association if such a requirement is necessary or appropriate to achieve the purposes of the Act.[211] Moreover, the Commission may make that determination and give its approval notwithstanding any other provision of law. As previously mentioned,[212] the NFA has proposed such a compulsory membership requirement with respect to Commission registered FCMs, CPOs, CTAs and agents of FCMs.[213] In the NFA's case, the compulsory membership requirement is indirect. Once joining the NFA, members would be prohibited from engaging in any customer-related business with, or on behalf of, any non-member (or suspended member) FCM, CPO, CTA, or agent that is neither a member of another registered futures association nor otherwise exempted from this prohibition.[214]

[210] See Prepared Statement of Mr. Magnussen at 7.

[211] 7 U.S.C. §21(m) (Supp. III 1979).

[212] See pp. 4-5 supra.

[213] In addition, APs affiliated with a member FCM or agent must themselves register with or be members of the NFA. Bylaw 301(a).

[214] Bylaw 1101. See also Article III, Section 1(f).

The issue concerning the Commission's authority to approve rules compelling membership in a futures association surfaced in 1977, when the NFA put forward its proposed approach to ensure the comprehensive effectiveness of its regulatory programs. The NFA proposed to prohibit NFA members from handling customer business for any firm not also a member of NFA,[215/] thereby assuring its jurisdiction over all industry participants toward whom the NFA's programs were directed. Justice asserted at that time, however, that not only did Congress not intend Section 17 to infer compulsory membership, but also such a membership requirement was unconstitutional under the Fifth Amendment[216/] and inconsistent with antitrust law. Subsection (m) was added to Section 17 by the Futures Trading Act of 1978[217/] to settle the question whether the Commission has the authority to register a futures association which provides for mandatory membership.

[215/] See letter from Mr. Johnson to Commissioner Dunn, dated January 31, 1977, with an accompanying memorandum dated January 20, 1977 from Mr. Johnson to the NFA organizing committee.

[216/] See the 1977 Justice comment letter. In light of the adoption of Section 17(m) of the Act, Justice apparently no longer contends that a compulsory membership requirement would be unconstitutional. See Comment letter from Justice. In 1977, Justice relied on several Depression-era cases that involved statutes which the Supreme Court held to be unconstitutional delegations of legislative authority. See, e.g., Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935), which struck down a statutory provision permitting the President to approve a code of regulation proposed by a trade association for all persons engaged in the interstate buying and selling of live poultry. Since 1935, however, Congress enacted, and the Supreme Court has upheld, statutes granting greater government oversight of private association activities. See, e.g., Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381 (1940). See also Federal Power Commission v. New England Power Co., 415 U.S. 345, 352-53 (1974): "The notion that the Constitution narrowly confines the power of Congress to delegate authority to administrative agencies, which was briefly in vogue in the 1930's, has been virtually abandoned by the Court for all practical purposes. . . ." (Marshall, J. concurring).

[217/] Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865, amending 7 U.S.C. §21 (1976).

In enacting current Section 17(m), Congress took note that:

> This objective [of effective self-regulation] would be frustrated if futures industry professionals were free to discontinue their membership in the relevant association or associations when their own acts and practices came under scrutiny or investigation -- since a title III association could not investigate, discipline, or impose corrective sanctions on non-member persons and firms. 218/

Congress thus affirmatively rejected the arguments against a mandatory approach to futures association membership. Instead, Congress expressly authorized the Commission, in its discretion, to approve requirements that directly or indirectly mandate membership in futures associations in order to prevent the associations' inability to enforce their standards. When introducing the 1978 amendment, Rep. Foley stated that:

> [a]t the present time there are industry participants operating largely beyond exchange supervision which are increasing in number. Regulation of any such persons could be achieved through expansion of Commission activities or, instead, through registration of one or more futures associations which would provide a self-regulatory program under Commission oversight. The committee has left the determination of that issue to the Commission. It has, however, included an amendment which provides expressly that the Commission may approve rules for any futures association or associations that would require persons eligible for membership to become members of at least one such association, upon a determination by the Commission that such rules and regulations are appropriate to achieve the purposes and objectives of the Act. Use of the authority of this amendment would be completely discretionary with the Commission. 219/

Thus, there is no longer any question that the Commission may, in registering a futures association, entertain and approve a proposal that would, in effect, mandate membership in the association.

218/ S. Rep. No. 850, 95th Cong., 2d Sess. 31 (1978).

219/ Remarks of Rep. Foley, 124 Cong. Rec. 7206 (daily ed. July 24, 1978) (emphasis supplied). See also 1978 House Conference Report at 26-27.

The NFA proposal focuses on those members involved in the flow of customer orders (i.e., FCMs and their agents, CPOs and CTAs, but not floor brokers or floor traders). It is likely that most if not all industry participants handling customer accounts will seek to join the NFA, either voluntarily, under contract market requirement or in order to do business with NFA members -- thus the compulsory effect of the prohibition. Although those not joining the NFA will not be restricted from conducting business with other non-members, the need to use contract market members for order execution services on each of the contract markets will, for all practical purposes, make non-NFA membership highly unlikely.[220/]

The Commission also notes that the prohibition will not be effective immediately. Rather, it will be imposed in conjunction with the phase-in of corresponding regulatory programs.[221/] For example, FCM members will not be prohibited from dealing with non-member FCMs until the FCM membership and surveillance programs are in operation.[222/] Accordingly, at no time will any person be subject to the prohibition against order acceptance unless the person has become an NFA member and the NFA has adopted and implemented a regulatory program with respect to that person's category of membership.

Having considered the record before it, and, in particular, the significant public interest benefits which will be realized through registration of the

[220/] NFA intends to urge all the contract markets, which themselves are expected all to be NFA members, to require their own members to join NFA. See Prepared Statement of Mr. Melamed at 19. The Commission recognizes, however, that it is not necessary that all contract markets require their memberships to join NFA in order for the prohibition to result in virtually industry-wide NFA membership.

[221/] See Response II at 4. See also p. 8 supra.

[222/] Id.

NFA and implementation of its self-regulatory programs, the Commission believes that NFA's membership requirement is fully appropriate to achieve NFA's objectives and the purposes and objectives of the Act. Requiring membership in a registered futures association is an essential factor in providing the effective, industry-wide customer protection that the NFA proposes. If membership were purely voluntary, those engaging in abusive practices could evade self-regulatory compliance and sanctions simply by not joining, or by resigning from, the NFA or any comparable organization. Effective self-regulation will, in turn, reduce the Commission's (and thus the taxpayers') increasing and costly burden to monitor the activities of the various professionals not subject to appropriate industry regulation and to enforce compliance under the Act.

V. Section 15 Considerations

Under Section 15 of the Act, the Commission must "consider the public interest to be protected by the antitrust laws and . . . endeavor to take the least anticompetitive means" to achieve the objectives and policies of the Act in approving bylaws and rules of registered futures associations established pursuant to Section 17.[223/] Thus, in reviewing the NFA's application, the Commission has balanced the potential anticompetitive effects of the NFA's requirements and procedures, the interests to be protected by the antitrust laws, and the regulatory benefits to be derived from this proposal. The Commission is not required, however, to choose the least anticompetitive means in acting upon the NFA's application. Rather, given the Commission's statutory responsibilities and the complexities of the commodities industry, it is incumbent upon

[223/] 7 U.S.C. §19 (1976).

the Commission to give due weight to the regulatory consequences of NFA registration and the interests of self-regulation.[224/]

In addition, the Commission notes that possible inconsistencies with antitrust law need not prevent the Commission from approving rules that, in effect, serve to compel membership in a futures association. Indeed, Section 17(m) of the Act permits the Commission to approve compulsory membership rules that are necessary or appropriate to achieve the purposes and objectives of the Act notwithstanding any other provision of law. The Commission nevertheless has examined NFA's application in light of the possibility that its compulsory membership requirement may act as a disincentive to competition.

The ramifications of not registering the NFA must be considered together with any anticompetitive implications which the proposal may raise. As previously discussed, the commodities industry in general does not currently afford an adequate level of self-regulatory customer protection and, where self-regulators have adopted customer protection rules, there is a lack of uniformity in the standards and procedures provided.[225/] For example, while contract markets impose minimum financial requirements on, and conduct financial audits of, their members, they rarely, if ever, intercede regarding retail sales practices. The need for

[224/] The Supreme Court has held that simple antitrust enforcement cannot be compared to the complex duties of an agency that has pervasive regulatory authority. See, e.g., Gordon v. New York Stock Exchange, 422 U.S. 659 (1975). The Supreme Court has also held that public regulatory activities are not subject to the same competitive requirements applicable to private commercial conduct. See, e.g., Silver v. New York Stock Exchange, 373 U.S. 341 (1963), where the Supreme Court noted that when there is direct agency review, the antitrust laws will sustain self-regulatory activity meeting a "rule of reason" standard rather than a per se test. Id. at 358, n. 12. In United States v. National Association of Securities Dealers, Inc., 422 U.S. 694 (1974), the Supreme Court exempted NASD restrictions from antitrust attack because they were subject to SEC review (citing Silver).

[225/] See pp. 23 and 32 supra.

industry participants to comply with multiple, conflicting regulations in itself raises barriers to free and open competition. To the extent that the NFA application raises anticompetitive concerns, including its provision for compulsory membership, the Commission believes that the potential for the NFA to implement a comprehensive regulatory scheme, including the prevention or elimination of anticompetitive and conflicting contract market regulations, will serve the public interest and clearly outweigh any anticompetitive effects.

Moreover, the Commission does not believe that regulation of industry participants is, per se, an impediment to the free and open function of the market. On the contrary, as the NFA assumes responsibility for sales practice and financial regulation and related audits of its members, the Commission believes that the NFA may relieve the contract markets of responsibility to devote substantial resources to these areas, as well as to other regulatory areas where the NFA assumes a central regulatory role (e.g., arbitration of customer grievances). In this manner, the contract markets should have available greater resources to devote to the development of new products, self-regulation of their individual trading facilities, and the development of more efficient means of handling and executing orders. The Commission strongly believes that the availability of greater resources for these purposes will foster inter-market competition.[226/] Moreover, the NFA's assumption of regulatory responsibility with respect to sales practices and financial protection -- regulatory areas where inter-market competition to provide the least burdensome regulatory environment could lead to inadequate customer

[226/] Similarly, Commission establishment, surveillance and enforcement of effective industry-wide measures would require the Commission to redirect its limited resources and, consequently, jeopardize other Commission programs that could foster efficient, competitive and fair commodities markets.

protection — should assist the industry in establishing broadly based minimal standards in these areas and thereby avoid any potential adverse consequences of competition.

In conclusion, the Commission has considered the potential anticompetitive effects of the NFA proposals as well as the benefits to be derived, particularly in light of the Commission's other statutory responsibilities and resources. The Commission has found NFA's proposals to be in the public interest and the compulsory membership aspect to be fully appropriate under the Act. Moreover, the Commission believes that the NFA's regulatory approach will strengthen the industry's integrity and foster competition. Accordingly, the Commission believes that the regulatory and public interest advantages expected to flow from registration of the NFA outweigh any potential anticompetitive consequences.

VI. Conclusions and Findings

The NFA has submitted an application for a viable futures association whose registration will be in the public interest. While the proposal as submitted does not provide for immediate implementation of the NFA's regulatory functions, the regulatory framework set forth in the application meets the standards established by Section 17 of the Act and Part 170 of the Commission's regulations.

As the NFA develops its regulatory programs and related rules, final implementation of such programs and rules will be subject to the review requirement of Section 17(j) of the Act.[227] Thus, the Commission's role with respect to the NFA will be an ongoing one. Additionally, the Commission will carefully

[227] 7 U.S.C. §21(j)(1976).

monitor other aspects of the NFA's rules which have raised concerns to determine whether in operation, as well as has been represented by the NFA, they will conform to the statutory standards.

The Commission has carefully studied the application and supplemental letters submitted by the NFA, written comment letters from the public and the testimony presented at the June 4, 1981 hearing. From this analysis, the Commission concludes that the NFA has demonstrated its ability to comply with Section 17 of the Act and Part 170 of the regulations, that it will promote fair and open competition among its members and otherwise further the purposes of the Act, and that it appears able to conduct its affairs consistent with the public interest to be protected by the antitrust laws. On this basis, the Commission is able to conclude that the NFA has met all of the requirements for registration set forth in the Act and the Commission's regulations thereunder, particularly those set forth in Section 17 and Part 170 thereunder.

Accordingly, the Commission hereby orders that the registration of the National Futures Association is granted and that the Articles, Bylaws, Compliance Rules, Code of Arbitration and Financial Requirements contained in its Registration Statement are approved.

Issued in Washington, D.C., this 22nd day of September 1981 by the Commission (Commissioners Dunn, Gartner and Stone; Chairman Johnson did not participate).

Jane K. Stuckey

Jane K. Stuckey
Secretary of the Commission

April 7, 1997

To : CFTC

ATTN : Ms. Jean A. Webb
Secretary of the Commission
Ms. Susan C. Ervin
Chief Counsel
1155 21st Street, NW
Washington, DC 20581

BY FAX ; 202-418-5536

Dear Ms. Webb and Ms. Ervin;

1. I thank you both so much for your April 3, 1997 replies to my February 26, 1997 letter. I find it strangely coincidental, however, that April 3, 1997 is the date that NFA also chose to respond to my letter.

You mentioned the September 22, 1981 order in which "the Commission granted registration as a futures association to NFA and approved its initial rules" and cited NFA Registration Order 7.

I hate to bother you with such trivialities, and apologize in advance for doing so, but I do not know where to obtain copies of these two orders. Would it be too great an imposition to ask that they be forwarded? You herein have my pledge that I will reimburse you for all reasonable copying and mailing charges.

2. It's nice to know that "Congress was aware from NFA's inception that a portion of NFA's operating funds would be derived from a per-transaction assessment on member FCMs that would be passed on to customers and has not objected to the per-transaction fee as a funding mechanism for NFA". Fortunately or unfortunately, however, we are not governed by what Congress knows, but by the laws Congress actually passes. It would seem to me that, had Congress wished to allow the NFA the ability to impose a tax upon the Citizenry or to grant the power to adjust tax rates periodically, it would have been very specific in granting and the President would have signed into law such power, especially since "taxation without representation" was one of the founding concepts of this glorious country of ours. I further find it difficult to believe that Congress would grant a public administrative agency the power to allow a second regulatory agency, private at that, or any number of additional private regulatory agencies, the power to each impose a $ .01 or $ .25 or $ 25.00 or some other per-transaction tax upon the Citizenry or that Congress would intentionally allow the NFA to feed at the

public trough, allow its officials to be paid unconscionable salaries and perks, while allowing such agency to be exempt from public scrutiny as Mr. Wilmouth claims for his agency.

3. It makes one request the following; what is the original par value of NFA's stock, who are the stockholders, how many shares have been issued, and how much are these stockholders compensated each year for the "risk" they have assumed in this monopoly?

4. NFA Rule 1301 specifically, and repeatedly, refers to this per-transaction fee as an "assessment".

Black's Law Dictionary, the definitions of which, I am told, will withstand the scrutiny of a few court proceedings, defines "assess" as "To tax", "To adjust or fix the proportion of a tax . . . ", "to apportion a tax . . . ", "to distribute taxation . . . ", "To calculate the rate and amount of taxes . . . " and states that "assess" is sometimes used as synonymous with "levy". Need I say more?

I, therefore, again pose my question, where is the lawful authority for NFA's per-transaction tax?

5. With respect to Ms. Jean Webb's April 3, 1997 letter to me regarding my "Petition for Repeal of Commission Rules 4.13 (a) (2) (i) and 4.13 (a) (2) (ii)", the CFTC failed to address my specific question that the current $ 200,000. 15 person limitation is an unlawful restraint of trade or to answer my concerns that these regulations are in violation of the Constitution. I am again asking for a response to these questions. Are these regulations a restraint of trade, or not? Are they in violation of the Constitution, or not? If not, upon what authority do you claim that they trump the Constitution?

6. Under the provisions of CFTC 13.2, I am petitioning for the following rule changes;

a. Change the amount in 4.13 (a) (2) (i) from $ 200,000 to $ 1,000,000,000, and

b. Change the amount in 4.13 (a) (2) (ii) from 15 participants to 10,000 participants.

I am petitioning for these rule changes for the reasons stated in #s 1-12, pages 3-6, of my February 26, 1997 letter.

7. Your answer that the limitations of CFTC 4.13 are not arbitrary and capricious since they have been posted to the Federal Register, etc., does not address the question of whether they are Constitutional violations. I would reiterate that not only am I being prevented from handling the monies of those who have indicated their desire to have me manage their funds, but these same individuals are also being damaged by not being able to receive the benefits of my efforts.

8. If the CFTC cannot agree to increase the arbitrary and capricious $ 200,000 and 15 person limitations as I have requested, even the formation of "The Exempt Commodity Pool Operators Association", an alternative to the NFA, would not solve the problem since members would still be subject to the arbitrary and capricious limitations of CFTC 4.13.

9. Certainly, you cannot expect a United States of America Citizen to subject himself to an organization (the National Futures Association) whose own president admits is not required to pledge that the Constitution will be upheld. Is the CFTC not, therefore, extorting Citizens to join an unlawful organization or otherwise surrender one's Constitutional right as a condition for gainful employment in the futures industry? Is the CFTC not converting a Constitutional right to a licensed privilege?

10. Even more disturbing is the answer to the following question; is the CFTC requiring the NFA to execute those deeds that might otherwise violate the oaths of CFTC attorneys and executives? As an example, NFA's unlawful per-transaction tax. As another example, NFA's suspension of Constitutional rights in its disciplinary proceedings, as evidenced by the proceeding involving J&J DEVELOPMENT CORPORATION. As another example, the 1990 interpretative letter CFTC's attorneys sent NFA's attorneys for prosecution against myself for the high crime of publishing a book without first registering the book with the CFTC and NFA. As another example, the monopolistic restraint of trade caused when the CFTC requires that Citizens register with a self-regulatory agency but then provides no other self-regulatory agency other than the NFA with which one might register. As another example, the CFTC's approval of NFA rule 1101 which requires that NFA only engage in commerce with other NFA members. In other words, of what value would a second self-regulatory agency have in light of the draconian NFA Rule 1101 and requirement that we line the pockets of Wilmouth and other NFA favored officials?

Frank Anthony, Taucher
Suite 190
8210 East 71st Street
Tulsa, Oklahoma state

NonDomestic, 74133

918-493-1132 (fax)

NFA NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

TAC 7-1/17

RECEIVED
C.F.T.C.

1998 SEP 14 P 1:10

September 10, 1998

OFFICE OF THE SECRETARIAT

Ms. Jean A. Webb
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition for Rulemaking to Amend CFTC Regulations 4.21(a) and 4.31(a)

Dear Ms. Webb:

National Futures Association ("NFA") respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulations 4.21(a) and 4.31(a). These amendments would provide relief from the CFTC's requirement that a disclosure document be delivered prior to a CPO or CTA soliciting a prospective client. These amendments would allow NFA to enforce through its rules the use of a shorter disclosure document called a "profile" for soliciting a prospective investor prior to the delivery to the investor of a full disclosure document. The profile document would be limited to certain key information about the pool or trading program and would provide specific cautionary disclosures as explained more fully below.

I. Text of the Proposed Amendments (additions are underscored and deletions are stricken through)

PART 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

* * *

§4.21 Required delivery of pool Disclosure Document.

(a) Except in accordance with rules promulgated by a registered futures association regarding profile documents, ~~N~~no commodity pool operator registered or required to be registered under the Act may, directly or indirectly, solicit, accept or receive funds, securities or other property from a prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the commodity pool operator delivers or causes to be delivered to the prospective participant a Disclosure Document for the pool containing the information set forth in §4.24; *Provided, however,* that where the prospective participant is an accredited investor, as defined in 17 CFR 230.501(a), a notice of intended offering and statement of the terms of the intended offering may be provided prior to delivery of a Disclosure Document, subject to compliance with rules promulgated by a registered futures association pursuant to section 17(j) of the Act.

* * *

§4.31 Required delivery of Disclosure Document to prospective clients.

(a) Except in accordance with rules promulgated by a registered futures association regarding profile documents, ~~N~~no commodity trading advisor registered or required to be registered under the Act may solicit a prospective client, or enter into an agreement with a prospective client to direct the client's commodity interest account or to guide the client's commodity interest trading by means of a systematic program that recommends specific transactions, unless the commodity trading advisor, at or before the time it engages in the solicitation or enters into the agreement (whichever is earlier), delivers or causes to be delivered to the prospective client a Disclosure Document for the trading program pursuant to which the trading advisor seeks to direct the client's account or to guide the client's trading, containing the information set forth in §§4.34 and 4.35.

* * *

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. NFA is interested in streamlining the regulatory process so that its Members can more efficiently and effectively comply with the Act, Commission regulations and NFA rules. NFA believes that the proposed amendments to Regulations 4.21(a) and 4.31(a) which would allow for the use of a profile document furthers this goal.

III. **Supporting Arguments**

As you may know, the Commission recently asked NFA to develop a rule proposal similar to the profile document rule implemented by the Securities and Exchange Commission ("SEC") effective June 1, 1998. The SEC adopted a rule permitting mutual funds to solicit and accept fund investments through a shorter disclosure document called a "profile." This profile document summarizes, in a standardized format, key information about the fund, including the fund's investment strategies, risks, performance and fees. The profile document must also inform the prospective investor that a copy of the full prospectus is available upon request. After reviewing the profile document, an interested prospective investor has the choice of requesting a copy of the fund's prospectus or making an investment in the fund based on the profile document. If an investor decides to purchase shares in a fund based on the profile document, however, the fund must provide a copy of the prospectus to the investor with a copy of the purchase confirmation.

Implementing such an NFA rule proposal, however, would also require that CFTC Regulations 4.21(a) and 4.31(a) be amended to provide relief from the CFTC's requirement that a disclosure document be delivered prior to soliciting a prospective client.

The rule which NFA developed, and which is currently pending CFTC review and approval, would permit member CPOs to solicit prospective investors with a profile document. Unlike the SEC's rule, however, CPOs would still be required to deliver a disclosure document prior to accepting any funds or property from a prospective client. The profile document itself would be limited to certain key information about the pool and the CPO and would provide specific cautionary disclosures. With regard to performance disclosures, the CPO would be limited to providing actual performance of the offered pool. The profile document would, however, notify the prospective investor if other performance information is presented in the disclosure document.

The following eight points describe the contents of a profile document and make comparisons to the SEC's rule. The main changes from the SEC's rule are based on the differing nature of a pool investment and a mutual fund investment.

1. Cover Page – The SEC's rule requires a cover page which contains the Fund's name and, at the Fund's option, the Fund's investment objective or the type of fund offered. A statement identifying the document as a "profile" without using the term "prospectus," the approximate date of the profile's first use, a cautionary legend regarding the summary nature of the profile, and directions on where to get a prospectus or further infor-

mation are also required. NFA's proposed rule requires all this information plus, immediately following the cover page, an additional cautionary statement regarding the risky nature of commodity pools and a statement that neither NFA nor the CFTC has passed on the merits of participating in the pool or the adequacy or accuracy of the profile document. NFA's rule also requires that the cover page include a break-even analysis with respect to an investment in the pool.

2. Objectives/Goals and Principal Investment Strategies – The SEC's rule requires that the profile include information about the Fund's investment objective or goals as required by the prospectus rules for mutual funds. In addition, the profile must include information about the Fund's principal investment strategies. NFA's proposed rule does not require information about the pool's investment objectives or goals but does require a non-marketing orientated discussion of the trading strategy to be used by the pool.

3. Principal Risks of Investing – The SEC's rule requires narrative disclosure, a bar chart, and a table required by the mutual fund prospectus rule which highlights the principal risks of investing in the Fund. This section must also include information on the Fund's average annual total returns. NFA's rule requires the cautionary statement regarding the risks of investing in the pool and a statement identifying any risks unique to the particular pool. NFA's profile rule also requires, if applicable, a statement in the body of the profile indicating the extent to which a participant may be held liable for obligations of the pool in excess of the funds contributed by the participant for the purchase of an interest in the pool. In addition, NFA's rule requires that the document include the capsule performance for the offered pool, with reference, if applicable, to the fact that the disclosure document contains performance information on other pools operated by the CPO, or for pools with no operating history, performance of major CTAs trading the pool.

4. Fees and Expenses – The SEC's rule requires disclosure of fees and expenses, including commissions, associated with an investment in the Fund. NFA's rule requires this information as part of the break-even analysis.

5. Identity of Certain Key Persons – The SEC's rule requires that the investment adviser, subadviser, and portfolio manager be identified. In addition, for those persons associated with the investment adviser who are primarily responsible for the day-to-day management of the Fund's portfolio, the profile must summarize each person's business experience for the last five years and indicate their length of service with the adviser. NFA's rule requires that the profile identify each principal of the pool operator, the pool's trading manager and its principals and, if any, any major CTA and its principals. NFA's rule does not require disclosure of the business background of these individuals. Since prospective participants will still have to receive the disclosure document before investing in the pool, staff felt it was unnecessary to disclose this information in both documents. NFA's rule does, however, require a summary of any material administrative or criminal actions, whether pending or concluded, within five years of the date of the profile, against the commodity pool operator or any of its principals.

6. Purchase/Sale of Shares – The SEC's rule requires that the profile disclose the Fund's minimum initial or subsequent investment requirements, the initial sales load and, if applicable, the initial sales load breakpoints or waivers. With regard to the sales of shares, the SEC's rule requires that the document disclose the procedures for redeeming shares and identify any charges or sales loads that may be assessed. NFA's rule requires the profile to provide a brief description of any restrictions on transfers of a participant's interest in the pool and information on how a participant may redeem his interest in the pool. As previously noted, NFA's proposal also requires the CPO to include the break-even table on the cover page of the profile document.

7. Distributions and Tax Information – The SEC's profile rule requires a description of how frequently the fund intends to make distributions and what options for reinvestment of distributions are available for investors. The document must also indicate the tax status of these distributions. NFA's profile rule does not include this information since regular distributions are generally not a feature of a pool investment and the taxable status of any distribution is best determined by an investor and its tax adviser.

8. Other Services Available – Under this section, the SEC requires that the document provide a brief summary of services available to Fund shareholders. NFA did not include this section in the proposed rule because it was not applicable to a pool investment.

As the benefits of this profile document are also applicable to CTAs, the rule proposal also permits CTAs to use a profile document to solicit prospective clients. As with CPOs, however, the CTA will be required to deliver the disclosure document prior to entering into any agreement to direct or guide a client's commodity futures account.

NFA respectfully petitions the Commission to amend Regulations 4.21(a) and 4.31(a) as described herein.

Respectfully submitted,

Daniel J. Roth
General Counsel

DJR:ckm(sub\petiton re profile)

cc: Chairperson Brooksley Born
Commissioner Barbara Pedersen Holum
Commissioner John E. Tull, Jr.
Commissioner David D. Spears
Commissioner James E. Newsome
Geoffrey Aronow, Esq.
I. Michael Greenberger, Esq.
Alan L. Seifert, Esq.
Lawrence B. Patent, Esq.
David Van Wagner, Esq.

CME Group

Received
CFTC

2013 FEB -5 PM 1:53

Office of the
Secretariat

fAC 8-9

February 1, 2013

VIA E-MAIL AND FEDERAL EXPRESS

Secretariat of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Regulation 13.2 Petition for Amendment of Regulation 38.154

Dear Secretariat:

CME Group Inc. ("CME Group"), on behalf of its five affiliated designated contract markets ("DCMs"), respectfully petitions the Commodity Futures Trading Commission ("CFTC" or "Commission") pursuant to CFTC Regulation 13.2 ("Petition for issuance, amendment, or repeal of a rule") to amend CFTC Regulation 38.154 ("Regulatory services provided by a third party"). As discussed in our October 17, 2012 letter addressed to Mr. Richard Shilts seeking no-action relief, Regulation 38.154 does not address the type of regulatory structure adopted by CME Group whereby a single, centralized regulatory department and Market Regulation Oversight Committee oversee multiple affiliated DCMs. Amending Regulation 38.154, as proposed below, would provide for more efficient allocation of regulatory resources and more effective administration of regulatory responsibilities. Conversely, strict adherence to Regulation 38.154 as currently written will result in an inefficient allocation of regulatory resources and unnecessary structural complexity, while yielding no corresponding regulatory benefit.

1. Background

On October 17, 2012, the four DCMs then owned and controlled by CME Group, Chicago Mercantile Exchange Inc. ("CME"), Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX") and Commodity Exchange, Inc. ("COMEX") submitted a petition ("Petition") to the CFTC for no-action relief from the provisions of CFTC Regulation 38.154 in connection with the regulatory services provided by CME and NYMEX to CME, CBOT, NYMEX and COMEX. On November 30, 2012, CME Group acquired Board of Trade of Kansas City, Missouri, Inc. ("KCBT") (collectively, with CME, CBOT, NYMEX and COMEX, the "CME Group DCMs"), a DCM registered with the Commission under CFTC Regulation 38.3 ("Procedures for designation"). KCBT is wholly-owned by CME Group and affiliated with the other CME Group DCMs by virtue of common ownership under the CME Group umbrella. CME Group's Market Regulation Oversight Committee ("MROC") is now responsible for overseeing KCBT's regulatory and compliance activities, and its Charter (attached as Exhibit A) has been amended to include KCBT.

CME Group's regulatory and compliance efforts are centralized in a single, cohesive Market Regulation Department ("Market Regulation") that provides services on behalf of all the CME Group DCMs.[1] As noted in our October 17 letter (attached as Exhibit B), we purposely organized Market

[1] KCBT's regulatory and compliance functions are currently handled by KCBT staff on location in Kansas City. Plans are underway to fully integrate KCBT's regulatory services into CME Group's Market Regulation

Regulation in this manner to maximize effectiveness and efficiency. Rather than having separate compliance and regulatory groups for each DCM, Market Regulation is organized into functional areas (*e.g.*, trade practice investigations, market surveillance, data quality assurance, regulatory systems and strategic initiatives, enforcement and employee learning initiatives) that focus on particular areas of responsibility across all of the CME Group DCMs' markets to provide for the best visibility and consistency with respect to discharging our regulatory responsibilities. This structure also enables us to continue to comply with incorporation and employment commitments following the mergers.

2. Proposed Amendments to Regulation 38.154

The CME Group DCMs propose making three amendments to Regulation 38.154. For the Commission's convenience, a complete "redline" version of the proposed amendments is attached as Exhibit C.

- Amendment 1: Title Change

  The title of Regulation 38.154 should be changed from "Regulatory services provided by a third party" to "Regulatory services provided by a third party or an affiliated designated contract market."

- Amendment 2: Reorganization of current subparts (a), (b) and (c)

  A new subpart (a) should be added immediately after the title for Regulation 38.154. It should state "Regulatory services provided by a third party." To accommodate this addition, current subparts (a), (b) and (c) should be re-designated as (1), (2) and (3) and follow new subpart (a).

- Amendment 3: Add a new subpart (b) to set forth language for affiliated DCMs

  A new subpart (b) should be added to accommodate regulatory structures of affiliated DCMs. The CME Group DCMs propose the following language:

> (b) *Regulatory services provided by an affiliated designated contract market.* A designated contract market may choose to utilize an affiliated designated contract market for the provision of services to assist in complying with the core principles, as approved by the Commission. An affiliated designated contract market is any designated contract market directly or indirectly controlling, controlled by or under common control with a designated contract market, control being the ownership of more than 50% of the capital stock or other equity interests or possession, directly or indirectly, the power to direct or cause the direction of management or policies (whether through ownership of securities or partnership or other ownership interests, by contract or otherwise) of such designated contract market. The affiliated designated contract markets must enter into a written agreement that sets forth the terms and conditions for any

Department. KCBT will then become a party to the inter-affiliate regulatory services agreement that CBOT and COMEX entered into with CME and NYMEX.

> regulatory, trade cancellation or price adjustment services that will be provided. A designated contract market will at all times remain responsible for the performance of any regulatory, trade cancellation or price adjustment services received from an affiliated designated contract market, and for compliance with the designated contract market's obligations under the Act and Commission regulations.

3. Rationale for Proposed Amendments

As set forth in our October 17 letter (which we adopt by reference herein), it is clear from the current language of Regulation 38.154 and earlier guidance on the provision of regulatory services that Regulation 38.154 does not address the regulatory structure employed by CME Group. Rigid application of Regulation 38.154 would result in an inefficient use of regulatory resources. As noted above, the CME Group DCMs' regulatory structure is based on a single department (Market Regulation) that oversees all of the CME Group DCMs' markets. That department is organized across functional areas and reports into a Chief Regulatory Officer and Deputy Chief Regulatory Officer. We have found over time that this structure provides the most effective means of satisfying the regulatory responsibilities of each DCM.

Subpart 38.154(b) imposes the following obligations on a DCM that utilizes a third-party service provider for regulatory services:

- "retain sufficient compliance staff to supervise the quality and effectiveness of the services provided on its behalf;"
- "hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern;"
- "conduct periodic review of the adequacy and effectiveness of services provided on its behalf;" and
- "carefully" document the periodic reviews and make them available to the Commission upon request.

Strictly adhering to these requirements would effectively require the CME Group DCMs to do away with their current structure and replace it with superfluous governance and administrative constraints that yield no meaningful regulatory benefit. Our current structure, which we think is the most optimum for complying with our regulatory responsibilities, would need to be replaced with one of two lesser options.

One option would be to decentralize Market Regulation by dividing it into separate and autonomous regulatory departments for each of the DCMs. Each would be responsible for carrying out all the regulatory responsibilities for that DCM's markets. This would be less effective and efficient for several reasons. To begin with, breaking up Market Regulation into separate regulatory staffs would obligate each DCM to employ its own staff, which is not currently the case. Changing current practice would require that we set up employment, human resource and benefits support for employees of COMEX and CBOT, which would require additional cost for CME Group while providing no added regulatory benefit.

A much more important consideration than this, however, is that decentralizing Market Regulation would result in significantly less effective regulatory oversight of our markets and participants. Take, for example, the case of our wash trade review team. Currently, we have a dedicated team that reviews potential wash trade violations within or across the CME Group DCMs' markets.

Decentralizing Market Regulation in order to demonstrate compliance with subpart 38.154(b) would mean that instead of having one wash trade team analyzing potential violations across all markets, we would instead have multiple teams – one for each DCM – reviewing wash trades only within a respective DCM. This would jeopardize the cohesive application of the wash trade review program across DCMs, and lose the current benefit gained from having a single team with visibility into activity in all markets. While it is possible that the teams could communicate with one another, that would certainly be a less efficient alternative, and it could not replace the effectiveness of utilizing people with broader visibility across markets. This would not be a desirable result, and its perils are even more evident when considered in the context that the wash trade program is but one of Market Regulation's regulatory programs that are staffed across DCMs to maximize utility. The perils are more pronounced when multiplied by the number of other regulatory programs that would be affected, such as cross trades, money passes, open interest reporting, block reviews and trading ahead, to name only a few.

CME Group's second option would be to outsource the regulatory obligations of one or more DCMs to other CME Group DCMs, which is what we are currently doing pursuant to the regulatory services agreement mentioned above. CME Group has utilized this arrangement for several years now following the various mergers, and it has worked extremely well. CME Group believes, however, that the heightened supervision requirements imposed by subpart 38.154(b) set forth unnecessary hurdles that, when applied to CME Group's structure, would have no corresponding regulatory benefit. To begin with, subpart 38.154(b) mandates that each DCM retain "sufficient compliance staff" in order to supervise the regulatory activities being provided by the other CME Group DCMs (*i.e.*, the regulatory service provider). In order to meet this requirement, we would still need to staff and employ compliance professionals in each DCM, which is different than our current construct whereby CME and NYMEX employ all staff in Market Regulation.[2] This would add the same employment, human resource and benefit restraints that we discussed in option 1 were we to revert to self-autonomous regulatory departments for each of the CME Group DCMs.

Moreover, this would result in highly inefficient and less effective administration of our regulatory responsibilities. For illustrative purposes, let us revisit the wash trade team example used above. If we were to maintain a single wash trade review team that is outsourced to other CME Group DCMs, strict application of subpart 38.154(b) would require that team to meet regularly with the regulatory staffs of each of the DCMs upon whose behalf it is performing the regulatory responsibility of analyzing potential wash trades. In other words, if CME employed the regulatory staff charged with reviewing trades for potential wash trade violations, and it provided those services to CBOT, NYMEX and COMEX, then that wash trade review team would have to set up separate, regular meetings with the supervision staffs of each of the other DCMs to review its work. Further, CBOT, NYMEX and COMEX would each have to separately conduct periodic reviews of the "adequacy and effectiveness" of the CME wash team's services, and then document that review. This is highly inefficient and not the best use of available regulatory resources. A more effective use of those resources would be to ensure that our regulatory efforts are harmonized, applied consistently, and are able to be discharged free of the unnecessary reviews and meetings that the DCMs are contemplated by subpart 38.154(b).

The untenable outcomes that arise out of the strict application of the requirements of subpart 38.154(b) also extend to the requirements of subpart 38.154(c). Under that subpart, each DCM must "retain exclusive authority in decisions involving the cancellation of trades." Currently, staff of CME and NYMEX already have this responsibility, both for themselves and other CME Group DCMs. Strictly adhering to the language of subpart 38.154(c), however, would preclude the CME Group DCMs from continuing this practice. Instead, subpart 38.154(c) would have us hire and employ staff at each DCM so

[2] Again, this does not apply to KCBT at the moment.

they would be responsible for making such determinations. This is unnecessary and provides no added regulatory benefit, however, because current CME and NYMEX staff (in the Global Command Center ("GCC")) are very experienced in trade cancellation procedures, considerations and decision-making. And they are intimately familiar with all markets owned and operated by CME Group DCMs. GCC should be able to retain full authority to cancel trades or make price adjustments for CME, CBOT, NYMEX and COMEX without having to contact (in the middle of the night, for example) a specifically designated person to obtain approval. This structure is much more efficient and effective than what is contemplated in subpart 38.154(c) because it allows for more decisive and comprehensive action across markets, and for those actions to be more quickly communicated to market participants. Obtaining approval from a designated person at another DCM only adds unnecessary delay, expense and administration.

The amendments proposed in Section 2 above provide a straightforward solution that will eliminate the loss of effectiveness and efficiency in regulatory oversight that would result from a strict application of Regulation 38.154. It will enable the CME Group DCMs to continue operating under their current operating structure, which we have found to be the most efficient and effective way to demonstrate compliance with core principle requirements. Further, it will obviate the need to add superfluous administrative governance and human resource, employment and benefits requirements that provide no regulatory benefit to the marketplace.

4. Conclusion

The CME Group DCMs respectfully request that the Commission amend Regulation 38.154 to account for the provision of regulatory services by an affiliated designated contract market. Doing so will allow for the more efficient allocation of regulatory resources without sacrificing the effectiveness of the CME Group DCMs in carrying out their regulatory responsibilities. CME Group's current structure provides for more effective regulation of their markets and participants compared to what is contemplated by subparts 38.154(b) and 38.154(c).

If you have any questions regarding this submission or if you require any additional information, please contact me at (312) 930-3488 or kathleen.cronin@cmegroup.com, or Joe Adamczyk at (312) 648-3854 or joseph.adamczyk@cmegroup.com

Sincerely,

Kathleen M Cronin

Kathleen M. Cronin
Senior Managing Director, General Counsel
and Corporate Secretary

cc: Richard Shilts
Rachel Berdansky
Bryan Durkin
Julie Holzrichter
Tom LaSala
Dean Payton
Joe Adamczyk

CME GROUP INC.
CHICAGO MERCANTILE EXCHANGE INC.
BOARD OF TRADE OF THE CITY OF CHICAGO, INC.
NEW YORK MERCANTILE EXCHANGE, INC.
COMMODITY EXCHANGE, INC.
THE BOARD OF TRADE OF KANSAS CITY, MISSOURI, INC.
KANSAS CITY BOARD OF TRADE CLEARING CORPORATION
MARKET REGULATION OVERSIGHT COMMITTEE

CHARTER

I. Purpose

The Market Regulation Oversight Committee (the "Committee") is a Committee of the Board of Directors (the "Board") of CME Group Inc. ("CME Group"), Chicago Mercantile Exchange Inc. ("CME"), Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX"), Commodity Exchange, Inc. ("COMEX"), The Board of Trade of Kansas City, Missouri, Inc.("KCBT"), and Kansas City Board of Trade Clearing Corporation ("KCBT Clearing"), (collectively, referred to as, the "Company"). The primary purpose of the Committee is to provide independent oversight of the policies and programs of the Company's regulatory functions relating its operations of designated contract markets, designated clearing organizations and a swap data repository and their senior management and compliance officers, as applicable, collectively referred to as the "Regulatory Compliance Functions" with the goal that the policies and programs enable each of those individuals and departments to administer effectively and independently the regulatory responsibilities of the Company.

II. Membership & Organization

- The members of the Committee and its Chairperson shall be appointed in accordance with the provisions of the Company's Corporate Governance Principles. In accordance with the Principles, the Governance Committee, after consultation with the Executive Chairman & President, shall make a recommendation to the Board with respect to the assignment of directors to the Committee, including the designation of Chair, to the full Board for approval. After reviewing the Executive Chairman & President's recommendations, the Board shall be responsible for appointing the members of the Committee.

- The Committee shall be comprised of three (3) or more directors who qualify as public directors as that term is defined in Appendix B to Part 38 (Designated Contract Markets) of the Commission's regulations under the Commodity Exchange Act.

- The Chairperson shall schedule all meetings of the Committee and provide the Committee with a written agenda as appropriate. A quorum of the Committee shall consist of a majority of the appointed members of the Committee. The Committee may ask members of management or others to attend the meeting and provide information.

EXHIBIT A

III. Committee Meetings, Tasks and Authority

General

- The Committee shall meet at least quarterly and keep minutes of its proceedings.

Responsibilities

- The Committee shall review the scope of and make recommendations with respect to the responsibilities, budget and staffing of the Company's Regulatory Compliance Functions and the resources available to the them with the goal that each department, business unit or function is able to fulfill its regulatory responsibilities. Additionally, the Committee shall oversee the performance of the Regulatory Compliance Functions with the goal that each department, business unit or function is able to implement its regulatory responsibilities independent of any improper interference or conflict of interest that may arise.

- The Committee will review the annual performance evaluations and compensation determinations and any termination decisions made by senior management with respect to the Managing Director and Chief Regulatory Officer, the Managing Director, Audit Department, the Clearing House Compliance Officer and the Swap Data Repository Chief Compliance Officer, with the goal that the determinations or decisions are not designed to influence improperly the independent exercise of their regulatory responsibilities.

- The Committee shall review the compliance of CME, CBOT, NYMEX, COMEX, KCBT and KCBT Clearing with their regulatory responsibilities as prescribed by statute and the rules and regulations promulgated thereunder.

- The Committee shall review such other matters and perform such additional activities, within the scope of its responsibilities, as the Board deems necessary or appropriate.

- The Committee shall review changes (or proposed changes, as appropriate) to the rules of CME, CBOT, NYMEX, COMEX, KCBT and KCBT Clearing to the extent that such rules are likely to impact significantly regulatory functions.

- The Committee shall review conflict of interest matters brought to its attention by the senior management and compliance officers responsible for the Company's Regulatory Compliance Functions.

EXHIBIT A

Reporting Activities

- The Committee Chairperson, or his or her designee, shall make regular reports to the Board of the Committee's activities.

- The Committee shall prepare and adopt an annual report to the Board summarizing the activities, conclusions and recommendations of the Committee during the previous year and the Committee's working agenda for the coming year and such other matters as considered appropriate.

- The Committee shall confer with Company management and other employees to the extent it may deem necessary or appropriate to fulfill its duties.

- The Committee shall reassess the adequacy of this Charter no less frequently than annually and submit any recommended changes to the full Board for approval.

Approved effective January 30, 2013

EXHIBIT A

CME Group

October 17, 2012

VIA E-MAIL AND FEDERAL EXPRESS

Mr. Richard Shilts
Acting Director, Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: No-Action Request in Connection with Rule 38.154

Dear Mr. Shilts:

On behalf of the four affiliated Designated Contract Markets ("DCMs") of CME Group Inc., Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange Inc. ("COMEX"), I am requesting no-action relief from the provisions of Commodity Futures Trading Commission ("CFTC" or "Commission") Rule 38.154 ("Regulatory Services Provided by a Third Party") in connection with the regulatory services provided by CME and NYMEX to CME, CBOT, NYMEX and COMEX.

I. Introduction

As part of the regulations implementing the DCM Core Principles, which have a compliance date of October 17, 2012, CFTC Rule 38.154 requires, in part, that a DCM using a regulatory service provider maintain compliance staff to supervise the regulatory service provider through regular meetings and periodic reviews. Given the affiliated (rather than arms-length) relationship between CME, CBOT, NYMEX and COMEX, and the manner in which regulatory services are structured and performed, the requested no-action relief is appropriate because rigid application of CFTC Rule 38.154 in this context would impose artificial structures and unnecessary costs, and would result in the inefficient allocation of regulatory resources in the absence of any legitimate regulatory benefit.

EXHIBIT B

a. Relevant Facts

CME, CBOT, NYMEX and COMEX are each DCMs under the holding company CME Group Inc. Although each DCM is separately registered with the CFTC, the DCMs are affiliated by common ownership under the CME Group umbrella. CME and CBOT are wholly owned by CME Group, Inc.; NYMEX is wholly owned by CME Group NYMEX Holdings, Inc., which is wholly owned by CME Group, Inc.; and COMEX is wholly owned by NYMEX.

The four DCMs are party to a regulatory services agreement (attached hereto) whereby CME and NYMEX jointly provide all regulatory services that are required for each of the four DCMs to satisfy their regulatory obligations under the Commodity Exchange Act and Commission regulations.

The regulatory services for all four DCMs are performed by the Market Regulation Department, which is comprised of staff who are employees of either CME or NYMEX, depending upon location. However, Market Regulation operates as a single department, and staff responsibilities are broadly functionally oriented. The Market Regulation global leadership team, which includes the Chief Regulatory Officer, Deputy Chief Regulatory Officer, and five functional area Executive Directors, are each responsible for their respective responsibilities across all four DCMs, and the various functions they oversee are functionally oriented rather than DCM oriented. The Commission has recognized this structure, and conducts joint rule enforcement reviews of CME/CBOT and NYMEX/COMEX, rather than of each DCM separately.

b. CFTC Rule 38.154

CFTC Rule 38.154 addresses a DCM's use of a CFTC-registered entity for the provision of services to assist the DCM in complying with the core principles; such entity is referred to as a "regulatory service provider". A DCM that elects to utilize a regulatory service provider is required to retain sufficient compliance staff of its own to supervise the quality and effectiveness of the services on its behalf, to hold regular meetings with the regulatory service provider and conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf.

Although the definition of "regulatory service provider" in CFTC Rule 38.154 is silent on the treatment of a regulatory service provider that is itself an affiliate of the DCM, the heading of the rule and headings in the rule text, as well as certain language in the CFTC's preamble adopting the rule, indicate that CFTC Rule 38.154 applies only to *third-party* regulatory service providers. The heading of Rule 38.154 states that it applies to "regulatory services provided by ***third***

EXHIBIT B

party*"** (emphasis added). Moreover, the headings in the text of the rule include: (a) "Use of a ***third-party provider permitted"; and (b) "Duty to supervise ***third-party*"** (emphasis added).

In the preamble to the final rule, the Commission stated that "[i]n the past, the Commission has described acceptable 'contracting' and 'delegating' arrangements for the performance of core principle functions by ***third parties***. The Commission proposed 38.154 to clarify its previous guidance on such arrangements." 77 Fed. Reg. at 36612, 36627 (June 19, 2012) (emphasis added).

The "previous guidance" to which the CFTC refers is found in a 2001 Federal Register final rule release entitled "A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations." In that guidance, the CFTC specifically refers to conditions on a DCM's use of "***outside contractors*** to perform duties in connection with self-regulatory functions." *See* 66 Fed. Reg. 42256, 42266 (Aug. 10, 2001) (emphasis added).

Moreover, in the preamble to the final rule, the Commission further states that "[t]he Commission also notes that DCMs must remain responsible for carrying out any function delegated to a ***third party***, and that DCMs must ensure that the services received will enable the DCM to remain in compliance with the CEA's requirements. The Commission believes that proposed 38.154 effectively establishes a system for administering regulatory services provided to DCMs by ***third party*** regulatory services providers." 77 Fed. Reg. at 36612, 36627 (June 19, 2012) (emphasis added).

It appears clear from the foregoing that the rule was not designed to address the type of scenario presented by CME Group's structure, and as explained in the subsequent section, rigidly applying CFTC Rule 38.154 to the four affiliated CME Group DCMs whose regulatory services are provided by a single Market Regulation Department would yield illogical results.

c. Basis for No-Action Relief

The application of CFTC Rule 38.154 to affiliated relationships such as those between the four CME Group DCMs is incongruous with the objectives of the rule. The affiliated DCMs currently share a single compliance staff that provides all of the regulatory services for the four DCMs and the rule requires each DCM's compliance staff to monitor the regulatory service provider's performance through regular meetings and periodic reviews. In this circumstance, however, the compliance staff of the four affiliated DCMs is the Market Regulation Department, and the Market Regulation Department is itself the regulatory services provider.

The rigid application of Rule 38.154 would require that each of the affiliated DCMs create additional, unique compliance staffs to meet with and monitor both CME and NYMEX, which jointly provide regulatory services to all four DCMs -- CME to CBOT, NYMEX and COMEX, and NYMEX to CME, CBOT and COMEX. This would make little practical sense, result in the inefficient allocation of regulatory resources and undermine a structure that has been in place and operated effectively for a number of years following the mergers of CME, CBOT and NYMEX, as well as the NYMEX/COMEX relationship that preceded the CME/NYMEX merger. It would create clearly unnecessary costs and yield no corresponding regulatory benefit.

Moreover, it should be noted that CME Group has a single Board-level Market Regulation Oversight Committee, comprised of five public directors, which provides independent oversight of Market Regulation's programs to ensure the independent and effective administration of its responsibilities with respect to all four DCMs.

II. Conclusion and Request for No-action Relief

CME Group, its Market Regulation Oversight Committee and the Market Regulation Department are all committed to preserving market integrity and to the effective administration of our regulatory responsibilities as designated contract markets. Mandating that the affiliated CME Group exchanges implement new regulatory structures that were clearly intended to ensure proper oversight for DCMs contracting with independent third-parties to provide regulatory services would be to mandate form over substance and would unnecessarily create unwarranted inefficiencies in the administration of our regulatory responsibilities.

CME, CBOT, NYMEX and COMEX therefore respectfully request that Division staff provide the requested no action relief and agree not to recommend any enforcement action against the four CME Group DCMs for failure to comply with the requirements of CFTC Rule 38.154.

Please do not hesitate to contact me at 212-299-2897 or via email at Thomas.LaSala@cmegroup.com or Christopher Bowen, Managing Director, Chief Regulatory Counsel, at 212-299-2200 or via email at Christopher.Bowen@cmegroup.com.

Very truly yours,

Thomas LaSala
Managing Director,
Chief Regulatory Officer

EXHIBIT B

Exhibit C – Redline of Proposed Amendments to CFTC Regulation 38.154

§ 38.154 Regulatory services provided by a third party or an affiliated designated contract market.

(a) *Regulatory services provided by a third party.*

(1) *Use of third-party provider permitted.* A designated contract market may choose to utilize a registered futures association or another registered entity, as such terms are defined under the Act, (collectively, ''regulatory service provider''), for the provision of services to assist in complying with the core principles, as approved by the Commission. Any designated contract market that chooses to utilize a regulatory service provider must ensure that its regulatory service provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and automated surveillance systems. A designated contract market will at all times remain responsible for the performance of any regulatory services received, for compliance with the designated contract market's obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf.

(~~b~~2) *Duty to supervise third party.* A designated contract market that elects to utilize a regulatory service provider must retain sufficient compliance staff to supervise the quality and effectiveness of the services provided on its behalf. Compliance staff of the designated contract market must hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern. A designated contract market also must conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf. Such reviews must be documented carefully and made available to the Commission upon request.

(~~c~~3) *Regulatory decisions required from the designated contract market.* A designated contract market that elects to utilize a regulatory service provider must retain exclusive authority in decisions involving the cancellation of trades, the issuance of disciplinary charges against members or market participants, and the denials of access to the trading platform for disciplinary reasons. A designated contract market may also retain exclusive authority in other areas of its choosing. A designated contract market must document any instances where its actions differ from those recommended by its regulatory service provider, including the reasons for the course of action recommended by the regulatory service provider and the reasons why the designated contract market chose a different course of action.

(b) *Regulatory services provided by an affiliated designated contract market.* A designated contract market may choose to utilize an affiliated designated contract market for the provision of services to assist in complying with the core principles, as approved by the Commission. An affiliated designated contract market is any designated contract market directly or indirectly controlling, controlled by or under common control with a designated contract market, control being the ownership of more than 50% of the capital stock or other equity interests or possession, directly or indirectly, the power to direct or cause the direction of management or policies (whether through ownership of securities or partnership or other ownership interests, by contract or otherwise) of such designated contract market. The affiliated designated contract markets must enter into a written agreement that sets forth the terms and conditions for any regulatory, trade cancellation or price adjustment services that will be provided. A designated contract market will at all times remain responsible for the performance of any regulatory, trade cancellation or price adjustment services received from an affiliated designated contract market, and for compliance with the designated contract market's obligations under the Act and Commission regulations.

1

INVESTMENT
COMPANY
INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

PAC-16

March 11, 2014

Ms. Melissa D. Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulations 4.12(c)(3), 4.23 and 4.33

Dear Ms. Jurgens:

The Investment Company Institute (the "ICI" or "Petitioner") respectfully petitions the Commodity Futures Trading Commission (the "Commission" or the "CFTC") under CFTC Regulation 13.2 to amend (i) CFTC Regulation 4.12(c), which contains exemptions from Subpart B of the Commission's Part 4 regulations, (ii) CFTC Regulation 4.23, which contains recordkeeping requirements applicable to commodity pool operators ("CPOs"), and (iii) CFTC Regulation 4.33, which contains recordkeeping requirements applicable to commodity trading advisors ("CTAs").

The Petitioner specifically requests that the entities listed below may satisfy their recordkeeping requirements under the CFTC's regulations through substituted compliance with the recordkeeping rules of the Securities and Exchange Commission (the "SEC") under the Investment Company Act of 1940, as amended (the "Investment Company Act"), and the Investment Advisers Act of 1940, as amended (the "Advisers Act"):

(i) CPOs to investment companies registered under the Investment Company Act ("Registered Funds") that are unable to rely on the exclusion in CFTC Regulation 4.5 ("Registered Fund CPOs"),

(ii)CTAs that are sub-advisers to Registered Funds whose operators are unable to rely on the exclusion in Regulation 4.5 ("Registered Fund CTAs"), and

(iii) CPOs and CTAs to controlled foreign corporations ("CFCs") of Registered Funds ("CFC CPOs" and "CFC CTAs," respectively).

In particular, the Petitioner requests that the Commission amend CFTC Regulations 4.12(c)(3), 4.23 and 4.33 to allow for substituted compliance with the SEC's recordkeeping rules under the Investment Company Act and the Advisers Act for these Registered Fund CPOs, Registered Fund CTAs, CFC CPOs and CFC CTAs (collectively, "Registrants"). Specifically, the ICI is requesting:

(i) Relief regarding the content of records to be kept; and

(ii)Relief regarding the manner of keeping such records, which relates to:

(1) Who may keep such records, and

(2) How such records must be kept (*i.e.*, the technological requirements relating to recordkeeping).

For the reasons set forth below, the ICI is also respectfully requesting temporary no-action relief on an expedited basis to last until final rules relating to this petition are adopted and effective.

The text of the proposed rule amendments is set forth in Appendix A to this letter.

I. The Petitioner

A. Petitioner's Background

The ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. The ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors and advisers. Members of the ICI manage total assets of $16.3 trillion and serve more than 90 million shareholders.

B. Nature of Petitioner's Interest

Registrants[1] are already subject to a comprehensive recordkeeping regime under the Investment Company Act and the Advisers Act and the rules thereunder. This recordkeeping regime serves the same regulatory purposes as the CFTC's recordkeeping regulations and, as discussed further below, is tailored to registered funds and their advisers. Furthermore, the CFTC would have full access to these records if substituted compliance is granted as requested herein. As a result of the changes to the Part 4

[1] Frequently, the Registered Fund's CPO serves as the CPO to the Registered Fund's wholly-owned CFC.

regulations made in 2012,[2] many investment advisers (and sub-advisers) to Registered Funds and CFCs are now also registered as CPOs or CTAs and consequently are subject to dual regulation by the CFTC and the SEC with respect to recordkeeping, which is inefficient and costly to these entities. The ICI is therefore requesting, on behalf of its members, that the CFTC provide for the recordkeeping relief requested herein.[3]

II. Supporting Arguments

A. Harmonization

When the CFTC narrowed the Regulation 4.5 exclusion for Registered Funds, it indicated that these changes might result in inconsistent regulation of Registered Fund CPOs and CTAs, and that, accordingly, it was proposing to harmonize its rules with those of the SEC.[4] Consequently, at the same time it issued the Adopting Release, the CFTC issued a companion release stating its intention to harmonize certain of its rules with the corresponding SEC rules in the areas of disclosure, reporting and recordkeeping requirements for dual registrants (*i.e.*, Registered Fund CPOs).[5]

[2] *See Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252 (Feb. 24, 2012), amended by *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 17328 (Mar. 26, 2012) (collectively, "Adopting Release").

[3] In prior letters to the CFTC staff, ICI requested confirmation that the CFTC would provide relief for Registered Funds to maintain their books and records with a variety of third-party recordkeepers including, in addition to the third parties currently permitted under amended CFTC Regulation 4.23, professional records maintenance and storage companies, sub-advisers, CTAs, and transfer agents. We understand that the CFTC staff intends to address this issue through interpretive relief in the near future. *See* Letters from Karrie McMillan, General Counsel, Investment Company Institute, to Mr. Gary Barnett, Director, Division of Swap Dealer and Intermediary Oversight, Commodity Futures Trading Commission, dated Aug. 28, 2013 ("August ICI Letter"), and Sept. 24, 2013.

[4] Adopting Release, *supra* note 2, at 11255 ("A number of commenters who expressed general opposition also acknowledged that if the Commission determined to proceed with its proposed changes to § 4.5, certain areas of harmonization with SEC requirements should be addressed. To that end, concurrently with the issuance of this rule, the Commission plans to issue a notice of proposed rulemaking detailing its proposed modifications to part 4 of its regulations to harmonize the compliance obligations that apply to dually registered investment companies. . . . The Commission also recognizes that modification to § 4.5 may result in costs for registered investment companies. For that reason, as stated above, in conjunction with finalizing the proposed amendments to § 4.5, the Commission has proposed to adopt a harmonized compliance regime for registered investment companies whose activities require oversight by the Commission. Although the Commission believes the modifications to § 4.5 enhance the Commission's ability to effectively oversee derivatives markets, it is not the Commission's intention to burden registered investment companies beyond what is required to provide the Commission with adequate information it finds necessary to effectively oversee the registered investment company's derivatives trading activities. Through this harmonization, the Commission intends to minimize the burden of the amendments to § 4.5.").

[5] *See Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators*, 77 Fed. Reg. 11345, at 11350 (Feb. 24, 2012) (the proposing release for harmonization) ("To address the

ICI appreciates that some limited recordkeeping relief was granted in the Harmonization Release.[6] We note, however, that much of that relief (specifically, the ability to keep records with certain third-party recordkeepers and the relief from the subsidiary ledger requirement) sought to modernize the CFTC's recordkeeping rules for all CPOs. The only aspect of the relief specific to Registered Fund CPOs avoids a direct conflict with the federal securities laws.[7] Given the robust recordkeeping requirements to which Registered Fund CPOs are already subject, we believe more comprehensive harmonization in this area is necessary, appropriate and consistent with the Commission's stated intention. Accordingly, we are recommending a substituted compliance approach (similar to the approach to disclosure provided by the Harmonization Release), with respect to both the content of books and records and the manner in which they are maintained.

Moreover, while the Harmonization Release focused solely on Registered Fund CPOs, we believe relief is also needed for Registered Fund CTAs; otherwise, harmonization relief would apply to Registered Fund advisers but not also to Registered Fund sub-advisers.[8] Importantly, the SEC's rules under the Investment Company Act and the Advisers Act do not distinguish between Registered Fund advisers and sub-advisers — they are each treated as an "adviser" and required to be registered under the Advisers Act. Thus, not providing relief for Registered Fund CTAs as requested herein will undercut the benefit of substituted compliance for Registered Funds.

Furthermore, Registered Funds and their advisers and sub-advisers are subject to established requirements under the Investment Company Act and the Advisers Act with respect to the maintenance of a broad range of books and records, including records with respect to CFCs. These records, whether maintained by the adviser, sub-adviser, or other third party, are readily accessible by

commenters' concerns about the content and timing of disclosure documents, account statement delivery and certification, and *recordkeeping* requirements, the Commission is proposing to harmonize its regulatory requirements with those of the SEC to reduce the costs for dual registrants. Each of these harmonizing provisions involves recordkeeping and reporting obligations that would be a collection of information under the [Paperwork Reduction Act].") (emphasis added).

[6] *See Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators*, 78 Fed. Reg. 52308 (Aug. 22, 2013) ("Harmonization Release").

[7] The recordkeeping relief specific to Registered Fund CPOs is contained in Regulation 4.12(c)(3)(iii), which exempts Registered Fund CPOs from having to make their records available to participants for inspection or copying. *See id.* at 52321.

[8] *See Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions – CPO/CTA: Amendments to Compliance Obligations* (Aug. 14, 2012), which postponed the recordkeeping, reporting, and disclosure compliance obligations for Registered Fund CTAs until "60 days following the effective date of a final rule implementing the Commission's proposed harmonization effort." Unfortunately, the Harmonization Release did not address the compliance obligations for Registered Fund CTAs.

the SEC. As detailed in Appendix B,[9] we believe that these existing recordkeeping requirements serve the same purposes as, and in some respects are more extensive than, those set forth in CFTC Regulations 4.23 and 4.33.

B. CFTC Recordkeeping Rules

CFTC Regulation 4.23 establishes the recordkeeping requirements for CPOs, and CFTC Regulation 4.33 establishes the recordkeeping requirements for CTAs. Books and records required to be maintained under Regulation 4.23 and 4.33 must be maintained in accordance with CFTC Regulation 1.31,[10] which prescribes how those records must be kept and imposes certain detailed requirements regarding electronic records. Moreover, pursuant to CFTC Regulation 4.23(c)(2), if a Registered Fund CPO wishes to use a third party to keep some of its records, such recordkeeper must certify that it will keep and maintain the records in compliance with CFTC Regulation 1.31.[11]

When CFTC Regulation 1.31 was originally adopted in 1937, it required all CFTC registrants to retain records for five years, the first two years of which the records were to be readily accessible. The regulation further required that such books and records be subject to inspection by the appropriate government agencies.

When the Commission subsequently amended CFTC Regulation 1.31 in 1976 and 1993, it added provisions to allow for keeping records in microfilm or microfiche[12] and electronically.[13] And when the CFTC adopted current CFTC Regulation 1.31(b) in 1999, it modeled its rule on the SEC's electronic recordkeeping rule for broker-dealers, which the SEC adopted in 1997 (Rule 17a-4(f) under the Securities Exchange Act of 1934 ("Exchange Act")).[14] Those SEC recordkeeping requirements, including the electronic maintenance requirements, only applied to broker-dealers, however, not

[9] Appendix B contains a comparison of the content of records required to be kept under the CFTC's regulations and the SEC's rules under the Investment Company Act and the Advisers Act.

[10] *See* CFTC Regulations 4.23 and 4.33.

[11] CFTC Regulation 4.23(c)(2) states, "[t]he pool operator shall also file electronically with the National Futures Association a statement from each person who will be keeping required books and records in lieu of the pool operator wherein such person...[a]grees to keep and maintain such records required in accordance with §1.31 of this chapter."

[12] *See Rules Under the Commodity Exchange Act - General Conformity Revisions*, 41 Fed. Reg. 3192 (Jan. 21, 1976).

[13] *See Recordkeeping*, 58 Fed. Reg. 27458 (May 10, 1993).

[14] *Recordkeeping*, 64 Fed. Reg. 28735, at 28735 (May 27, 1999) ("In light of the significant number of Commission registrants that are subject to the recordkeeping requirements of the [SEC], the Proposal included many provisions similar to those adopted by the SEC in 1997.").

investment advisers.[15] Four years later, however, the SEC adopted a separate electronic recordkeeping rule for advisers and Registered Funds, as discussed below.[16]

C. Investment Company Act and Advisers Act Recordkeeping Rules

The SEC's recordkeeping rules under the Investment Company Act and the Advisers Act provide comprehensive recordkeeping requirements with respect to registered investment advisers ("RIAs") and Registered Funds, and also include requirements that apply with respect to CFCs, generally requiring the same types of records be maintained as are required under the CFTC's regulations. Additionally, the Investment Company Act and the Advisers Act recordkeeping rules are more tailored to the Registered Fund and RIA business models than the CFTC's regulations.[17]

For example, the SEC's electronic recordkeeping rules under the Investment Company Act and the Advisers Act applicable to RIAs and Registered Funds are better suited, for the reasons discussed above, to Registered Fund CPOs and CTAs than current CFTC Regulation 1.31(b) which is based on SEC Rule 17a-4(f) for broker-dealers.

Requiring Registered Fund CPOs and Registered Fund CTAs (and their third-party recordkeepers) to comply with CFTC Regulation 4.23 and Regulation 4.33, each of which require compliance with CFTC Regulation 1.31, would subject these Fund advisers to burdensome, outdated, and costly technological requirements that are unnecessary to meet the CFTC's regulatory objectives. The SEC considered similar factors when it determined to adopt different electronic recordkeeping requirements for RIAs and Registered Funds than it did for broker-dealers, noting in the Electronic Records Adopting Release that:

> We requested commenters to address whether rules 31a-2 and 204-2 should require funds and advisers to preserve records in a non-rewriteable, non-erasable (also known as

[15] *See Reporting Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934*, 62 Fed. Reg. 6469, at 6469 (Feb. 12, 1997) ("The [SEC] is amending its broker-dealer record preservation rule to allow broker-dealers to employ, under certain conditions, electronic storage media to maintain records required to be retained.").

[16] *See Electronic Recordkeeping by Investment Companies and Investment Advisers*, 66 Fed. Reg. 29224 (May 30, 2001) ("Electronic Records Adopting Release"), which allowed "funds and advisers . . . to maintain records electronically if they establish and maintain procedures: (i) To safeguard the records from loss, alteration, or destruction, (ii) to limit access to the records to authorized personnel, the [SEC], and (in the case of funds) fund directors, and (iii) to ensure that electronic copies of nonelectronic originals are complete, true, and legible." *Id.* at 29224. Importantly, the SEC did not adopt the specific electronic recordkeeping requirements it had adopted for broker-dealers regarding how the records are to be maintained.

[17] *See* Rule 31a-2(f) under the Investment Company Act and Rule 204-2(g) under the Advisers Act. *See* Appendix B for a comparison of the content of records required to be kept under the CFTC's regulations and the SEC's rules under the Investment Company Act and the Advisers Act.

> "write once, read many," or "WORM") format. Commenters concurred . . . that the costs of such a requirement would be likely to outweigh the benefits (with respect to advisers and funds). Based on our consideration of costs, benefits, and other factors described in the proposing release we are not adopting such a requirement at this time. *We recognize that the standards for electronic recordkeeping we are adopting for funds and advisers are different from the rules that we have adopted for broker-dealers, which require brokerage records to be preserved in a WORM format. We have not experienced any significant problems with funds or advisers altering stored records. Moreover, most advisory and mutual fund arrangements involve multiple parties (e.g., brokers, custodians, transfer agents), each with its own, often parallel, recordkeeping requirement. As a result, our compliance examiners typically have an alternative means to verify the accuracy of adviser and fund records. In light of these factors, the costs of requiring funds and advisers to invest in new electronic recordkeeping technologies may not be justified.*[18]

More broadly, we believe that the recordkeeping objectives of the CFTC with respect to Registered Fund CPOs and CTAs can be satisfied by requiring that such entities adhere to the SEC's recordkeeping requirements and by requiring that the CFTC be given the same access to these records as the SEC.[19] This substituted compliance approach would avoid overlapping requirements from the two regulatory regimes, as well as the high costs associated with making changes to existing recordkeeping arrangements or systems, which would likely be borne by Registered Fund shareholders.

D. Current Industry Practices

It is our understanding that many CPOs and CTAs maintain books and records in a manner that may not strictly comply with CFTC Regulation 1.31, and that the National Futures Association staff, during examinations, generally has not been critical of these entities in such circumstances, provided that they can promptly produce the required records. Because the requirements of CFTC Regulation 1.31(b) are based on old, outdated technology, and were adopted at a time when electronic records were just emerging, the requirements of CFTC Regulation 1.31(b) do not comport with current industry practice. Electronic recordkeeping has become standard in the industry, and thus the recordkeeping rules of CFTC Regulation 1.31(b) are no longer appropriate.

[18] Electronic Records Adopting Release, *supra* note 16, at 29224 (emphasis added).

[19] If, for some reason, the CPO of a business development company (a "BDC") cannot comply with the conditions of CFTC No-Action Letter 12-40 (Dec. 4, 2012), which are modeled on CFTC Regulation 4.5 with the addition of a notice to the CFTC's Division of Swap Dealer and Intermediary Oversight, the CPO of a BDC should be treated as the CPO of a Registered Fund for purposes of this petition and the related temporary no-action relief requested. Accordingly, we have included in Appendix A in brackets proposed rule amendments that would also provide relief for such BDCs.

Now, more persons are subject to CFTC Regulation 1.31. This includes not only Registrants but also many of their third-party recordkeepers. We understand that such recordkeepers, despite their best efforts, have faced challenges in meeting the technical requirements of Regulation 1.31. Moreover, some third-party recordkeepers (such as professional records maintenance and storage companies)[20] only keep the records in the manner in which the records have been entrusted to them, and they have no obligation under their storage contracts to maintain these records in a manner other than that in which the records have been supplied.

E. Relief Relating to CPO and CTA Required Records

In the August ICI Letter,[21] ICI requested that the CFTC staff confirm (and subsequently provide more definitive relief through rule amendments or no-action relief) that, where a substantive requirement for Registered Fund CPOs was removed by the Harmonization Release, there should be no corresponding recordkeeping requirement for that item.

For example, while the Harmonization Release exempted Registered Fund CPOs from the Account Statement preparation and distribution requirements under CFTC Regulation 4.22(a) and (b), it did not contain a corresponding exemption from maintaining books and records relevant to such Account Statements called for by paragraphs (a)(10), (a)(11), and (a)(12) of CFTC Regulation 4.23. As a further example, CFTC Regulations 4.23(b)(1)-(3) require a CPO to keep records regarding the proprietary commodity interest trading of the CPO itself and of its principals as well as the confirmations of those transactions. However, Registered Fund CPOs that cannot comply with CFTC Regulation 4.5 are only required to show the CPO's related performance in the Registered Fund's disclosure documents (and only if the pool has less than three years of operating history). There is no requirement to show the performance of the CPO's or principals' proprietary trading under CFTC Regulation 4.12(c). Thus, there should be no record maintenance requirement for a record that is not otherwise substantively required by the applicable CFTC rules. As stated above, we have requested that the CFTC reconcile such inconsistencies and confirm that Registered Fund CPOs are not required to maintain any books and records under CFTC Regulation 4.23 related to compliance obligations to which they are not subject by virtue of the Harmonization Release.

The CFTC should take a similar approach with respect to recordkeeping by Registered Fund CTAs. For example, CFTC Regulations 4.33(b)(1) and 4.33(b)(2)(i) and (ii) require a CTA to keep records regarding the proprietary commodity interest trading of the CTA itself and of its principals. However, the performance of a CTA that is not the Registered Fund CPO is not required to be included in the Registered Fund's disclosure document under CFTC Regulation 4.12(c)(3)(i)(A).

[20] We understand that the CFTC staff expects shortly to permit professional records maintenance and storage companies to serve as permissible third-party recordkeepers. *See supra* note 3.

[21] August ICI Letter, *supra* note 3.

Thus, there should be no corresponding recordkeeping requirement. Consequently, Registered Fund CTAs should be granted similar relief from CFTC Regulation 4.33(b)(2)(i) and (ii), which corresponds to the trade confirmation recordkeeping requirement for CPOs under Regulation 4.23(b)(2)(i) and (ii). This relief was not requested in the August ICI Letter and, accordingly, the Petitioner respectfully requests that the CFTC reflect this relief in any recordkeeping amendments adopted pursuant to this petition.

III. Requested Relief

The Petitioner hereby respectfully requests that the Commission amend CFTC Regulations 4.12(c)(3), 4.23 and 4.33 to allow for substituted compliance by Registrants with the SEC's recordkeeping rules under the Investment Company Act and Advisers Act and applicable regulations thereunder, as set forth in Appendix A to this letter.

There are two main reasons why the Petitioner is requesting substituted compliance with the SEC's recordkeeping rules under the Investment Company Act and the Advisers Act, and those are cost and time. Principally, it is extremely costly for Registrants and their third-party recordkeepers to comply with CFTC Regulations 4.23 and 4.33, including Regulation 1.31. Firms have trended for years toward maintaining records in electronic format because most documents are now created electronically. Converting these systems to use non-erasable, non-rewriteable media would have significant costs for these firms, including purchasing hardware, migrating document repositories, implementing software to remove records once the retention period expires and training staff.[22] In particular, the requirement in Regulation 1.31(b) that any person who uses only electronic storage media to preserve some or all of its required records must enter into an arrangement with at least one third-party technical consultant ("Technical Consultant") is a costly and unnecessary burden on the recordkeeper. The Technical Consultant would need to be granted access to, and trained on, a multitude of proprietary systems (as opposed to common systems, such as email). Many Registrants and their third-party recordkeepers may balk at granting access to systems that are critical to their operations or present a competitive advantage. The SEC's recordkeeping rules under the Investment Company Act and the Advisers Act do not contain a similar Technical Consultant requirement, and the SEC generally has not had difficulty obtaining required records from those advisers or sub-advisers based on the manner in which their records are required to be maintained.

Furthermore, it is important to note that the requirements of CFTC Regulation 1.31(b) are based on old, outdated technology, and were adopted at a time when electronic records were just

[22] *See* discussion in Section II.C above.

emerging. Now that electronic recordkeeping is standard in the industry, these recordkeeping requirements are no longer appropriate.[23]

Finally, it would be very time consuming, with little or no corresponding benefit, for Registrants to comply with CFTC Regulation 1.31. Many of the required records are maintained in system-critical applications that cannot be quickly modified to work with new storage media. Additionally, the lack of practical alternatives for Registrants and their third-party recordkeepers may ultimately prove to be a time consuming task for them. If a Registrant (or a third-party recordkeeper) cannot comply with the requirements of CFTC Regulation 1.31(b), its main alternatives are to store records in hard copy or on micrographics. This would be a very time consuming task and would provide little, if any, benefit to the CFTC or to the general public (as it would require the recordkeeper to print out and store paper, microfilm or microfiche copies of countless records). These costs likely will be borne by the shareholders of the Registered Fund.

IV. Temporary No-Action Relief

The Petitioner acknowledges that it will take time for the CFTC to give its full consideration to this request and to conduct a further rulemaking. For this reason, Petitioner also requests temporary no-action relief, which would allow the CFTC adequate time to fully consider the substituted compliance request while sparing Registrants (and their third-party recordkeepers) from having to modify long-standing recordkeeping arrangements and systems, the cost of which would likely be borne by Registered Fund shareholders. We request that this temporary no-action relief exempt all Registrants from compliance with CFTC Regulation 4.23, subject to their adherence to the SEC's recordkeeping requirements under the Investment Company Act and the Advisers Act and applicable regulations thereunder, until the effective date of the further rulemaking.

V. Conclusion

Registrants already must comply with the extensive recordkeeping requirements under the Investment Company Act and the Advisers Act. These rules serve the same regulatory purposes as the CFTC's recordkeeping regulations, provide comprehensive recordkeeping requirements with respect to RIAs and Registered Funds, and require similar types of books and records. With respect to the manner of their maintenance, we respectfully submit that the SEC has not had difficulty obtaining electronically-maintained records from RIAs and third-party recordkeepers, even though these parties are subject to recordkeeping procedures that are different than those required by CFTC Regulation 1.31(b). Therefore, the Petitioner respectfully requests that the CFTC adopt a substituted compliance

[23] We recognize that these issues suggest the need for a general overhaul of CFTC Regulation 1.31. As discussed above, the Petitioner is requesting substituted compliance relief for Registered Funds in the context of CFTC Regulations 4.23 and 4.33, which would include relief from Regulation 1.31 for Registered Funds.

approach for Registrants that adhere to the SEC's recordkeeping requirements under the Investment Company Act and the Advisers Act and applicable regulations thereunder. As discussed above, the CFTC would have full access to these records.

The Petitioner also respectfully requests temporary expedited no-action relief in this regard, to last until final rules relating to this petition are adopted and effective.

* * * *

We sincerely appreciate the Commission's willingness to address the industry's concerns. If you have questions or require further information, please contact me at (202) 218-3563, Sarah A. Bessin at (202) 326-5835, or Rachel H. Graham at (202) 326-5819, or our outside counsel at K&L Gates, Cary J. Meer at (202) 778-9107, or Mark Amorosi at (202) 778-9351.

Sincerely,

/s/ Dorothy M. Donohue

Dorothy M. Donohue
Acting General Counsel

cc: Gary Barnett, Director
Amanda Olear, Associate Director
Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission

APPENDIX A

Text of Proposed Rule Amendments[24]

Additions to current regulations in *bold italics*. Deletions in ~~strikethrough~~.

§4.12 Exemption from provisions of part 4.

* * * * *

(c) * * *

(3) * * *

* * * * *

(iii) ~~Exemption from the provisions of §4.23 that require that a pool operator's books and records be made available to participants for inspection and/or copying at the request of the participant.~~ ***The pool operator of an offered pool will be exempt from the requirements of §4.23; Provided, that (1) the pool's books and records, the books and records of any controlled foreign corporation of the pool and the pool operator's books and records are maintained in accordance with the Investment Advisers Act of 1940 and/or the Investment Company Act of 1940, and applicable regulations thereunder, and (2) any such records are made available for inspection upon request by an authorized representative of the Commission or the United States Department of Justice.***

* * * * *

§4.23 Recordkeeping

* * * * *

(d) Notwithstanding the foregoing, if a commodity pool operator is registered as an investment adviser under the Investment Advisers Act of 1940 and is advising a controlled foreign corporation of an investment company registered under the Investment Company Act of 1940 [or a business

[24] Text of amendments providing relief to business development companies is bracketed below.

development company that has made an election under Section 54 of such act and continues to be regulated by the Securities and Exchange Commission as a business development company], such commodity pool operator may keep the books and records with respect to such entities in accordance with the requirements of such acts; Provided, that such books and records are made available for inspection upon request by an authorized representative of the Commission or the United States Department of Justice.

* * * * *

§4.33 Recordkeeping.

* * * * *

(c) Notwithstanding the foregoing, if a commodity trading advisor is registered as an investment adviser under the Investment Advisers Act of 1940 and is advising an investment company registered under the Investment Company Act of 1940, a controlled foreign corporation of such investment company, [or a business development company that has made an election under Section 54 of such act and continues to be regulated by the Securities and Exchange Commission as a business development company] (collectively, "Regulated Entities"), such commodity trading advisor may maintain the books and records with respect to such Regulated Entities in accordance with the requirements of such acts and applicable regulations thereunder.

(d) Notice of claim for exemption. Any commodity trading advisor that desires to claim the relief available under subsection (c) of this §4.33 must file electronically a claim of exemption with the National Futures Association through its electronic exemption filing system. Such claim must:

> ***(1) Provide the name, main business address and main business telephone number of the registered commodity trading advisor making the request;***
>
> ***(2) Contain a representation that the books and records required to be maintained by the Investment Advisers Act of 1940 and/or the Investment Company Act of 1940 will be maintained (i) in accordance with the Investment Advisers Act of 1940 and/or the Investment Company Act of 1940, and applicable regulations thereunder, as applicable, and (ii) made available for inspection upon request by an authorized representative of the Commission or the United States Department of Justice; and***
>
> ***(3) Be filed by a representative duly authorized to bind the commodity trading advisor.***

APPENDIX B

Relief Regarding Content of Books and Records

This exhibit compares the books and records that Registered Funds and their RIAs (including advisers and sub-advisers to Registered Funds) are required to maintain under SEC rules with the books and records that CPOs and CTAs are required to maintain under the CFTC's Part 4 regulations. Investment advisers and sub-advisers also are required to maintain similar records under the Advisers Act with respect to CFCs. In addition, Registered Funds are required, under the Investment Company Act, to maintain books and records relating to CFCs in connection with preparing consolidated financial statements for the Registered Fund.

I. Comparable Records

The books and records that Registered Funds and RIAs are required to maintain under the Investment Company Act, the Advisers Act, and the rules promulgated thereunder are generally equivalent to, and serve the same purposes as, the required books and records under CFTC Regulations 4.23 and 4.33 under the Commodity Exchange Act (the "CEA"). Examples of comparable records required to be maintained under the two regulatory regimes include the following:

- Journals containing an itemized daily record of all purchases or sales of securities and commodity interest transactions;[25]

- General ledgers or other records reflecting, among other things, all asset, liability, capital, income and expense accounts;[26]

- Separate ledger accounts (which may be maintained by a transfer agent) showing for each shareholder of record or commodity pool participant the securities or commodity interests held;[27]

- Check books, bank statements, cancelled checks, and cash reconciliations and all bills or statements (or copies thereof);[28]

[25] *Cf.* CFTC Regulations 4.23(a)(1) and 4.23(a)(2) with Investment Company Act Rule 31a-1(b)(1) and Advisers Act Rule 204-2(a)(1).

[26] *Cf.* CFTC Regulation 4.23(a)(6) with Investment Company Act Rule 31a-1(b)(2) and Advisers Act Rule 204-2(a)(2).

[27] *Cf.* CFTC Regulation 4.23(a)(4) with Investment Company Act Rule 31a-1(b)(iv).

[28] *Cf.* CFTC Regulations 4.23(a)(8) and 4.23(b)(3) with Advisers Act Rules 204-2(a)(4) and (a)(5).

- Notices, circulars, advertisements, newspaper articles, investment letters, bulletins or other communications sent to clients and prospective clients;[29]

- Powers of attorney and other documents granting the CTA, RIA or Registered Fund sub-adviser discretionary authority over a client's assets or account;[30] and

- Copies of written agreements with clients.[31]

II. Additional Records Under SEC Rules

The recordkeeping requirements under the Investment Company Act and the Advisers Act also impose additional recordkeeping obligations on Registered Funds and RIAs (including sub-advisers to Registered Funds) that are not required under the CFTC's Part 4 regulations. Examples of additional records required to be maintained by Registered Funds and RIAs (including sub-advisers to Registered Funds) include the following:

- The Registered Fund's corporate charter, certificate of incorporation, and by-laws, as well as minute books of stockholders' and directors' meetings;[32]

- All bills or statements (paid or unpaid), trial balances, financial statements, and internal audit working papers related to the business of a Registered Fund adviser or sub-adviser;[33]

- Communications sent to or received by a Registered Fund adviser or sub-adviser that detail proposed investment advice, any receipt, disbursement, or delivery of funds or securities, or the placing or execution of any order to purchase or sell any security;[34]

- A copy of the code of ethics of a Registered Fund adviser and sub-adviser, and records of any violation of the code of ethics and any action taken as a result of such violation;[35]

- A record of certain securities transactions in which a Registered Fund adviser or sub-adviser or its "access persons" have a direct or indirect beneficial ownership or interest;[36]

[29] *Cf.* CFTC Regulations 4.23(a)(9) and 4.33(a)(7) with Advisers Act Rule 204-2(a)(11).

[30] *Cf.* CFTC Regulation 4.33(a)(3) with Advisers Act Rule 204-2(a)(9).

[31] *Cf.* CFTC Regulation 4.33(a)(4) with Advisers Act Rule 204-2(a)(10).

[32] Investment Company Act Rule 31a-1(b)(4).

[33] Advisers Act Rule 204-2(a)(5) and (6).

[34] Advisers Act Rule 204-2(a)(7).

[35] Advisers Act Rules 204-2(a)(12)(i) and 204-2(a)(12)(ii).

- Copies of performance advertisements and documents necessary to form the basis for or demonstrate the calculation of such performance information;[37]

- Copies of a Registered Fund adviser and sub-adviser's brochures and brochure supplements, and each amendment or revision thereto;[38]

- Copies of a Registered Fund adviser's and sub-adviser's policies and procedures, as well as any records documenting the annual review of such policies and procedures;[39]

- Records that substantiate compliance with the "pay-to-play" rules under Rule 206-4(5) under the Advisers Act;[40]

- Records (*e.g.*, questionnaires or other documents) of each initial and subsequent determination that a director is not an interested person of a Registered Fund, as well as any materials used by the Registered Fund's "disinterested" directors to determine that the person who is acting as legal counsel to the directors is independent;[41] and

- Documents related to the approval or renewal of contracts between a Registered Fund and its adviser and/or sub-adviser.[42]

Based on the significant overlap between the content of the required records under the SEC's and CFTC's regimes, as well as the additional recordkeeping requirements under the SEC's rules, we believe that compliance with the SEC's books and records rules by Registrants is fully consistent with investor protection and should be permitted in lieu of compliance with the CFTC's recordkeeping regulations.

[36] Advisers Act Rule 204-2(a)(13).

[37] Advisers Act Rule 204-2(a)(16).

[38] Advisers Act Rule 204-2(a)(14)(i).

[39] Advisers Act Rule 204-2(a)(17).

[40] Advisers Act Rule 204-2(a)(18).

[41] Investment Company Act Rule 31a-2(a)(5).

[42] Investment Company Act Rule 31a-2(a)(6).

PRC 14

MANAGED FUNDS ASSOCIATION

IAA INVESTMENT ADVISER ASSOCIATION

aima

July 21, 2014

Ms. Melissa D. Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: **Petition for Rulemaking to Amend CFTC Regulations 1.31, 4.7(b) and (c), 4.23 and 4.33**

Dear Ms. Jurgens:

Managed Funds Association[1] ("MFA"), the Investment Adviser Association[2] ("IAA"), and the Alternative Investment Management Association[3] ("AIMA") (together, the "Associations" or the "Petitioners") respectfully petition the Commodity Futures Trading Commission (the "Commission" or the "CFTC") under CFTC Regulation 13.2 to amend (i) CFTC Regulation 1.31, which in part sets forth electronic recordkeeping and third-party

[1] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission (the "SEC"). Founded in 1937, the IAA's membership consists of more than 550 advisers that collectively manage approximately $14 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit its website: www.investmentadviser.org.

[3] AIMA is the trade body for the hedge fund industry globally; its membership represents all constituencies within the sector – including hedge fund managers, funds of hedge fund managers, prime brokers, fund administrators, accountants and lawyers. Its membership comprises over 1,300 corporate bodies in over 50 countries.

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technical consultant requirements; (ii) CFTC Regulations 4.7(b) and (c), which in part set forth recordkeeping requirements applicable to those registrants relying upon such exemptions; (iii) CFTC Regulation 4.23, which sets forth recordkeeping requirements generally applicable to commodity pool operators ("CPOs"); and (iv) CFTC Regulation 4.33, which sets forth recordkeeping requirements generally applicable to commodity trading advisors ("CTAs").

In particular, the Petitioners request that the Commission amend CFTC Regulation 1.31 to provide relief relating to certain electronic recordkeeping requirements applicable to CPOs and CTAs, including the requirement to use a third-party technical consultant. In addition, the Petitioners request that the Commission expand the list of permissible entities that may maintain records in CFTC Regulations 4.7(b) and (c), 4.23, and 4.33 to permit a CPO or CTA to retain any third party as a recordkeeper, as long as the CPO or CTA, as applicable, bears all responsibility for maintaining and producing required records pursuant to the Commission's regulations.

For the reasons set forth below, the Petitioners also respectfully request temporary time-limited no-action relief on an expedited basis to last until the Commission adopts final rules relating to this petition and such rules become effective.

The text of the requested rule amendments is set forth in Appendix A to this letter.

I. Nature of Petitioners' Interest

The Petitioners collectively represent a broad segment of the global investment management industry. For purposes of this petition, the Petitioners represent managers, investment advisers, and sub-advisers to many types of pooled investment vehicles and separate accounts, many of which trade commodity interests. As a result of the changes to the Part 4 regulations adopted by the CFTC in 2012[4] and the adoption of a broad definition of the types of swaps subject to CFTC regulation,[5] many of these managers, investment advisers, and sub-advisers registered as CPOs and/or CTAs as of January 1, 2013, and thus are subject to compliance with the applicable provisions of the Commodity Exchange Act (the "CEA"), and the Commission's regulations thereunder. Many of these CPOs and CTAs are finding compliance with the CFTC's recordkeeping regulations unduly burdensome, indeed infeasible, and costly, due to the regulations' incorporation of outdated technology and incongruity with standard market practices, particularly with respect to electronic recordkeeping and third-party recordkeepers. The Petitioners therefore are requesting, on behalf of their members, that the Commission amend CFTC Regulations 1.31, 4.7(b) and (c), 4.23 and 4.33 and provide the temporary no-action relief as requested herein.

[4] See *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252 (Feb. 24, 2012), amended by *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 17328 (Mar. 26, 2012).

[5] *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208 (Aug. 13, 2012).

II. Electronic Recordkeeping Requirements

The Petitioners fully support the need to ensure that CPOs and CTAs maintain records in a secure, retrievable, and auditable electronic format. We also acknowledge that it is essential to the integrity of the supervisory system to be able to reproduce records, even years after the CPO or CTA created the record, in an "as of" condition (in other words, to be able to retrieve a record with the same content and in the same condition as it existed on the date that the CPO or CTA originally created and/or saved the record to an electronic recordkeeping system).

The Petitioners, however, understand that CPOs and CTAs face technical compliance issues resulting from requirements that were reasonable and prudent when adopted but that have become outdated and irrelevant due to the passage of time and changing technical standards.

A. Background

CFTC Regulation 4.23 sets forth the recordkeeping requirements generally applicable to CPOs registered or required to register under the CEA and CFTC Regulation 4.33 sets forth the recordkeeping requirements generally applicable to CTAs registered or required to register under the CEA. Each of CFTC Regulation 4.23 and 4.33 requires books and records to be maintained in accordance with CFTC Regulation 1.31, which permits electronic recordkeeping subject to certain conditions set forth in CFTC Regulations 1.31(a), (b) and (c).

As a result of the changes to the Part 4 regulations adopted by the CFTC in 2012[6] and the adoption of a broad definition of the types of swaps subject to CFTC regulation,[7] many additional firms are newly subject to compliance with the CPO recordkeeping requirements in Regulation 1.31.

However, Regulation 1.31, as it applies to electronic recordkeeping, is quite outdated. Its obsolete concepts force CPOs and CTAs to choose between accepted electronic distributed storage systems (which are essential for disaster recovery and privacy protection) and compliance with the letter of the law. Indeed, when the Commission adopted the relevant electronic recordkeeping provisions of Regulation 1.31, it noted that "the pace of technological changes will require the Commission continually to review the standards articulated in this rule to ensure that the recordkeeping requirements reflect to the extent possible the reality of established technological innovation."[8] The outmoded requirements embedded in Regulation 1.31 include the following:

[6] *See supra*, note 4.

[7] *See supra*, note 5.

[8] *Recordkeeping: Storing Records: SEC & CFTC Harmonization*, 64 Fed. Reg. 28735, at 28736 (May 27, 1999) (hereinafter "1999 Recordkeeping Release"). The 1999 Recordkeeping Release went on to state that "The Commission therefore welcomes consultation with industry participants and specific proposals regarding how the regulations might be amended in the future to permit the futures industry to use available technology and to respond to the Commission's legitimate need to have access to complete and accurate records when necessary."

- CFTC Regulation 1.31(a) requires that electronic records be kept in their native (or original) format. Given that programs sometimes become obsolete and are no longer supported by their manufacturers (for example, WordPerfect, Lotus Notes), we strongly feel that it is counterproductive to specify the "format" of the electronic record, as long as there is demonstrable (and auditable) integrity and fidelity in the preservation of the underlying data and contents.

- CFTC Regulation 1.31(b) requires that electronic records be preserved in a "non-rewritable, non-erasable format," a concept that repeats in CFTC Regulation 1.31(c)'s requirement to represent whether electronic storage records use media other than "optical disk or CD-ROM technology." This requirement mirrors the broader "WORM" ("write once-read many") requirement that was state of the art in the late 1990s and early 2000s. However, the use of optical disks is now a relic of the past and would be indicative of a poorly–managed infrastructure in today's world.[9] Instead, state-of-the-art storage systems rely on storage that is subject to restricted access and include secure logs that reflect any and all changes to a file (often in addition to electronic archived copies).

- In addition, CFTC Regulation 1.31(b) requires firms that use only electronic recordkeeping with respect to some or all of their required records to incur the cost of retaining a third-party technical consultant who has access to, and the ability to download, the firm's electronic records. This third-party technical consultant must file with the Commission an undertaking that, upon request, it will furnish or provide access to information to any representative of the Commission or the U.S. Department of Justice. The purpose of requiring a technical consultant was to ensure that the Commission or other law enforcement had the technical ability to access the records in the event that the recordkeeper was unable or unwilling to provide records.[10] This also is a relic of another age and is simply unworkable; it is not needed in an age where both internal and external technical expertise is common. In addition, CPOs and CTAs are sharing data and access to data with administrators, counterparties, custodians and other service providers, and this dynamic environment ensures that current safeguard systems are broadly adopted and reinforced. Parties in this environment generally are either registered with a governmental entity or are subject to subpoena and preservation orders, which should also ameliorate access and alteration concerns.[11]

[9] Imagine if the Commission (and its predecessors) over time had required regulated entities to employ wax cylinders, Bakelite records, "78s," "LPs," Dictaphone belts, wire recorders, "45s," 8 track cassettes, audio cassettes, 1960s era hard drives (roughly the size of a home washing machine), RCA video discs, beta tapes, VHS tapes, IBM 360 SXs, Apple Macintoshes, Palm Pilots, or any other specific technology.

[10] *See supra*, note 8. In response to concerns with respect to the costs related to retaining a technical consultant, the Commission stated that registrants could avoid the need for a technical consultant "by maintaining backup copies of electronically stored records in either a hard copy or micrographic version." *Id.* at 28739.

[11] Further, we note that when the Commission adopted these requirements, electronic recordkeeping was considered relatively exotic and the Commission adopted the rules noted to permit electronic recordkeeping but with

Accordingly, as described in further detail below, we respectfully request that the Commission update its electronic recordkeeping regulations applicable to CPOs and CTAs, among other things, to provide more flexibility with regard to permitted formats (both now existing and as yet to be developed) and to eliminate the requirement to retain extraneous, costly, third-party technical consultants.[12]

B. Supporting Arguments

Investment management firms have created and maintained electronic records for years, perhaps approaching two decades for some firms. The relevant provisions in CFTC Regulation 1.31(b) were adopted in 1999,[13] at the cusp of the age of electronic records, and the regulation requires firms either to remain suspended in time by using obsolete technology or to duplicate recordkeeping efforts to meet modern business needs in addition to outdated recordkeeping requirements. As the Investment Company Institute also noted in its letter requesting relief from various provisions of the CFTC's electronic recordkeeping requirements, converting existing systems (or creating parallel systems) to use non-erasable, non-rewriteable media would require these firms to incur significant costs for new hardware and software, migration of document repositories and staff training.[14] These media and equipment requirements become less available by the day: consumer electronics are now based on solid state memory and cloud storage support and DVD drives are "special order" items.

A reversion to easily misplaced, lost, or stolen physical media is simply out of step with the industry and presents significant challenges to a firm trying to maintain a robust disaster recovery/BCP plan program. Strict adherence to CFTC Regulation 1.31 now links a firm's survival of a disaster to physical access to the storage location housing the physical back-up media – this is a model that a series of natural disasters, utility grid failures, and terroristic attacks have demonstrated is flawed. The new focus on hacking and cybersecurity only further demonstrates the need to be able to remotely restore files and functionality – sometimes (unfortunately) in real time in an active trading environment.

In addition, firms must incur the wholly unnecessary cost to retain and train a third-party technical consultant, rather than relying upon existing staff who already have familiarity with

an abundance of caution. Today, it is inconceivable that any business would keep records by any means other than electronic media. Indeed, a CPO or CTA that uses paper ledgers, typewriters, and carbon paper would be unlikely to maintain accurate records and probably would be more able to falsify and alter records than is possible with the modern means of electronic recordkeeping noted above.

[12] One of the Commission's goals in the 1999 Recordkeeping Release was "maximize[ing] the cost-reduction and time-savings arising from technological developments in the area of electronic storage media." 1999 Recordkeeping Release at 28735, *supra* note 8.

[13] *Id.*

[14] *See* Petition for Rulemaking to Amend CFTC Regulations 4.12(c)(3), 4.23 and 4.33 from Dorothy M. Donohue, Acting General Counsel, Investment Company Institute, to Ms. Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission, dated March 11, 2014.

and access to required records. In the "new world" of electronic storage of the 1990s and 2000s, when technical expertise was not common, this requirement may have made sense. However, in today's world, with sophisticated National Futures Association (the "NFA"), CFTC, and even SEC examination personnel and programs, robust retention systems, and very extensive investor due diligence, such an expense would be wasteful and of little value. Moreover, with the rise of cybersecurity threats, providing additional third parties with access to sensitive, confidential and proprietary information greatly increases cybersecurity intrusions.

Alternatively, if firms determine that they cannot comply with these requirements, such firms must take the time-consuming, costly and old-fashioned step of preserving records in hard copies or micrographics, solely for purposes of compliance with CFTC Regulation 1.31(b).[15] This is simply not possible to do in any way that would enable the variable-based searching that any regulatory inquiry or legal process requires.[16]

These issues could be resolved if CFTC Regulation 1.31 provided a more adaptable approach toward technology and permitted various types of recordkeeping formats (whether now existing or as yet to be developed).

For example, the SEC took the approach of providing flexibility when it tailored its recordkeeping rule applicable to investment advisers by adopting Rule 204-2(g) under the Investment Advisers Act of 1940, as amended (the "Advisers Act").[17] By adopting different recordkeeping requirements for advisers, as compared to those applicable to broker-dealers,[18] the

[15] The 1999 Recordkeeping Release, *supra* note 8, provides that:

> Recordkeepers are only required to enter an arrangement with a Technical Consultant if they choose to store all required records or all of a particular class of required records solely on electronic storage media. As a result, recordkeepers may protect themselves from costs related to retaining a Technical Consultant by maintaining backup copies of electronically stored records in either a hard copy or micrographic version.

[16] *See, e.g.*, CFTC Regulation 1.35(a), records of commodity interest and related cash or forward transactions, which requires records to "be kept in a form and manner identifiable and searchable by transaction."

[17] Ironically, one of the reasons the Commission indicated that it was adopting provisions similar to the SEC's recordkeeping provisions was because of the significant number of dual registrants. *See* 1999 Recordkeeping Release, *supra* note 13. The SEC's recordkeeping requirements for investment advisers were adopted subsequent to the 1999 Recordkeeping Release.

[18] Current CFTC Regulation 1.31(b) was modeled on Rule 17a-4(f) under the Securities Exchange Act of 1934, as amended, the SEC's electronic recordkeeping rule for broker-dealers. *Recordkeeping*, 64 Fed. Reg. 28735, at 28735 (May 27, 1999) ("In light of the significant number of Commission registrants that are subject to the recordkeeping requirements of the [SEC], the Proposal included many provisions similar to those adopted by the SEC in 1997."). The SEC later adopted a separate electronic recordkeeping rule for investment advisers, which differs significantly from Rule 17a-4(f), as discussed below. *See Electronic Recordkeeping by Investment Companies and Investment Advisers*, 66 Fed. Reg. 29224 (May 30, 2001) ("Electronic Records Adopting Release"), which announced amendments to SEC Regulation 275.204-2(g). However, the Commission applied Regulation 1.31(b) to all registrants, rather than only to futures commission merchants and introducing brokers (whose business models are somewhat similar to broker-dealers).

SEC explicitly stated that the cost of requiring advisers to adopt non-rewriteable, non-erasable formats of electronic records may not be justified.[19] Rule 204-2(g) does not tether advisers to any particular electronic format, nor does it require the use of third-party consultants. Instead, Rule 204-2(g) sets forth general principles that advisers must follow when arranging, accessing and reproducing their records. A principles-based approach facilitates adaptable recordkeeping requirements that can withstand evolutions in technology and software. In contrast, specifying the format of an electronic record inevitably will lead to obstacles to compliance at some point in the future when that format becomes obsolete and is no longer supported by its manufacturer (again, for example, Word Perfect).

Further, the burden of maintaining and producing required records under Rule 204-2(g) logically falls on the registered adviser itself, rather than any third parties who likely would charge a premium to subject themselves to such regulatory obligations. The current requirements of CFTC Regulation 1.31 to utilize native format and a third-party technical consultant appear to be intended both to preserve records without alteration and to ensure access to such records. However, technology has evolved, and today there are other safeguards to ensure the integrity and availability of data. Technological expertise is much more widely available today than it was fifteen years ago. Experts can readily determine whether and how records have been altered, and these experts are well-equipped to obtain access to various computer systems. The need for a third-party technical consultant has fallen away as technological expertise has become woven into our everyday lives.

As the Commission acknowledged in its release regarding harmonization of compliance obligations for operators of registered investment companies that also must register as CPOs, there are certain advantages to crafting regulations that "allow the Commission to fulfill its regulatory mandate while, at the same time, avoiding unnecessary regulatory burdens on dually-regulated [entities] with respect to ... Commission recordkeeping requirements."[20] We believe that the Commission's objectives with respect to electronic recordkeeping requirements by CPOs and CTAs can be satisfied with provisions substantially similar to Rule 204-2(g). Moreover, structuring a CFTC recordkeeping rule to be consistent with the SEC's recordkeeping rule for investment advisers would be consistent with the Commission's original goal in the 1999

[19] In its adoption of electronic recordkeeping standards for funds and advisers, the SEC noted:

> We recognize that the standards for electronic recordkeeping we are adopting for funds and advisers are different from the rules that we have adopted for broker-dealers, which require brokerage records to be preserved in a WORM format [(*i.e.*, non-rewriteable, non-erasable or "write once, read many," format)]. We have not experienced any significant problems with funds or advisers altering stored records. Moreover, most advisory and mutual fund arrangements involve multiple parties (e.g., brokers, custodians, transfer agents), each with its own, often parallel, recordkeeping requirement. As a result, our compliance examiners typically have an alternative means to verify the accuracy of adviser and fund records. In light of these factors, the costs of requiring funds and advisers to invest in new electronic recordkeeping technologies may not be justified.

Electronic Records Adopting Release, *supra* note 18, at 29224.

[20] *See Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators*, 78 Fed. Reg. 52308 at 52309 (Aug. 22, 2013).

Recordkeeping Release to align with similar SEC changes and "thereby harmonizing procedures for those firms regulated by both the Commission and the [SEC]." To the Petitioners' knowledge, the SEC has not experienced difficulties in obtaining the electronic records of investment advisers since the rule's adoption in 2001.

C. Requested Relief

The Petitioners hereby respectfully request that the Commission adopt new Regulation 1.31(e) (the full text of which can be found in Appendix A), which would apply to all CPOs and CTAs registered or required to register under the CEA (in lieu of Regulations 1.31(b) and (c)) and would substantially mirror Rule 204-2(g) under the Advisers Act. Regulation 1.31(e) would permit a CPO or CTA to maintain records on (i) micrographic media, including microfilm, microfiche or any similar medium; or (ii) electronic media, including any electronic medium or system or cloud technology that otherwise meets applicable recordkeeping requirements. Generally, the CPO or CTA must (i) arrange and index the records in a way that permits easy location, access and retrieval of any particular record; (ii) promptly provide a legible, true and complete copy of any record either in the medium and format in which it is stored (or a printout), as well as the means to access, view and print the record; and (iii) separately store a duplicate copy of the records in any permitted medium for the required length of time.

Additionally, with respect to electronic media, the CPO or CTA must establish and maintain procedures to: (i) maintain and preserve the records, so as to reasonably safeguard them from loss, alteration or destruction; (ii) limit access to the records to properly authorized personnel and the Commission (including its examiners and other representatives); and (iii) reasonably ensure that any reproduction of a non-electronic original record on electronic media is complete, true and legible when retrieved. Regulation 1.31(a) will continue to apply to CPOs and CTAs and require, among other things, that such records be open to inspection by the Commission or the U.S. Department of Justice and that such records will be produced to a CFTC representative upon request. The records will also be available for inspection by representatives of the NFA.

III. Expansion of Third-Party Recordkeeping for All CPOs

A. Background

Current CFTC Regulations permit delegation of recordkeeping by CPOs only to certain third parties and further require such third-party recordkeepers to comply with Regulation 1.31. Specifically, Regulation 4.23 permits CPOs to utilize only third-party recordkeepers that serve as the pool's administrator, distributor or custodian, or a bank or registered broker-dealer acting in a similar capacity with respect to the pool. In addition, Regulation 4.23(c)(2) requires such third-party recordkeeper to certify that it will keep and maintain the records in compliance with CFTC Regulation 1.31. Regulation 4.7(b) sets forth identical third-party recordkeeping requirements for CPOs who rely upon the limited regulatory relief therein.

As a result of the changes to the Part 4 regulations adopted by the CFTC in 2012[21] and the adoption of a broad definition of the types of swaps subject to CFTC regulation,[22] many additional firms are newly subject to compliance with the CPO recordkeeping requirements in Regulations 4.23 or 4.7(b). The requirement to renegotiate contracts with existing recordkeepers or to find new recordkeepers that fall within the categories of permitted recordkeepers and that are willing to subject themselves to compliance with Regulation 1.31 is a significant, expensive burden. Accordingly, as described in further detail below, we respectfully request that the Commission expand third-party recordkeeping requirements to permit a CPO or CTA to use any third-party to retain such records and to eliminate the duplicative requirement that a third-party recordkeeper (in addition to the registered CPO or CTA) certify that they keep and maintain records in accordance with Regulation 1.31.

B. Supporting Arguments

The Petitioners understand that many of their members are having difficulty finding recordkeepers that fall within the permitted categories and that are willing to subject themselves to compliance with Regulation 1.31 (as discussed below). Many of these firms have existing relationships with third-party recordkeepers, some of whom do not fall within the categories of permitted recordkeepers under Regulations 4.23 or 4.7(b), such as CTAs and sub-advisers, futures commission merchants and professional records maintenance and storage companies. In addition, the process of changing a recordkeeper is labor-intensive and costly, since often many physical records must be manually moved to the new recordkeeper's recordkeeping infrastructure. We note that the CFTC places no restrictions on who may act as a recordkeeper for a futures commission merchant or introducing broker, and we are unaware of any issues that the CFTC or NFA has experienced as a result.

With respect to the requirement for currently permitted third-party recordkeepers to certify that they are maintaining records in compliance with Regulation 1.31, existing contracts with these recordkeepers, particularly professional records maintenance and storage companies, typically do not require such companies to maintain records in a manner other than that in which the records have been supplied. Renegotiating these contracts likely would result in significantly increased costs to compensate the companies for increased responsibilities and potential liabilities under CFTC Regulation 1.31; in fact, renegotiation may be impossible because these companies are reluctant to undertake these responsibilities and potential liabilities. Accordingly, even utilizing the narrow universe of permitted third-party recordkeepers under CFTC Regulations 4.23 or 4.7(b) is unduly burdensome and costly. The burden of complying with Regulation 1.31 logically should fall on the registered CPO itself, rather than any third parties, which likely would charge a premium to subject themselves to such regulatory obligations. By requiring the CPO to bear responsibility for maintaining and producing required records, we

[21] *See supra*, note 4.

[22] *See supra*, note 5.

believe that the Commission's objectives can be satisfied while accommodating current appropriate market practices with respect to the use of third-party recordkeepers.[23]

C. Requested Relief

The Petitioners hereby respectfully request that the Commission revise Regulations 4.23 and 4.7(b)(4) to eliminate the requirement that records be maintained only with specified categories of third parties (the pool's administrator, distributor or custodian, or a bank or registered broker-dealer acting in a similar capacity with respect to the pool), instead permitting CPOs to utilize any third-party recordkeeper.[24] In addition, the Petitioners request that the Commission revise Regulations 4.23(c)(2) and 4.7(b)(5) to eliminate the requirement that third-party recordkeepers certify that they keep and maintain records in accordance with Regulation 1.31. In our proposal, the CPO will retain responsibility under Regulation 1.31 for compliance thereunder. The full text of the proposed revisions to Regulation 4.23 and Regulation 4.7(b) can be found in Appendix A attached hereto.

IV. Expansion of Third-Party Recordkeeping to CTAs

A. Background

Neither Regulation 4.33 nor Regulation 4.7(c) permits delegation of recordkeeping by CTAs to third parties. Many additional firms are newly subject to compliance with the CTA recordkeeping requirements in CFTC Regulations 4.33 or 4.7(c) as a result of the changes to the Part 4 regulations adopted by the CFTC in 2012[25] and the adoption of the broad definition of the types of swaps subject to CFTC regulation.[26] Many of these firms have existing relationships with third-party recordkeepers, including professional records maintenance and storage companies. Requiring these firms to terminate third-party recordkeeping arrangements and to manage all record-keeping internally would be a significant, expensive burden that simply may not be practicable for certain registrants. Accordingly, we respectfully request that the Commission revise third-party recordkeeping requirements to permit CTAs to use third-party recordkeepers, as described in further detail below.

B. Supporting Arguments

We believe that CTAs should be granted the same third-party recordkeeping relief described above with respect to CPOs. Currently, CTAs are not permitted to rely on third-party

[23] Also, we note that this accommodates technological developments to enhance safeguards with respect to the recordkeeping process, such as the current trend to move to cloud computing.

[24] Contrast a third-party recordkeeper, as described above, with a third-party technical consultant, which is required by current CFTC Regulation 1.31(b)(4) to furnish the registrant's electronic records to the CFTC or the Department of Justice if the CPO is unwilling or able to do so.

[25] *See supra*, note 4.

[26] *See supra*, note 5.

recordkeepers at all. Many firms that are newly registered with the CFTC have existing relationships with third-party recordkeepers, including with professional records maintenance and storage companies and with affiliates. Rearranging internal operations and terminating these contracts is unduly burdensome and costly. In addition, we do not believe that there is any policy reason to treat CPOs and CTAs substantially differently with respect to the use of third-party recordkeepers. We believe that the Commission's objectives can be satisfied while expanding the use of third-party recordkeepers to CTAs in order to accommodate current market practices. As noted above, the CFTC places no restrictions on who may act as a recordkeeper for a futures commission merchant or introducing broker, and we are unaware of any issues that the CFTC or NFA has experienced as a result.

C. Requested Relief

The Petitioners hereby respectfully request that the Commission revise Regulation 4.33 to permit CTAs to utilize third-party recordkeepers, the relevant language of which would be substantially similar to Regulation 4.23 (including the revisions proposed above). The Petitioners also request that the Commission revise Regulation 4.7(c)(2) to permit CTAs in reliance upon such exemption to utilize third-party recordkeepers. The full text of the proposed revisions to Regulation 4.33 and Regulation 4.7(c)(2) can be found in Appendix A attached hereto.

V. Temporary No-Action Relief

The Petitioners acknowledge that it will take time for the Commission to give its full consideration to this request and to conduct a further rulemaking. For this reason, the Petitioners also request temporary no-action relief, which would allow the Commission adequate time to fully consider these requests while sparing CPOs and CTAs (and their third-party recordkeepers) from having to modify long-standing recordkeeping arrangements and systems. We request that this temporary no-action relief exempt all CPOs and CTAs from compliance with CFTC Regulation 1.31(b) and (c) as well as from compliance with provisions of CFTC Regulations 4.7(b) and (c), 4.23 and 4.33 relating only to third-party recordkeeping until the effective date of the further rulemaking; provided that CPOs and CTAs maintain the types of records required to be maintained under CFTC Regulation 4.23 or CFTC Regulation 4.33, as applicable, for the required length of time specified by CFTC Regulation 1.31(a) in a manner that preserves the text of the original record.

VI. Conclusion

The Commission's regulations concerning electronic recordkeeping were adopted nearly fifteen years ago, and there have been revolutionary changes in technology since such time. We respectfully request that the Commission adopt the amendments to CFTC Regulations 1.31, 4.7(b) and (c), 4.23 and 4.33 as set forth in Appendix A. Specifically, we respectfully request that the Commission update its electronic recordkeeping regulations to eliminate outdated, unnecessary requirements. We respectfully submit that CPOs and CTAs have evolved with such changes in technology, in part by hiring knowledgeable employees who are already familiar with and who already have access to their electronic recordkeeping systems. We urge the Commission to adopt a standards-based recordkeeping requirement that places the responsibility for maintaining accurate records on the CPO and CTA. Further we believe that specifying specific technology in a rule is ultimately self-defeating. Accordingly, we respectfully request that the Commission eliminate the requirement to retain extraneous, costly, third-party technical consultants. On a different but related note, we respectfully request that the Commission expand third-party recordkeeping requirements to permit a CPO or CTA to use any third-party to retain such records and to eliminate outdated requirements for such third parties. We respectfully submit that the Commission's objectives can be satisfied by requiring the CPO or CTA to bear all responsibility for maintaining and producing records pursuant to the Commission's regulations.

The Petitioners also respectfully request temporary expedited no-action relief in this regard, to last until final rules relating to this petition are adopted and effective.

* * * *

We sincerely appreciate the Commission's willingness to address the industry's concerns. If you have questions or require further information, please contact Jennifer Han or Stuart Kaswell of MFA at (202) 730-2600, Karen Barr of IAA at (202) 293-4222, and Jiří Król of AIMA at +44 (0)20 7822 8380, or our outside counsel at K&L Gates, Cary J. Meer at (202) 778-9107.

Respectfully submitted,

/s/ Stuart Kaswell

Stuart Kaswell
General Counsel
Managed Funds
Association

Karen Barr
General Counsel
Investment Adviser
Association

Jiří Król
Deputy CEO
Head of Governmental and
Regulatory Affairs
Alternative Investment
Management Association

cc: Clark Ogilvie, Chief of Staff, Office of Chairman Massad
Lawranne Stewart, Interim Senior Counsel, Office of Chairman Massad
Bella Rozenberg, Legal Counsel, Office of Commissioner O'Malia
Scott Reinhart, Special Counsel and Policy Advisor, Office of Commissioner Wetjen
Mark Fajfar, Interim Senior Advisor-Counsel, Office of Commissioner Bowen
Marcia Blase, Senior Counsel, Office of Commissioner Giancarlo
Gary Barnett, Director, and Amanda Olear, Associate Director
Division of Swap Dealer and Intermediary Oversight
Jonathan Marcus, General Counsel
Aitan Goelman, Director, Division of Enforcement
Vincent McGonagle, Director of the Division of Market Oversight
Cory Claussen, Director of Legislative Affairs

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Respectfully submitted,

Karen L. Barr

Stuart Kaswell
General Counsel
Managed Funds
Association

Karen Barr
General Counsel
Investment Adviser
Association

Jiří Król
Deputy CEO
Head of Governmental and
Regulatory Affairs
Alternative Investment
Management Association

cc: Clark Ogilvie, Chief of Staff, Office of Chairman Massad
Lawranne Stewart, Interim Senior Counsel, Office of Chairman Massad
Bella Rozenberg, Legal Counsel, Office of Commissioner O'Malia
Scott Reinhart, Special Counsel and Policy Advisor, Office of Commissioner Wetjen
Mark Fajfar, Interim Senior Advisor-Counsel, Office of Commissioner Bowen
Marcia Blase, Senior Counsel, Office of Commissioner Giancarlo
Gary Barnett, Director, and Amanda Olear, Associate Director
Division of Swap Dealer and Intermediary Oversight
Jonathan Marcus, General Counsel
Aitan Goelman, Director, Division of Enforcement
Vincent McGonagle, Director of the Division of Market Oversight

We sincerely appreciate the Commission's willingness to address the industry's concerns. If you have questions or require further information, please contact Jennifer Han or Stuart Kaswell of MFA at (202) 730-2600, Karen Barr of IAA at (202) 293-4222, and Jiří Król of AIMA at +44 (0)20 7822 8380, or our outside counsel at K&L Gates, Cary J. Meer at (202) 778-9107.

Respectfully submitted,

Stuart Kaswell

General Counsel
Managed Funds
Association

Karen Barr

General Counsel
Investment Adviser
Association

Jiří Król
Deputy CEO
Head of Government and
Regulatory Affairs
Alternative Investment
Management Association

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APPENDIX A

Text of Proposed Rule Amendments

Additions to current regulations in *bold italics and underlined*. Deletions in ~~strikethrough~~.

§1.31 **Books and records; keeping and inspection.**

(a)(1) All books and records required to be kept by the Act or by these regulations shall be kept in their original form (for paper records) or ***such other media permitted under this section as long as the contents of the original record are preserved*** ~~native file format~~ (for electronic records) for a period of five years from the date thereof and shall be readily accessible during the first 2 years of the 5-year period; *Provided, however*, That records of any swap or related cash or forward transaction shall be kept until the termination, maturity, expiration, transfer, assignment, or novation date of the transaction and for a period of five years after such date. Records of oral communications kept pursuant to §§1.35(a) and 23.202(a)(1) and (b)(1) of this chapter shall be kept for a period of one year. All such books and records shall be open to inspection by any representative of the Commission, or the United States Department of Justice. ~~For purposes of this section, native file format means an electronic file that exists in the format in which it was originally created.~~

* * *

(b) Except as provided in paragraph***s*** (d) ***and (e)*** of this section, books and records required to be kept by the Act or by these regulations may be stored on either "micrographic media" (as defined in paragraph (b)(1)(i) of this section) or "electronic storage media" (as defined in paragraph (b)(1)(ii) of this section) for the required time period under the conditions set forth in this paragraph (b); Provided, however, For electronic records, such storage media must ***be*** preserve***d*** ~~the native file format of the electronic records~~ as required by paragraph (a)(1) of this section.

* * *

(c) ***Except as provided in paragraph (e) of this section,*** ~~P~~***p***ersons employing an electronic storage system shall provide a representation to the Commission prior to the initial use of the system. The representation shall be made by the person required to maintain the records, the storage system vendor, or another third party with appropriate expertise and shall state that the selected electronic storage system meets the requirements set forth in paragraph (b)(1)(ii) of this section. Persons employing an electronic storage system using media other than optical disk or CD-ROM technology shall so state. The representation shall be accompanied by the type of oath or affirmation described in §1.10(d)(4).

(d) * * *

(e)(1) In lieu of complying with paragraphs (b) and (c) of this section, any commodity pool operator registered or required to be registered under the Act or any commodity trading

advisor registered or required to be registered under the Act may comply with this paragraph (e). Any registered commodity pool operator or any registered commodity trading advisor may maintain and preserve books and records required to be kept by the Act or by these regulations (i) on paper, (ii) on micrographic media, including microfilm, microfiche, or any similar medium; or (iii) on electronic media, including any electronic medium or environment that meets the terms of this paragraph, as long as the contents of the original record are preserved.

(2) To comply with this paragraph (e), the commodity pool operator registered or required to be registered under the Act or the commodity trading advisor registered or required to be registered under the Act must:

(i) Arrange and index the records in a way that permits easy location, access, and retrieval of any particular record;

(ii) Provide promptly any of the following that the Commission or a registered futures association (by its examiners or other representatives) may request:

(A) A legible, true, and complete copy of the record in the medium and format in which it is stored;

(B) A legible, true, and complete printout of the record; and

(C) Means to access, view, and print the records; and

(iii) Separately store, for the time required for preservation of the original record, a duplicate copy of the record on any medium allowed by this paragraph.

(3) In the case of records on electronic media, the commodity pool operator or commodity trading advisor must establish and maintain procedures to:

(i) Maintain and preserve the records, so as to reasonably safeguard them from loss, alteration, or destruction;

(ii) Limit access to the records to properly authorized personnel, the Commission or a registered futures association (including its examiners and other representatives) and other appropriate regulators and self-regulatory organizations; and

(iii) Reasonably ensure that any reproduction of a non-electronic original record on electronic media is complete, true, and legible when retrieved.

* * * * *

§4.7 Exemption from certain part 4 requirements for commodity pool operators with respect to offerings to qualified eligible persons and for commodity trading advisors with respect to qualified eligible persons.

(a) * * *

(b) Relief available to commodity pool operators. * * *

(1) * * *

(2) * * *

(3) * * *

(4) *Recordkeeping relief.* Exemption from the specific requirements of §~~4,23~~ ***4.23***; Provided, That the commodity pool operator must maintain the reports referred to in paragraphs (b)(2) and (3) of this section and all books and records prepared in connection with his activities as the pool operator of the exempt pool (including, without limitation, records relating to the qualifications of qualified eligible persons and substantiating any performance representations). Books and records that are not maintained at the pool operator's main business office ~~shall~~ ***may*** be maintained by ~~one or more of the following: the pool's administrator, distributor or custodian, or a bank or registered broker or dealer acting in a similar capacity with respect to the pool~~ ***a third party***. Such books and records must be made available to any representative of the Commission, the National Futures Association and the United States Department of Justice in accordance with the provisions of §1.31.

(5) If the pool operator does not maintain its books and records at its main business office, the pool operator shall~~: (i) A~~***, a***t the time it registers with the Commission or delegates its recordkeeping obligations ***or [insert 180 days after the change to this rule]***, whichever is later, file a statement that:

(~~A~~***i***) Identifies the name, main business address, and main business telephone number of the person(s) who will be keeping required books and records in lieu of the pool operator;

(~~B~~***ii***) Sets forth the name and telephone number of a contact for each person who will be keeping required books and records in lieu of the pool operator;

(~~C~~***iii***) Specifies~~, by reference to the respective paragraph of this section,~~ the books and records that such person will be keeping; and

(~~D~~***iv***) Contains representations from the pool operator that:

(~~1~~***A***) It will promptly amend the statement if the contact information or location of any of the books and records required to be kept by this section changes, by identifying in such amendment the new location and any other information that has changed;

(~~2~~***B***) It remains responsible for ensuring that all books and records required by this section are kept in accordance with §1.31;

(~~3~~***C***) Within 48 hours after a request by a representative of the Commission, it will obtain the original books and records from the location at which they are maintained, and provide them for inspection at the pool operator's main business office; Provided, however, that if the original books and records are permitted to be, and are maintained, at a location outside the United States, its territories or possessions, the pool operator will obtain and provide such original books and records for inspection at the pool operator's main business office within 72 hours of such a request; and

(~~4~~***D***) It will disclose in the pool's Disclosure Document the location of its books and records that are required under this section.

~~(ii) The pool operator shall also file electronically with the National Futures Association a statement from each person who will be keeping required books and records in lieu of the pool operator wherein such person:~~

~~(A) Acknowledges that the pool operator intends that the person keep and maintain required pool books and records;~~

~~(B) Agrees to keep and maintain such records required in accordance with §1.31 of this chapter; and~~

~~(C) Agrees to keep such required books and records open to inspection by any representative of the Commission, the National Futures Association, or the United States Department of Justice in accordance with §1.31 of this chapter.~~

(c) *Relief available to commodity trading advisors.* * * *

(1) * * *

(2) *Recordkeeping relief.* Exemption from the specific requirements of §4.33; Provided, That the commodity trading advisor must maintain, at its main business office, all books and records prepared in connection with his activities as the commodity trading advisor of qualified eligible persons (including, without limitation, records relating to the qualifications of such qualified eligible persons and substantiating any performance representations). ***Books and records that are not maintained at the commodity trading advisor's main business office may be maintained by a third party.*** ~~And must make s~~ ***S***uch books and records ***must be made*** available to any representative of the Commission, the National Futures Association and the United States Department of Justice in accordance with the provisions of §1.31.

(3) If the commodity trading advisor does not maintain its books and records at its main business office, the commodity trading advisor shall, at the time it registers with the Commission or delegates its recordkeeping obligations or [insert 180 days after the change to this rule], whichever is later, file a statement that:

(i) Identifies the name, main business address, and main business telephone number of the person(s) who will be keeping required books and records in lieu of the commodity trading advisor;

(ii) Sets forth the name and telephone number of a contact for each person who will be keeping required books and records in lieu of the commodity trading advisor;

(iii) Specifies the books and records that such person will be keeping; and

(iv) Contains representations from the commodity trading advisor that:

(A) It will promptly amend the statement if the contact information or location of any of the books and records required to be kept by this section changes, by identifying in such amendment the new location and any other information that has changed;

(B) It remains responsible for ensuring that all books and records required by this section are kept in accordance with §1.31; and

(C) Within 48 hours after a request by a representative of the Commission, it will obtain the original books and records from the location at which they are maintained, and provide them for inspection at the commodity trading advisor's main business office; Provided, however, that, if the original books and records are permitted to be, and are maintained, at a location outside the United States, its territories or possessions, the commodity trading advisor will obtain and provide such original books and records for inspection at the commodity trading advisor's main business office within 72 hours of such a request.

(d) * * *

§4.23 **Recordkeeping.**

Each commodity pool operator registered or required to be registered under the Act must make and keep the following books and records in an accurate, current and orderly manner. Books and records that are not maintained at the pool operator's main business office ~~shall~~ ***may*** be maintained by one ~~or more~~ of the ~~following:~~ ~~the pool's administrator, distributor or custodian, or a bank or registered broker or dealer acting in a similar capacity with respect to the pool~~ ***a third party***. All books and records shall be maintained in accordance with §1.31. All books and records required by this section except those required by paragraphs (a)(3), (a)(4), (b)(1), (b)(2) and (b)(3) must be made available to participants for inspection and copying during normal business hours. Upon request, copies must be sent by mail to any participant within five business days if reasonable reproduction and distribution costs are paid by the pool participant. If the books and records are maintained at the commodity pool operator's main business office that is outside the United States, its territories or possessions, then upon the request of a Commission representative, the pool operator must provide such books and records as requested at the place in the United States, its territories or possessions designated by the representative within 72 hours after the pool operator receives the request.

* * *

(b) * * *

(c) If the pool operator does not maintain its books and records at its main business office, the pool operator shall~~: (1) A,~~ *a*t the time it registers with the Commission or delegates its recordkeeping obligations, whichever is later, file a statement that:

(~~i~~*1*) Identifies the name, main business address, and main business telephone number of the person(s) who will be keeping required books and records in lieu of the pool operator;

(~~ii~~*2*) Sets forth the name and telephone number of a contact for each person who will be keeping required books and records in lieu of the pool operator;

(~~iii~~*3*) Specifies~~, by reference to the respective paragraph of this section,~~ the books and records that such person will be keeping; and

(iv*4*) Contains representations from the pool operator that:

(~~A~~*i*) It will promptly amend the statement if the contact information or location of any of the books and records required to be kept by this section changes, by identifying in such amendment the new location and any other information that has changed;

(~~B~~*ii*) It remains responsible for ensuring that all books and records required by this section are kept in accordance with §1.31;

(C*iii*) Within 48 hours after a request by a representative of the Commission, it will obtain the original books and records from the location at which they are maintained, and provide them for inspection at the pool operator's main business office; Provided, however, that if the original books and records are permitted to be, and are maintained, at a location outside the United States, its territories or possessions, the pool operator will obtain and provide such original books and records for inspection at the pool operator's main business office within 72 hours of such a request; and

(~~D~~*iv*) It will disclose in the pool's Disclosure Document the location of its books and records that are required under this section.

~~(2) The pool operator shall also file electronically with the National Futures Association a statement from each person who will be keeping required books and records in lieu of the pool operator wherein such person:~~

~~(i) Acknowledges that the pool operator intends that the person keep and maintain required pool books and records;~~

~~(ii) Agrees to keep and maintain such records required in accordance with §1.31 of this chapter; and~~

~~(iii) Agrees to keep such required books and records open to inspection by any representative of the Commission or the United States Department of Justice in accordance with §1.31 of this chapter and to make such required books and records available to pool participants in accordance with this section.~~

§4.33 **Recordkeeping.**

Each commodity trading advisor registered or required to be registered under the Act must make and keep the following books and records in an accurate, current and orderly manner ~~at its main business office and in accordance~~ with ~~§1.31~~. ***Books and records that are not maintained at the pool operator's main business office may be maintained by a third party. All books and records shall be maintained in accordance with §1.31.*** If the commodity trading advisor's main business office is located outside the United States, its territories or possessions, then upon the request of a Commission representative the trading advisor must provide such books and records as requested at the place designated by the representative in the United States, its territories or possessions within 72 hours after receipt of the request.

(a) * * *

(b) * * *

(c) If the commodity trading advisor does not maintain its books and records at its main business office, the commodity trading advisor shall, at the time it registers with the Commission or delegates its recordkeeping obligations or [insert 180 days after the change to this rule], whichever is later, file a statement that:

(1) Identifies the name, main business address, and main business telephone number of the person(s) who will be keeping required books and records in lieu of the commodity trading advisor;

(2) Sets forth the name and telephone number of a contact for each person who will be keeping required books and records in lieu of the commodity trading advisor;

(3) Specifies the books and records that such person will be keeping; and

(4) Contains representations from the commodity trading advisor that:

(i) It will promptly amend the statement if the contact information or location of any of the books and records required to be kept by this section changes, by identifying in such amendment the new location and any other information that has changed;

(ii) It remains responsible for ensuring that all books and records required by this section are kept in accordance with §1.31; and

(iii) Within 48 hours after a request by a representative of the Commission, it will obtain the original books and records from the location at which they are maintained, and provide them for inspection at the commodity trading advisor's main business office; Provided, however, that, if the original books and records are permitted to be, and are maintained, at a location outside the United States, its territories or possessions, the commodity trading advisor will obtain and provide such original books and records for inspection at the commodity trading advisor's main business office within 72 hours of such a request.

X-pand into the Future

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Secretariat

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Juli 25, 2014

Via electronic mail

Mr. Timothy G. Massad
Chairman
Commodity Futures Trading Commission
3 Lafayette Centre
1151 21st St., N.W.
Washington, D.C. 20581

Dear Chairman Massad:

On behalf of Eurex Group,[1] we would like to congratulate you on becoming Chairman of the Commodity Futures Trading Commission and wish you success in overseeing the execution of the Commission's many responsibilities. As you are doubtlessly aware, the Commission serves a pivotal and crucial role in the development of a global regime for effective derivatives regulation and institutions around the world depend on your and the Commission's leadership. Accordingly, we would like to draw your attention to an issue that directly affects the Eurex Group and that we respectfully request the Commission to address.

Not only one of the world's largest derivatives markets, Eurex Exchange was also one of the pioneers in electronic trading. As you may be aware, in February 1996 the Commission's Division of Trading & Markets provided its first 'foreign terminals no action letter" to Deutsche Terminbörse, Eurex Exchange's predecessor entity. Since then, Eurex Exchange has grown in the United States to include 68 legal persons as members. Eurex Deutschland applied for recognition as a "foreign board of trade" on August 17, 2012.

Eurex Clearing is the world's largest clearinghouse for euro-denominated instruments and, among other things, provides clearing services for Eurex Exchange. Eurex Clearing has applied for registration as a derivatives clearing organization ("DCO") in order to clear swaps for U.S. persons.[2] Although Eurex Clearing has progressed its application for registration as a U.S. DCO, we believe that operating in accordance with exemptive relief like that which was discussed at the Commission's recent Global Market's Advisory Committee meeting would be administratively less complex for Eurex Clearing, its customers and the Commission.[3] Eurex Clearing respectfully

[1] Eurex Group consists of Eurex Exchange (formally, "Eurex Deutschland"), International Securities Exchange, European Energy Exchange, Eurex Repo and Eurex Bonds in addition to Eurex Clearing.

[2] Eurex Clearing applied for registration as a DCO in order to clear swaps for U.S. clearing members and their customers on May 16, 2011 under Part 39 of the Commission's rules. At Eurex Clearing's request, the Division extended the review period on several occasions. Its application for registration remains pending. On July 4, 2013, Eurex Clearing applied for no-action relief for clearing certain interest rate swaps ("IRS") while its application was pending. On July 11, 2013, staff of the Division of Clearing and Risk ("Division") granted Eurex Clearing no-action relief subject to several conditions, most notable of which were that 1) the no-action relief had a limited duration and 2) applied only to the proprietary business of U.S. clearing members.

[3] Transcript of the Global Markets Advisory Committee meeting on May 21, 2014; http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/gmac_052114_transcript.pdf

Eurex Frankfurt AG
Mergenthalerallee 61
65760 Eschborn

Mailing address:
60485 Frankfurt/Main

T +49-69-211-1 47 71
F +49-69-211-81 47 71
thomas.book@
eurexclearing
Internet:
www.eurexchange.com

Chairman of the
Supervisory Board:
Reto Francioni

Executive Board:
Andreas Preuss (CEO),
Brendan Bradley, Mehtap Dinc,
Gary Katz, Michael Peters,
Peter Reitz

Aktiengesellschaft mit
Sitz in Frankfurt/Main
HRB Nr. 45817
USt-IdNr. DE196703222
Amtsgericht Frankfurt/Main
ARBN: 101 999 764

requests that the Commission act swiftly to propose a procedure and standards for applying for and granting exemptive relief which follows the provisions of the Commodity Exchange Act.[4]

A basic goal of the regulation of swaps under the Commodity Exchange Act ("Act") is to provide for competition the clearing of swaps.[5] The Commission would further those goals if it were to implement the authority granted to it by the Act and adopt an exemptive process for comprehensively and comparably regulated non-U.S. DCOs. In light of the significant infrastructure that is necessary to offer clearing services, an important source of competition for clearing services to U.S. persons is likely to be DCOs located outside the U.S. Easing the ability of U.S. persons to access the clearing services of such non-U.S. DCOs through an exemptive process for non-U.S. DCOs that meet the Commission's high standards through compliance with their home countries' comparably strict regulation will promote competition and open access for U.S. persons seeking to trade and clear swaps.

Finally, Eurex Clearing has heard that there have been numerous discussions between the CFTC and other national regulators regarding appropriate regulatory treatment of non-U.S. DCOs. We believe that the recently discussed proposals for exempting non-U.S. DCOs will constitute a very important contribution to addressing the relevant issues and could be the basis for rulemaking by being published for comment. Such action now would enable not only foreign regulators to participate in the rulemaking process but also the global swaps industry as well as the American public.

Eurex Clearing believes substantial public benefits would accrue to non-U.S. DCOs and their U.S. members, non-U.S. regulators, and the Commission itself and therefore respectfully asks the Commission to publish proposed rules establishing the procedures and substantive conditions to implement the exemptive authority authorized under the Act.

Respectfully submitted,

Andreas Preuss
Chief Executive Officer
Eurex Frankfurt AG

Thomas Book
Chief Executive Officer
Eurex Clearing AG

cc: Commissioner Scott O'Malia
Commissioner Mark Wetjen
Commissioner Sharon Y. Bowen
Commissioner J. Christopher Giancarlo
Ms. Melissa Jurgens, Secretary of the Commission
Mr. Jonathan L. Marcus, General Counsel
Mr. Ananda Radhakrishnan, Director of the Division of Clearing and Risk
Mr. Paul Architzel, Attorney-at-Law

[4] See Section 5b(h).
[5] See Section 2(h)(B).

PRC 8-9

ISDA® Safe, Efficient Markets

June 15, 2015

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend Parts 1 (General Regulations under the Commodity Exchange Act), 37 (Swap Execution Facilities) and 43 (Real-Time Public Reporting) of the Commodity Futures Trading Commission Regulations

Dear Mr. Kirkpatrick:

The International Swaps and Derivatives Association (ISDA) respectfully petitions the Commodity Futures Trading Commission (the Commission or CFTC) under Commission regulation 13.2 to amend certain provisions in Parts 1, 37 and 43 of the Commission's regulations.

For the reasons set forth below, we request that the Commission amend certain provisions of the Commission's regulations to more closely adhere to Congressional intent to establish a swaps trading platform regime that allows for flexible execution of swaps, to reduce undesirable regulatory outcomes that threaten the efficient functioning of markets, and to achieve cross-border harmonization of execution rules. The information required by Commission regulation 13.2 follows:

I. Text of Proposed Rule Amendments

Part 37—Swap Execution Facilities

Add new § 37.6(c):

> *Confirmation of the transactions not intended to be cleared.* (1) In satisfaction of the obligations imposed on a swap execution facility under paragraph (b) of this section: (i) Each confirmation of the transaction shall incorporate by reference the previously-negotiated documents and agreements (including, without limitation, ISDA master agreements,

other master agreements, terms supplements, master confirmation agreements, and incorporated industry definitions) governing such transaction existing at the time of execution between the counterparties. (ii) In the event of any inconsistency between a swap execution facility confirmation and the underlying previously-negotiated freestanding agreements, the terms of the swap execution facility confirmation shall legally supersede any conflicting terms. (iii) A swap execution facility shall incorporate by reference terms from previously-negotiated agreements between the counterparties, without obligating participants to provide copies of referenced agreements or documents; provided that:

(A) Upon request by a swap execution facility, counterparties to a transaction shall provide such swap execution facility with any underlying freestanding documents or agreements governing such transaction existing at the time of the execution between the counterparties; and

(B) Upon request from the Commission, the swap execution facility shall request from counterparties the underlying freestanding documents or agreements governing such transaction existing at the time of execution between the counterparties and the swap execution facility shall furnish such documents or agreements to the Commission as soon as they are available.

Add new § 37.9(a)(2)(C)

Other Methods of Execution as approved by the Commission under new paragraph (d) of this section.

Add new § 37.9(a)(4)

Exception for correction of errors or omissions. (i) A swap execution facility may, with consent of the counterparties, permit: (A) execution of a new transaction, with terms and conditions that match the terms and conditions of an intended to be cleared transaction rejected for clearing or (B) execution of one or more cleared transactions to offset and replace a transaction to correctly reflect the terms to which the parties mutually assented. Such transactions need not be executed pursuant to the methods set forth in paragraph (a)(2) of this section when executed for the correction of an operational or clerical error or omission made by the swap execution facility, either or both of the counterparties, or an agent of either or both of the counterparties. Such transactions shall not violate the requirements contained in § 37.203 of this chapter. (ii) This

> paragraph shall apply to the leg of a package transaction as defined in new § 1.3(www) of this chapter if the leg is either rejected from clearing due to an operational or clerical error or omission made by the swap execution facility, either or both of the counterparties, or an agent of either or both of the counterparties or requires correction or replacement due to errors or omissions for operational or clerical reasons. (iii) A swap execution facility shall adopt rules describing the conditions, if any, under which it will determine that an error or omission has occurred and the procedures it will follow to execute a transaction. The requirements contained in §§ 1.74, 23.610, 39.12(b)(7), 43.3(e) and 45.14 of this chapter apply to these transactions.

Add new § 37.9(d):

> A swap execution facility may submit a request to the Commission to approve additional execution methods to execute Required Transactions as defined in § 37.9(a)(1), pursuant to the procedures under § 40.5 of this chapter.

Revise § 37.10(a)(1) to read as follows:

> (a)(1) *Required submission*. A swap execution facility that intends to make a swap available to trade shall submit to the Commission its initial determination with respect to such swap as a rule, as that term is defined by § 40.1 of this chapter, pursuant to the procedures under § 40.5 of this chapter.
>
> (i) The Commission shall issue an order that a swap is made available to trade.
>
> (ii) The requirements contained in §§ 40.1, 40.7, 40.8, 40.11 and 40.12 shall apply to all submissions made pursuant to this section.
>
> (iii) *Public Comment*. The Commission shall provide a 30-day public comment period. The Commission shal publish a notice of the public comment period on the Commission website. Comments from the public shall be submitted as specified in that notice.

Revise § 37.10(b) to read as follows:

> (b) *Criteria to consider*. In making its initial determination under paragraph (a) of this section, a swap execution facility shall consider with sufficient particularity each of the following criteria:
>
> (1) Whether there are ready and willing buyers and sellers;

(2) Frequency and size of the transactions;

(3) The trading volume;

(4) The number and types of counterparties executing trades in each swap listed in (a)(2), including the presence of consistent liquidity providers and market makers that are actively involved in making markets considered in (b)(2)of this section;

(5) The bid/ask spread;

(6) The usual number of resting firm bids and offers; and

(7) Whether such swap has a high degree of standardization.

Revise 37.10(c) to read as follows:

(c) *Applicability*. Upon a Commission order that a swap is made available to trade, all swap execution facilities and designated contract markets shall comply with the requirements of section 2(h)(8) of the Act in listing such swap for trading.

Revise § 37.10 (d)(1) to read as follows:

(d) *Removal* - (1) Determination. The Commission shall issue an order that a swap is no longer required to be traded pursuant to the requirements of § 37.9(a)(2) upon a request made by either a swap execution facility or a swap execution facility's participant. In making such a request, the swap execution facility or the swap execution facility's participant shall consider each of the criterions described in paragraph (b) of this section.

Add new § 37.10(d)(1)(i) to read as follows:

Public Comment. The Commission shall provide a 30-day public comment period. The Commission shall publish a notice of the public comment period on the Commission website. Comments from the public shall be submitted as specified in that notice.

Add new § 37.10(f) to read as follows:

Prior to offering a package transaction as defined in new § 1.3(www) of this chapter, a swap execution facility shall certify to the Commission that: (1) the swap execution facility has the technological ability to arrange for the execution of such package transaction through the execution methods described in § 37.9(a)(2) and (2) the settlement of any non-swap leg is not adversely affected by execution of such package transaction through the execution methods described in § 37.9(a)(2). Such certification shall be submitted as a rule, as that term is defined by § 40.1 of this chapter, pursuant to the procedures under § 40.6 of this chapter.

Revise § 37.12 to read as follows:

(a) A swap transaction shall be subject to the trade execution requirements of section 2(h)(8) of the Act upon the later of:

(1) Sixty days after the applicable deadline established under the clearing requirement compliance schedule provided under § 50.25(b) of this chapter; or

(2) Thirty days after the Commission issues an order pursuant to § 37.10(a)(1)(ii).

(3) Nothing in this section shall prohibit any counterparty from complying voluntarily with the requirements of section 2(h)(8) of the Act sooner than as provided in paragraph (a) of this section.

Revise § 37.1301(c) to read as follows:

§ 37.1301 (c) General requirements

Financial resources shall be considered sufficient if their value is at least equal to a total amount that would enable the swap execution facility to conduct an orderly wind down of its operations. Financial resources shall not include any compensation or benefits of swap execution facility employees that receive commission-based compensation.

Revise § 37.1305 to read as follows:

§ 37.1305 Liquidity of financial resources

The financial resources allocated by the swap execution facility to meet the requirements of § 37.1301 shall include unencumbered, liquid financial assets (i.e., cash and/or highly liquid securities) equal to at least three months' operating costs. If any portion of such financial resources is not sufficiently liquid, the swap execution facility may take into account a committed line of credit or similar facility for the purpose of meeting this requirement.

Part 43 — Real Time Public Reporting

Revise § 43.2 to read as follows:

Block trade means a publicly reportable swap transaction that:

> (1) Involves a swap that is listed on a registered swap execution facility or designated contract market and that is either:
>
> (i) Executed away from the designated contract market's trading system or platform and is executed pursuant to the designate contract market's rules and procedures; or
>
> (ii) Executed on or away from the swap execution facility's trading system or platform and is executed pursuant to the swap execution facility's rules and procedures. Such transaction may be executed by any means of interstate commerce in accordance with the requirements described in § 37.9(c)(2) for Permitted Transactions as they are defined in § 37.9(c)(1) .

**(3) and (4) remain unchanged

Part 1 General Regulations under the Commodity Exchange Act

§ 1.3 Definitions

**(nnn)—(vvv)

Add new § 1.3(www):

> A "package transaction" is a transaction involving two or more components: (1) that is executed between two or more counterparties; (2) that is priced or quoted as one economic transaction with simultaneous or near simultaneous execution of all components; (3) that has at least one component that is a swap that is made available to trade and therefore is subject to the CEA section 2(h)(8) trade execution requirement; and (4) where the execution of each component is contingent upon the execution of all other components.

II. Nature of ISDA's Interest

ISDA has over 800 member institutions from 67 countries. These members include a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities end-users, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Our members rely on derivatives to manage efficiently the risks inherent in their core economic activities. ISDA advocates for stable, competitive and sustainable financial markets that support economic growth and benefit society.

ISDA has previously highlighted in its comment letters to the Commission the importance of maintaining a flexible approach in adopting and implementing a new regulatory framework, focusing on overall risk reduction and increased transparency and market integrity - rather than imposing stringent requirements - to allow for a smoother transition toward effective cross-border regulation of derivatives trading.

The Commission faces some challenges in implementing the Swap Execution Facilities (SEF) rules. In his testimony before the U.S. Senate Committee on Agriculture, Nutrition and Forestry, Chairman Massad recognized that the Commission should "fine-tune the rules or make other changes as appropriate." Chairman Massad also noted that "there is substantial work to be done to harmonize rules across national borders."[1] We appreciate the Commission's intent to engage with market participants and to make appropriate changes to the SEF rules "based on participant feedback and observing the new rules in practice."[2]

ISDA members would like to provide their feedback by offering specific solutions to some trading challenges that have been observed by our members. We believe that utilizing a petition process is an effective way of proposing concrete fixes, while keeping the regulatory structure intact.

In ISDA's Path Forward for Centralized Execution of Swaps published in April,[3] we pointed out that due to the restrictive nature of the Commission's execution rules, a clear split in trading liquidity has emerged. For instance, European dealers have opted to trade euro interest rate swaps with other European dealers rather than be subjected to U.S. rules. By December last year, 85% of euro IRS transactions were traded between European entities, up from 71% in September 2013 before the SEF rules came into force.

[1] Chairman Timothy Massad's Testimony before the U.S. Senate Committee on Agriculture, Nutrition and Forestry (May 14, 2015) is available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-10

[2] Remarks of Chairman Timothy Massad before the FIA International Derivatives Conference (June 9, 2015) available at: www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-25

[3] Path Forward For Centralized Execution of Swaps (April 1, 2015) available at: http://www2.isda.org/functional-areas/public-policy/united-states/

In that document, we also suggested ways to reduce the undesirable regulatory outcomes that threaten the efficient functioning of the derivatives markets, reduce barriers to market access, and minimize roadblocks to an effective cross-border regulatory regime, while preserving increased transparency and market integrity.

We believe that the targeted amendments outlined in this Petition will allow SEFs to offer trading flexibility, as intended under the Dodd-Frank Act, and will ensure that SEFs can successfully compete in the global execution space. In sum, we hope that our suggestions may help the Commission achieve its goal of "creat[ing] a framework that not only promotes transparency and integrity but also enables markets to thrive."[4]

III. Supporting Arguments

Confirmation Requirements for Uncleared Swaps

The requirement imposed on SEFs to obtain, prior to the time of execution, paper copies of the privately negotiated ISDA master agreements between counterparties to a trade in uncleared swaps does not have any legal basis, does not meet any regulatory objectives and carries high compliance costs as SEFs will have to request, store, manage and consult numerous complex bilateral agreements.

This requirement is in direct contravention of normal market practice in which the vast majority of swaps are confirmed electronically. In addition, this requirement discourages trading of swaps on SEFs. The Commission seems to acknowledge this issue by continuing to extend no-action relief from compliance with this requirement. However, uncertainty regarding whether the relief is going to be extended in the future requires SEFs to continue to spend resources in search of a compliance solution. We urge the Commission to make targeted amendments to its rules to relieve SEFs from this unnecessary obligation.

Void ab Initio

ISDA believes that an appropriate balance should be struck between the Commission's policy objectives of encouraging certainty of clearing while allowing counterparties to resubmit trades that were rejected from clearing because of operational or clerical errors. ISDA welcomes the issuance of recent no-action relief allowing a SEF, after a trade has been cleared and an error is discovered, to resubmit the original terms of the trade, without the trade having been executed pursuant to the execution methods set out in § 37.9(a)(2).

ISDA notes, however, that the relief is a temporary solution to resolving this issue. ISDA would like to offer a permanent fix in the SEF rules.

[4] Supra fn.2, Remarks of Timothy Massad before the FIA International Derivatives Conference.

Allowing Flexible Execution Methods on a SEF

Despite a broad definition of a SEF in the Dodd-Frank Act, the SEF rules contain unnecessary restrictions on swap execution mechanisms. The Dodd-Frank Act does not require that SEFs only execute transactions by means of an Order Book or an RFQ to 3. Such a restrictive interpretation contradicts Congressional intent to allow swaps to be traded by "any means of interstate commerce,"[5] discourages trading of swaps on SEFs and hurts pre-trade price transparency. We agree with Commissioner Giancarlo that "[a] better way to promote price transparency is through a balanced focus on promoting swaps trading and market liquidity as Congress intended."[6]

Moreover, such a restrictive interpretation makes it difficult to achieve the broad goal of global swaps trading envisioned by the G-20 member countries. As we noted in the Path Forward document, ESMA intends to allow derivative contracts that are subject to the trading obligation to be traded on a number of centralized venues, including Regulated Markets (RMs), Multilateral Trading Facilities (MTFs), and Organized Trading Facilities (OTFs). OTFs offer the least restrictive methods of execution and are designed to include much of the inter-dealer market and offer voice brokering services. Thus, to avoid further market fragmentation and maintain robust liquidity in swaps contracts, it is advisable to provide flexibility in execution methods on a SEF platform.

In this regard, we suggest that the Commission amend its rules to allow the Commission, under certain circumstances, to approve additional methods of execution for swaps that are made available to trade. Adjusting SEFs' execution models could clear a path toward achieving a substituted compliance regime for derivatives trading.[7]

Made Available to Trade Determination

We believe that the made available to trade (MAT) process should require SEFs to provide a more granular explanation as to why a particular swap contains the requisite trading liquidity for mandatory trading. We also believe the Commission and not SEFs should make the final decision as to when a swap should be considered to be "MATed."

In addition, the Commission should view a swap's availability for mandatory trading as a fluid determination. The SEF rules do not provide sufficient flexibility to both SEFs and SEF users to remove a certain swap from a MAT determination if the trading characteristics of the swap change such that it is no longer suited for trading on an Order Book or an RFQ to 3. We believe our proposed fixes address the above mentioned concerns.

[5] CEA section 1a(50).

[6] J. Christopher Giancarlo, Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank (White Paper) (Jan. 29, 2015) at 75.

[7] Supra fn. 3.

Package Transactions

As stated in the Path Forward document, unreasonably restrictive regulations have decreased the ability of market participants to execute package transactions that contain a "MATed" swap.[8] There have been two principal concerns expressed with respect to executing package trades on a SEF. First, if one leg of a package trade is subject to a mandatory trade execution requirement, then all legs of the package trade must be executed on a SEF by means of an Order Book or an RFQ to 3. While this may be possible for some package trades, not all package trades have the liquidity to be executed on a SEF via these restrictive execution methods. [9]

In addition to ensuring that the pricing and execution of these packages can be handled on a SEF, it is important to ensure that derivatives clearing organizations (DCOs) are able to net the risk of both legs of these packages at the time of execution. Because package transactions are currently cleared on a leg-by-leg basis, a DCO may reject an individual leg due to its risk exceeding its credit limit even though the net risk of the package may not exceed the limit.

Our proposed targeted fixes to the SEF rules address these concerns and ensure that SEFs, Futures Commission Merchants (FCMs) and DCOs have structural workflows to execute and clear these trades in a straight through processing regime.[10]

SEFs' Financial Resources

We note that one SEF's failure will not lead to a liquidity crisis because swaps trade on various trading platforms with various liquidity pools. Therefore, SEFs should only be required to hold adequate resources to be able to wind down their operations in one year. We note that some SEFs have their brokers inside the SEF, while others have their brokers outside the SEF. We believe that the financial resources requirements should exclude the compensation and benefits for brokers inside the SEF to even the playing field between the two different business models. Our proposed amendments reflect our views.

Execution of Block Trades

The Commission's regulatory objective behind requiring block trades to be executed away from the SEF's trading platform is unclear.[11] As Commissioner Giancarlo points out "[t]he "occurs

[8] Separately, ISDA continues to believe that if a price determined leg of a package trade is not made available to trade, then the entire package trade should not be made available to trade.

[9] Currently, these transactions are subject to phased-in no-action relief, CFTC NAL 14-137, Extension of No-Action Relief from Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 and Additional No-Action Relief for Swap Execution Facilities from Commission Regulation § 37.3(a)(2) for Swaps Executed as Part of Certain Package Transactions (Nov. 10, 2014).

[10] Although not addressed in this petition, we would like the Commission to amend the regulations to set forth with the requisite degree of particularity the appropriate execution methodology for package transactions that include at least one component leg that is a security and not within the jurisdiction of the Commission so that SEFs executing such packages are able to do so without running afoul of other regulatory requirements with respect to the execution of the security.

away" requirement creates an arbitrary and confusing segmentation between non-block trades "on-SEF" and block trades "off-SEF," especially given that a SEF may offer any method of execution for *Permitted Transactions*. The "off-SEF" requirement also undermines the legislative goal of encouraging swaps trading on SEFs."[12]

To complicate things further, in its clearing member risk management regulations,[13] the Commission requires, among other things, an FCM that is a clearing member (Clearing FCM) of a registered DCO to establish risk-based limits and to screen orders for compliance with those limits.[14] Commission § 37.702(b) requires a SEF to coordinate with each DCO to which it submits transactions for clearing and have rules and procedures to facilitate prompt and efficient processing by DCOs in accordance with § 39.12(b)(7).[15] Staff guidance on straight through processing[16] specifies that this requirement applies to orders for execution on or subject to the rules of a SEF or DCM, regardless of the method of execution (i.e., this requirement applies to block trades).

Market participants have expressed numerous concerns that adherence to the "occurs away" requirement under the current definition of a block trade in § 43.2 makes it very difficult to perform pre-execution credit screening against FCM risk-based limits. This is due to the fact that an FCM may have no involvement in a block transaction occurring away from a SEF's trading system or platform; thus, it is unable to implement a credit screening of the trade prior to the counterparties' execution of the block.

We believe, our proposed fixes allow blocks to be executed on a SEF, while preserving the Commission's straight through processing requirements.

ISDA respectfully petitions the Commission to amend Parts, 1, 37 and 43 as described above.

Sincerely,

David Geen
General Counsel

[11] Currently, these transactions are subject to no-action relief that expires on December 15, 2015, CFTC NAL 14-118, No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2 (Sept. 19, 2014).
[12] Supra fn. 6, White Paper at 27.
[13] Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21,278 (Apr. 9, 2012).
[14] 17. C.F.R. § 1.73.
[15] 17 C.F.R. § 39.12(b)(7) (DCOs must accept or reject all trades executed on a SEF or DCM as quickly as technologically practicable after execution).
[16] CFCT Staff Guidance on Swaps Straight Through Processing (Sept. 26, 2013).

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521
www.cftc.gov

PRC 21-2

Office of the Secretariat

August 23, 2016

George Frost, Esq.
Law Offices of George Frost
2930 Magnolia Street
Berkeley, CA 94705

Dear Mr. Frost:

This is to acknowledge receipt of the petition you submitted for a rulemaking to determine the requirement of "Actual Delivery" in the context of a cryptocurrency exchange transaction, whether on or off the Bitcoin blockchain or similar ledger. The petition has been referred to the Commission for such action as the Commission deems appropriate.

I will notify you of any action taken by the Commission on this petition.

Sincerely yours,

Natise L. Allen

Natise L. Allen
Secretariat Program Assistant

2016 [illegible] 17 [illegible]

Law Offices of George Frost
2930 Magnolia Street
Berkeley, CA 94705
510-647-8863
(415) 606-9804 (cell)
geofrost@comcast.net

August 8, 2016

Mr. Chris Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Cc: The Hon. Timothy Massad, Chair
The Hon. Sharon Bowen, Commissioner
The Hon. J, Christopher Giancarlo, Commissioner

Re: Petition for Rulemaking to Determine the Requirement of "Actual Delivery" in the context of a cryptocurrecy exchange transaction whether on or off the Bitcoin blockchain or similar ledger.

Dear Mr. Kirkpatrick,

I write on behalf of several clients in support of a request by the law firm Steptoe & Johnson that the Commodity Futures Trading Commission ("CFTC" or "the Commission") undertake a rulemaking pursuant to CFTC Regulation 13.2 to clarify what constitutes transfer of an "ownership interest" in bitcoin or similar cryptocurrencies in an exchange transaction.

I make this request with considerable urgency, in the aftermath of a $70 million hack of Hong Kong-based Bitcoin exchange Bitfinex, which coincidentally was recently the subject of a CFTC enforcement action (CFTC Docket Action No. 16 – 190). In that action, the CFTC fined Bitfinex for facilitating unregulated "margin" trading (i.e., allowing its customers to borrow funds from other customers in order to trade bitcoins[1] on a "leveraged, margined or financed basis") and accepted changes to Bitfinex' business practices to become compliant.

[1] Please note: As distinguished from the Bitcoin protocol, I refer to "bitcoins" – the currency -- in lower case. I apologize if this is disconcerting.

It is our initial understanding that Bitfinex modified its customer wallet implementation and security protocols in order to comply with the CFTC's *ad hoc* enforcement determination of what constitutes an "actual delivery" of bitcoin in an exchange transaction, and thereafter was granted relief from this registration requirement.[2]

Bitfinex apparently switched from a hosted and pooled wallet system (utilizing a "hot wallet" for a tiny percentage of customer funds, with the bulk held safely in offline cold storage) to storing funds in multi-signature accounts for each of its registered customers — with each individual hot wallet protected by private keys (which are randomly generated strings of letters and numbers required for a customer to access the funds). The hack quickly followed.

We do not suggest that the CFTC is to blame *in any way* for this criminal attack against Bitfinex, or even that the Commission is responsible for ensuring the security or prudential soundness of an exchange. We do not as yet know the technical details of the attack, or especially, if or how the hackers obtained the private keys of so many individual customer accounts.[3]

However, it appears that the hackers exploited vulnerabilities in the post-enforcement implementation of Bitfinex's customer wallets, whatever they in fact chose to do. This hack took place only after Bitfinex moved customer bitcoin out of its pooled, hot and cold wallet system, and into individual customer wallets on the blockchain maintained by a third party provider, BitGo. In light of this attack, and given its severity (with Bitfinex losing approximately 38% of all client assets), it is vital that we obtain greater clarity about what the "rules" are for cryptocurrency exchanges that may choose to explore setting up peer-to-peer lending facilities. Moreover, it is important that the Commission level the playing field by promulgating a formal rule, not rely on ad hoc adjudication or private briefings to certain exchanges, and not all.

As you know, under the Commodities Exchange Act (CEA), as amended by Section 742(a) of the Dodd Frank Act, exchanges that offer "margin trading" over certain leveraged, margined or financed retail commodity transactions arguably must register with the Commission as a futures commission merchant, in one form or another. The Commission has declared digital currencies to be a "commodity" within the meaning of the CEA. *See In the Matter of Coinflip, Inc. dba Derivabit, and Francisco Riordan, Before the CFTC, No. 15-29, Sept. 17, 2015.* However, the CEA (as

[2] The Order does not explain precisely what Bitfinex did or did not do in modifying its wallet system and security protocols. The Order states as follows: "In response to the Division of Enforcement's investigation, Bitfinex represents that it has made a number of changes to its business practices in order to come into compliance with the Act and Regulations."

[3] There may have been an "off switch" built into vendor Bitgo's code, or a "master key" of some kind. We simply do not know.

amended) also provides an exemption, which applies if *the margin trades taking place on an exchange result in "actual delivery" of the commodity to the buyer.*

While my clients do not at this time offer margin trading or "leverage" as did Bitfinex, they have received many requests from our customers that we do so, and soon. Prior to the Bitfinex hack, I was in contact with CFTC staff regarding an application for a "no enforcement" letter (or another form of clarification) on behalf of one client that would unambiguously affirm that what we understood to be the Bitfinex technical solution for "actual delivery" would be sufficient to satisfy the exemption from registration. This effort is now, alas, moot.

The Bitfinex Enforcement Order.

The CFTC Order found that by offering to enter into, executing, and/or confirming the execution of off-exchange financed retail commodity transactions, Bitfinex violated Section 4(a) of the CEA, which requires such transactions to be conducted on a designated contract market or derivatives transaction execution facility.[4] The Order further states that because the transactions did not result in "actual delivery" of bitcoins, Bitfinex could not rely on the Dodd Frank "actual delivery" exception to the CFTC's jurisdiction over such transactions, at Section 2(c)(2)(D)(ii)(III)(aa) of the CEA.

Under this exception, the Commission's authority to regulate retail commodity transactions does not extend to "a contract of sale that results in actual delivery within 28 days or such longer periods as the Commission may determine by rule or regulation based upon typical commercial practice in cash or spot markets for the commodity involved." *See* 7 USC § 2c(2)(D)(ii)(III)(aa).

In the Bitfinex Order, the Commission explained that customers' "bitcoins were held in an omnibus settlement wallet owned and controlled by Bitfinex, and to which Bitfinex held the private keys needed to access the wallet." *See Order.* Because Bitfinex retained control over one or more of the settlement wallet keys and could withhold customer funds until the condition precedent to delivery occurred – or could seize customer funds if a contract breach occurred -- the CFTC enforcement staff concluded that no "actual delivery" took place.

The Order also stated that Bitfinex' accounting for individual customer interests . . . "was insufficient to constitute actual delivery." *Id.* "Therefore Bitfinex engaged in illegal, off-exchange commodity transactions and failed to register as a

[4] The Order further finds that Bitfinex accepted customer orders and received funds in connection with retail commodity transactions without being registered with the CFTC as an FCM, as required by Section 4d(a). The Order explains that FCMs include all persons engaged in soliciting or accepting orders for retail commodity transactions, or who accept money in connection with such transactions. However, according to the Order, Bitfinex has never been registered in any capacity. Bitfinex therefore violated Section 4d(a) of the CEA.

futures commission merchant, in violation of Sections 4(a) and 4(d) of the Act, 7 U.S.C. §§ 6(a) and 6d)." *Id.*

However, as noted by Steptoe & Johnson, the underlying statutory language of the CEA does not expressly mandate coverage of exchange-based cryptocurrency transactions. Nor must the registration requirement extend to those transactions in which the exchange is not itself providing financing, but is merely acting as an agent in a peer-to-peer process, along with executing the trade. This is a threshold jurisdictional question.

Assuming the Commission's jurisdiction, *arguendo*, neither the statute nor any published rule or interpretation supports the Commission's requirement, as implied in the Order, that purchased bitcoin must be "actually delivered" *to a private deposit wallet to which only the buyer holds the private keys.*

What statutory interpretation or proposed regulatory language supports this conclusion? Where did this come from?

The Commission has not offered any interpretative guidance prior to making this determination, nor engaged in any rulemaking. This is *ad hoc* by definition. The fintech industry is almost completely in the dark here. What is the actual rule of decision? What is "actual delivery?" We are left to guess.

Moreover, the Commission's implied interpretation of what constitutes "actual delivery" with respect to an exchange-based bitcoin transaction (delivery to an individual wallet on the blockchain, with the consumer alone holding private keys) is particularly troubling when, as here, it (1) appears to undermine asset security and makes it harder for consumers to hold, buy or sell bitcoin, (2) runs counter to the actual contractual terms of the parties, and (3) ignores technological context and market practice.

Business Practice Overview.

The Bitcoin system is a peer-to-peer network of servers (each, a "node"), each running an open-source protocol that both enables the generation of new bitcoins according to a pre-ordained schedule and facilitates the creation of an immutable, ostensibly fraud-proof public registry of all transactions. A transfer of bitcoins from a buyer to a seller is usually conducted through a Bitcoin wallet, which integrates with the network through a node, enabling the publication of the transfer transaction to the network.

Many Bitcoin exchanges offer "hosted" wallets that are generally considered safer and easier to use by consumers than "native" wallets on the blockchain. Exchanges can safely protect consumer's bitcoins by using a "cold storage" vault. I am not aware of any documented theft from a cold storage system. An exchange and third party "multi-sig" provider typically may hold additional "keys" to an account in order to perform escrow services on behalf of their customers, such as ensuring that a buyer who is acquiring bitcoin on margin has sufficient reserves to cover potential losses, and/or delivering (or accepting delivery) of bitcoin only after conditions precedent *x, y or z* have occurred.

A Bitcoin wallet, whether native or "hosted," is a piece of software code that serves two main functions: (1) generating Bitcoin addresses and assigning them to individual users, and (2) facilitating transactions by enabling users to send and receive bitcoins, and publishing the transaction to the blockchain. A Bitcoin address is a randomly generated string of letters and numbers that identifies a user for the purpose of Bitcoin transactions. In addition to providing and supporting the exchange of credentials needed to evidence the transfer of bitcoins in a given transaction, Bitcoin wallets publish these transaction records to the network, enabling Bitcoin miners to record "blocks" of these transactions to the blockchain, and publicly register the accompanying change of ownership of the transferred bitcoin.

Each Bitcoin address is secured by the associated private key, which together are used to verify ownership of the bitcoins associated with the public address. Like the Bitcoin address, the wallet generates the private key. There is no overarching mechanism in the Bitcoin system to indelibly associate a public address/private key combination with a particular person. In this regard, possession of bitcoin is similar to cash or other similar bearer instruments – ownership of bitcoin is determined based on *possession of the public address/private key combination*. Possession of the address and key are not required to establish ownership in an exchange transaction, however, as the bitcoin are held in a hosted wallet for the benefit of the customer.

Bitcoin ownership and Bitcoin transactions are "anonymous" only in the sense that there is no comprehensive public registry associating Bitcoin addresses to their owners. At this point, thankfully, there is no practice or regulatory requirement that exchanges post their customers' personal identifying information ("PII") on the blockchain, where it could possibly be hacked. However, the Bitcoin address that "owns" a given bitcoin, as well as every Bitcoin address that has previously owned that bitcoin, is publicly viewable on the blockchain. Indeed, it is fairly easy to trace particular bitcoins through multiple transactions. However, to determine who actually owns the addresses, one must go to the private registries such as those maintained by exchanges.

Bitcoin has no central administrator or repository, and no entity is vested with the right or ability definitively to establish ownership of a given bitcoin. An exchange will record the "association" of a particular customer (who is a known person and has been fully KYC'd) on its own ledger; this is called an "account." Exchanges are required by law to make and keep records of all transactions that take place for each customer account.

Exchanges do the bidding of their customers. One of the most popular services has been facilitating a "peer-to-peer" financing system, under which customers borrow extra bitcoin from one another in order to make bigger trades, "on margin." An exchange may be asked by a customer to act as an escrow agent for a given leveraged transaction, as with the peer-to-peer financing provided through Bitfinex. For example, the exchange may be instructed to require a purchaser using peer-to-peer financing to maintain collateral in his or her account, and/or to withhold delivery of bitcoin until full payment has been made at a given price point.

It is also a common practice for exchanges to maintain small trading balances in a pooled "hot wallet ," with a sub-accounting system that tracks individual customer balances and transactions, and to store a customer's bitcoin in secure off-line cold storage. (This was Bitfinex's practice prior to making an adjudicative settlement with the CFTC, and changing its wallet system.) An exchange's Terms of Use is a binding contract that defines what a consumer may ask the exchange to do on its behalf, including terms directing a transfer of bitcoin to the customer's hosted wallet upon completion of a trade. Satisfaction of this contractual commitment arguably constitutes an actual delivery of bitcoin to the customer.

Once a transaction is finalized, the exchange publishes the transaction to the network, and Bitcoin miners record the address, transaction details, and the change of ownership on the blockchain.

At Bitfinex, the buyer and seller each contractually agreed to execute trades using peer-to-peer financing and escrow terms, including express *conditions precedent* to delivery, and each appointed Bitfinex to act as their agent to enforce the terms of their agreement. This included a promise to "deliver" purchased coins to the pooled wallet managed by Bitfinex, and also the *timing* of actual delivery of bitcoin into their wallets. We believe that this constitutes an "actual delivery" per the instructions of the customer.

Moreover, even if "actual delivery" is determined to take place only at the time the transaction is published on the blockchain (an hour or two later at most), this "two-step" settlement falls well with the "28 day" rule stated in the exception. Bitfinex, like all other Bitcoin exchanges, presumably did in fact regularly cause each transaction to be recorded on the blockchain, thus satisfying the exception. Thus, it seems reasonable to conclude that Bitfinex was engaged in facilitating contracts of sale resulting "in actual delivery within 28 days or such longer periods as the Commission may determine by rule or regulation based upon typical commercial practice in cash or spot markets for the commodity involved." The CFTC staff disagreed with this analysis. But we don't know why.

The Cited Authority is Inapposite.

The CFTC Order glides along on fairly thin ice. It relies almost entirely upon a single Eleventh Circuit case, *CFTC v. Hunter Wise Commodities, LLC,*[5] involving a gold bullion trading firm. *CFTC v. Hunter Wise* states that, in order to be exempted from regulation, "actual delivery" requires the physical delivery of the entire quantity of the purchased commodity (gold), including that portion that was purchased on margin using borrowed funds. For the *Hunter Wise* court, given this factual context (trading of a physical commodity), the "actual delivery" test is easily resolved. The *Hunter Wise* decision turned on the indisputable fact that the exchange traded "digital" certificates only – not gold bullion:

> The District Court concluded, as a matter of fact, that Hunter Wise had never taken delivery of any metals as a result of its trades had no metals to deliver in connection with these retail commodity transactions." *Id.* (internal quote omitted).

No gold was ever stored in *Hunter Wise'* vaults, *ergo,* no gold was *actually delivered to customers.*

End of analysis.

As shown above, it is not so simple when the "commodity" is an intangible asset. With respect to bitcoin, there is no underlying physical commodity to *actually deliver.* There is no place to back up the truck, nothing to unload, nothing to *schlepp.* In our view, *Hunter Wise* is in many ways inapposite and the Commission's reliance upon it results in a confused analysis and bad law. A few observations:

First, and most fundamentally, unlike gold bullion, with bitcoin we are dealing with a digital "commodity" that is, in essence, itself merely a cryptographic "book entry" on a private exchange account, that is later recorded or "settled" on a distributed worldwide public ledger. An "actual delivery" arguably consists of making the actual book entry, either on the exchange account or on the blockchain.[6] Either should satisfy the exception.

Second, ownership of bitcoin is determined based on *possession of the public address/private key combination.* While possession of the address and key *are*

[5] *CFTC v. Hunter Wise Commodities, LLC, 749 F.3d 967, 978-9 (11th Cir. 2014) (citing Black's Law Dictionary).*

[6] Along the same lines, the *Hunter Wise* court further distinguishes the "actual delivery" of a commodity (think: one bar of gold bullion) v. merely "constructive delivery." As the justices *opined:* "A book entry purporting to show that delivery had been made or that a sale had been covered or hedged would not suffice." *Id.* In the bitcoin world, it is the "book entry" itself which is the commodity.

tantamount to ownership of bitcoin in the wallet, consumers may, and regularly do, designate exchanges and other firms to manage their wallets for them, i.e., hosted wallets. This delegation of authority (and use of the key) also is a powerful indicia of ownership.

When using a hosted wallet, the consumer is paying the exchange a fee to facilitate his or her bitcoin transactions, and the exchange holds the bitcoin in an account for the customer's benefit. Would the CFTC argue that sending a wire for $100 to a consumer's bank account is not "actual delivery"? Is it only "delivered" when the cash is withdrawn and placed in the consumer's pocket? Of course not. Why apply such a rule here?

Moreover, this is a contractual relationship. The parties understand and agree that transferring bitcoin to a consumer's hosted wallet at an exchange *is the actual delivery*, fully and finally accomplishing the contractual goal. This is now established commercial practice.

Third, unlike the gold traders of *Hunter Wise*, Bitfinex and other Bitcoin exchanges do take "possession" of bitcoin in their pooled wallets, which they hold for the benefit of the owners.

Request for Rulemaking.

This is all new ground. Analogies drawn from prior models of commerce do not necessarily work very well.

It does not make sense to engage in *ad hoc* adjudicatory rulemaking or draw distinctions based upon archaic constructs that ignore the technological realities of the digital cryptocurrency marketplace, nor to ignore the parties' actual commercial understanding and practice. If a consumer chooses to patronize a hosted wallet service run by an exchange, and instructs the exchange to make delivery to that hosted wallet, why on earth would the CFTC make it harder – and riskier -- for consumers to do a trade?

Absent a compelling legal justification, which at this point has not been demonstrated by the Commission, why force a consumer who wants to do margin trading to maintain an individual native wallet on the blockchain? Or require that the consumer personally maintain all cryptographic keys to the wallet?

We join with Steptoe and Johnson to respectfully request a formal rulemaking as to what constitutes "actual delivery" in an exchange-based cryptocurrency transaction. We object to any interpretation that conditions "actual delivery" upon a customer obtaining *exclusive control* of all keys, and/or delivery of bitcoin to a customer's individual native account on the blockchain.[7] We are most particularly interested in a rulemaking process for determining what constitutes "actual delivery" of bitcoin in the context of an exchange that (1) offers secure custodial wallets, (2) utilizes a multi-sig security system that facilitates escrow capabilities, and (3) would continue to use an offline "cold" wallet of pooled customer funds, that has proven the most effective means to safeguard these assets.

I look forward to a very exciting dialog!

Thank you,

Most truly yours,

George Frost

George Frost, Esq.

[7] As Steptoe stated at page 4 of its Petition for Rulemaking, to do so "would (1) arbitrarily elevate the status of the control of private keys above the contractual agreements between parties to a transaction, which would proscriptively define and undermine the proper current functioning of the cryptocurrency market and blockchain modality; (2) raise significant policy issues affecting the use and development of blockchain and cryptocurrencies; and (3) potentially stifle innovation by placing artificial restraints on commerce that are contrary to the development and efficiency of cryptocurrency and other markets, which also rely on transacting without blockchain transfers.

U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521
www.cftc.gov

PC 21-2

Office of the Secretariat

July 7, 2016

Micah Green
Steptoe & Johnson LLP
1330 Connecticut Avenue, NW
Washington, DC 20036

Dear Mr. Green:

This is to acknowledge receipt of the petition for rulemaking that you submitted regarding requirements of "actual delivery" and transfer of ownership under the Commodity Exchange Act in the context of cryptocurrency markets utilizing blockchain for executing transactions. The petition has been referred to the Commission for such action as the Commission deems appropriate.

I will notify you of any action taken by the Commission on this petition.

Sincerely yours,

Christopher J. Kirkpatrick
Secretary of the Commission

1330 Connecticut Avenue, NW
Washington, DC 20036-1795
202 429 3000 main
www.steptoe.com

Steptoe
STEPTOE & JOHNSON LLP

July 1, 2016

Via Email and Courier

Mr. Chris Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Petition for Rulemaking Concerning the Requirements of "Actual Delivery" and the Transfer of Ownership under the Commodity Exchange Act in the Context of Cryptocurrency Markets Utilizing Blockchain for Executing Transactions

Dear Mr. Kirkpatrick:

Steptoe & Johnson LLP respectfully petitions the Commodity Futures Trading Commission ("CFTC" or "Commission") under CFTC Regulation 13.2 to undertake a rulemaking, following an opportunity for public notice and comment, that sets forth the requirements for effectuating a transfer of an ownership interest in a commodity under the Commodity Exchange Act ("CEA") in the context of cryptocurrency markets utilizing blockchain for executing transactions. As part of such rulemaking, the Commission is requested to promulgate the elements that are necessary to satisfy the requirements of "actual delivery" under CEA § 2(c)(2)(D)(ii)(III) as applied to leveraged or financed retail cryptocurrency transactions. We believe this is warranted because the Commission has not articulated these elements with respect to the newly developing cryptocurrency and blockchain marketplaces, which may have unique attributes that would suggest a different approach relative to the more traditional markets under the Commission's jurisdiction. Absent a definitive Commission statement identifying the essential elements, market participants must attempt to discern what is lawful and what is problematic through assessments of enforcement orders, which are focused on a single entity at a time and may or may not be instructive.

The transfer of an ownership interest in a commodity is an essential concept that the Commission has yet to publicly consider in the context of the blockchain environment. The lack of regulatory clarity in this area not only impedes the ability to interpret statutory provisions such as CEA § 2(c)(2)(D)(ii)(III), but is also harmful to the further development of cryptocurrency markets and blockchain modalities in general, which are in the nascent stages of growth and would benefit from legal certainty to flourish.

For the reasons set forth in this Petition, we request that the Commission undertake a rulemaking that provides the requirements for effectuating the transfer of an ownership interest with respect to blockchain transactions and cryptocurrency markets, as well as the elements of "actual delivery" under CEA § 2(c)(2)(D)(ii)(III).

I. Relevant Provisions

The Commission's regulations do not currently address the requirements for transferring an ownership interest in a commodity utilizing the blockchain to execute transactions. This Petition requests that the Commission undertake a rulemaking to determine such requirements and provide market participants with needed legal certainty.

With regard to certain cryptocurrency transactions, CEA § 2(c)(2)(D)(ii)(III) can be read to provide that retail commodity transactions within the terms and intent of such provision are required to be traded on a Commission-regulated exchange, unless the transaction falls within one of the stated exceptions.[1] CEA § 2(c)(2)(D)(ii)(III)(aa) provides an exception for transactions that result in "actual delivery" of a commodity within 28 days:

> **(D) Retail commodity transactions**
> **(i) Applicability.** – Except as provided in clause (ii), this subparagraph shall apply to any agreement, contract, or transaction in any commodity that is—
> **(I)** entered into with, or offered to (even if not entered into with), a person that is not an eligible contract participant or eligible commercial entity; and
> **(II)** entered into, or offered (even if not entered into), on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis.
> **(ii) Exceptions.** – This subparagraph shall not apply to—
>
> * * *
>
> **(III)** a contract of sale that
> **(aa)** ***results in actual delivery within 28 days or such other longer period as the Commission may determine by rule or regulation based upon the typical commercial practice in cash or spot markets for the commodity involved***[.] [Emphasis added.]

[1] The Commission has declared digital currencies to be a "commodity" within the meaning of the CEA. *See In the Matter of Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, Before the CFTC, No. 15-29, Sept. 17, 2015.

In order to determine whether certain digital currency transactions that are subject to CEA § 2(c)(2)(D)(ii)(III) fall within one of the stated exceptions, regulatory clarity regarding the elements that satisfy the requirement of "actual delivery" as applied to such transactions is needed. Given the novelty of both the cryptocurrency market and the use of blockchain technology, engaging the public through a notice-and-comment rulemaking process would help to inform the Commission about the relevant considerations in developing the elements of "actual delivery" and the potential unintended consequences in rendering such an articulation.

II. Nature of Interest

Steptoe & Johnson has been involved with numerous clients and others in various aspects of the development of cryptocurrency markets and blockchain modality and files this petition in a representative capacity. Steptoe & Johnson believes a CFTC rulemaking is needed to address the important policy issues identified in this Petition in an open and comprehensive manner.

III. Supporting Arguments

The Commission should undertake a rulemaking as requested in this Petition in order to (1) clarify the current legal uncertainty with respect to the transfer of ownership and control in cryptocurrency and blockchain transactions; and (2) ensure fair competition among market participants.

The Commission's order entered June 2, 2016—in *In the Matter of BFXNA INC. d/b/a Bitfinex*, Docket 16-19 ("Bitfinex Order")—is the Commission's first construction of the term "actual delivery" applied in the context of digital currency transactions. In the Bitfinex Order, the Commission found that Bitfinex, a Hong Kong based online platform for exchanging and trading cryptocurrencies, violated certain CEA provisions by engaging in retail-financed commodity transactions in bitcoin that did not result in "actual delivery" under CEA § 2(c)(2)(D)(ii)(III)(aa) to customers who traded on Bitfinex's platform and by failing to appropriately register with the Commission.[2] Specifically, the Commission found that the margin transactions were within the scope of the Retail Commodity Transactions provision because the transfer of cryptocurrency from one person's account to another's did not satisfy the requirement of "actual delivery" to exclude the transactions from the jurisdictional reach of the CEA.

While the Bitfinex Order appears to have introduced new elements for assessing actual delivery, the legal discussion did not provide the public with sufficient notice of the standards for compliance with the "actual delivery" exception or a sufficiently clear roadmap for applying such standards to transactions in the bitcoin environment. Rather, the Bitfinex Order generated legal uncertainty within the cryptocurrency market as to the elements of "actual delivery" and raised broader questions regarding the transfer of ownership of a commodity in the blockchain context. The uncertainties generated by the Bitfinex Order highlight the imperative need for the Commission to undertake comprehensive policymaking with respect to these questions through a

[2] *See In the Matter of BFXNA INC. d/b/a Bitfinex*, Docket 16-19.

transparent rulemaking process, rather than on a piecemeal basis through discrete enforcement actions.

Clarification of Legal Uncertainty

The legal significance of the facts highlighted in the Bitfinex Order is unclear, and the legal discussion in the order does not provide the public with a roadmap in terms of compliance with CEA § 2(c)(2)(D)(ii)(III)(aa). In the Bitfinex Order, the Commission noted that the customers' "bitcoins were held in an omnibus settlement wallet owned and controlled by Bitfinex, and to which Bitfinex held the private keys needed to access the wallet."[3] The Commission also stated that "Bitfinex's accounting for individual customer interests in the bitcoin held in the omnibus settlement wallet in its own database was insufficient to constitute 'actual delivery.'"[4]

The Bitfinex Order could be read to suggest that satisfying the requirement of "actual delivery" in some way requires that the cryptocurrency must be delivered to a deposit wallet for which the recipient controls the private keys. The statutory terms do not support such a requirement, however, and making control of private keys a prerequisite to having ownership and control of a cryptocurrency would be artificial and harmful to these markets because private keys have no innate legal significance with regard to the transfer, control, and possession of cryptocurrency on the blockchain. There is no attribute of the blockchain itself that defines how a private key may be used in order to authorize and effectuate a transaction. Rather, private keys are a modality to effectuate the parties' contractual agreements when they choose to transfer property via the blockchain, and the significance or lack of significance of private keys and personal addresses is determined entirely by the transacting parties. With respect to Bitfinex's customers, it appears that agreements between parties were clear that, when currency transferred from one customer account to another customer's account, the recipient received ownership of the currency.
In brief, because private keys have no independent bearing on ownership, there is no legal foundation for making private keys a condition of actual delivery. To do so would (1) arbitrarily elevate the status of the control of private keys above the contractual agreements between parties to a transaction, which would proscriptively define and undermine the proper current functioning of the cryptocurrency market and blockchain modality; (2) raise significant policy issues affecting the use and development of blockchain and cryptocurrencies; and (3) potentially stifle innovation by placing artificial restraints on commerce that are contrary to the development and efficiency of cryptocurrency and other markets, which also rely on transacting without blockchain transfers. It bears noting that the resolution of these issues can bear as much on prerequisites for ownership and control of cryptocurrency in spot transactions as in margin transactions.

The Commission should carefully consider and define the elements in the blockchain system that are necessary to satisfy the "actual delivery" requirement under the CEA. Such consideration would best be conducted through a comprehensive rulemaking in which the Commission determines the elements necessary to constitute "actual delivery" and transfer of an ownership

[3] *Id.* at 6.

[4] *Id.*

interest based on the benefit of public feedback on the merits of different approaches and any potential unintended consequences.

Fair Competition

Undertaking a notice-and-comment rulemaking process would counter the potentially anti-competitive nature of providing regulatory guidance on a piecemeal basis to certain market participants through discrete enforcement actions and non-public approvals by the Commission or its staff. A rulemaking process, accordingly, would assist the Commission in endeavoring "to take the least anti-competitive means of achieving the objectives of the [CEA], as well the policies and purposes of the [CEA]" in accordance with its responsibilities under CEA §15.

Without being informed of the standards that must be met, market participants that have not received private guidance from Commission staff may be placed at a competitive disadvantage as compared to other participants that have received regulatory acceptance of their transactional protocols. Clear notice to all participants and competitors of the elements relating to the transfer of property–whether by blockchain or within a deposit wallet–that will constitute "actual delivery" will provide the basis for every participant to know the standards for compliance with the requirement and, therefore, for fair competition.

In order to ensure that all market participants understand their compliance obligations under the law, including the standards for compliance with the "actual delivery" exception, and to enable all market participants to compete with each other on a fair footing in terms of their understanding of applicable laws, the Commission should undertake a public rulemaking that benefits from the views of various stakeholders in the cryptocurrency and blockchain communities.

* * *

Steptoe & Johnson respectfully petitions the Commission to issue a rulemaking concerning the transfer of an ownership interest in a commodity and "actual delivery" under the CEA in the context of cryptocurrency and blockchain transactions, as described above.

Sincerely,

Michael Dunn

Micah Green

cc: The Honorable Timothy Massad, Chairman
The Honorable Sharon Bowen, Commissioner
The Honorable J. Christopher Giancarlo, Commissioner

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202 429 3000 main
www.steptoe.com

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July 1, 2016

Via Email and Courier

Mr. Chris Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Petition for Rulemaking Concerning the Requirements of "Actual Delivery" and the Transfer of Ownership under the Commodity Exchange Act in the Context of Cryptocurrency Markets Utilizing Blockchain for Executing Transactions

Dear Mr. Kirkpatrick:

Steptoe & Johnson LLP respectfully petitions the Commodity Futures Trading Commission ("CFTC" or "Commission") under CFTC Regulation 13.2 to undertake a rulemaking, following an opportunity for public notice and comment, that sets forth the requirements for effectuating a transfer of an ownership interest in a commodity under the Commodity Exchange Act ("CEA") in the context of cryptocurrency markets utilizing blockchain for executing transactions. As part of such rulemaking, the Commission is requested to promulgate the elements that are necessary to satisfy the requirements of "actual delivery" under CEA § 2(c)(2)(D)(ii)(III) as applied to leveraged or financed retail cryptocurrency transactions. We believe this is warranted because the Commission has not articulated these elements with respect to the newly developing cryptocurrency and blockchain marketplaces, which may have unique attributes that would suggest a different approach relative to the more traditional markets under the Commission's jurisdiction. Absent a definitive Commission statement identifying the essential elements, market participants must attempt to discern what is lawful and what is problematic through assessments of enforcement orders, which are focused on a single entity at a time and may or may not be instructive.

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For the reasons set forth in this Petition, we request that the Commission undertake a rulemaking that provides the requirements for effectuating the transfer of an ownership interest with respect to blockchain transactions and cryptocurrency markets, as well as the elements of "actual delivery" under CEA § 2(c)(2)(D)(ii)(III).

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[3] *Id.* at 6.

[4] *Id.*

interest based on the benefit of public feedback on the merits of different approaches and any potential unintended consequences.

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In order to ensure that all market participants understand their compliance obligations under the law, including the standards for compliance with the "actual delivery" exception, and to enable all market participants to compete with each other on a fair footing in terms of their understanding of applicable laws, the Commission should undertake a public rulemaking that benefits from the views of various stakeholders in the cryptocurrency and blockchain communities.

* * *

Steptoe & Johnson respectfully petitions the Commission to issue a rulemaking concerning the transfer of an ownership interest in a commodity and "actual delivery" under the CEA in the context of cryptocurrency and blockchain transactions, as described above.

Sincerely,

Michael V Dunn

Michael Dunn

Micah Green

cc: The Honorable Timothy Massad, Chairman
The Honorable Sharon Bowen, Commissioner
The Honorable J. Christopher Giancarlo, Commissioner

fAL 7-1/17

NFA NATIONAL FUTURES ASSOCIATION

C.F.T.C.
OFFICE OF THE SECRETARIAT
2010-JUN-30 PM 2 16

June 29, 2010

Via E-Mail and Overnight Mail

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 4.5

Dear Mr. Stawick:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 4.5, which provides an exclusion from the definition of the term "commodity pool operator" for otherwise regulated persons operating certain qualifying entities. Prior to 2003, persons claiming this exclusion had to file a notice of eligibility pursuant to CFTC Regulation 4.5(c) and represent, in part, that the person will operate the qualifying entity such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for *bona fide* hedging purposes and, with respect to positions held for non-*bona fide* hedging purposes positions the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

For the reasons set forth below, we request that the CFTC amend Regulation 4.5(c) to restore operating restrictions that are substantially similar to those in effect prior to 2003. The information required by CFTC Regulation 13.2 follows:

I. Text of Proposed Rule Amendments [additions are underlined]

Part 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

4.5 Exclusion from the definition of the term "commodity pool operator."

* * *

(c)

* * *

(2) The notice of eligibility must contain representations that such person will operate the qualifying entity specified therein in a manner such that the qualifying entity:

(i) Will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1); *Provided, however,* That in addition, with respect to positions in commodity futures or commodity option contracts that may be held by a qualifying entity only which do not come within the meaning and intent of § 1.3(z)(1), a qualifying entity may represent that the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; And, *Provided further,* That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such 5 percent;

(ii) Will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets;

(iii) Will disclose in writing to each participant, whether existing or prospective, that the qualifying entity is operated by a person who has claimed an exclusion from the definition of the term "commodity pool operator" under the Act and, therefore, who is not subject to registration or regulation as a pool operator under the Act; *Provided*, that such disclosure is made in accordance with the requirements of any other federal or state regulatory authority to which the qualifying entity is subject; and

(iiv) Will submit to such special calls as the Commission may make to require the qualifying entity to demonstrate compliance with the provision of this § 4.5(c);

> *Provided, however,* That the making of such representations shall not be deemed a substitute for compliance with any criteria applicable to commodity futures or commodity options trading established by any regulator to which such person or qualifying entity is subject.

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. One of NFA's primary purposes is to ensure the protection of customers participating in the commodity futures markets. NFA is interested in ensuring that entities that engage in more than a *de minimis* amount of futures trading and that are offered to retail customers or are marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets are subject to the appropriate regulatory requirements and oversight by regulatory bodies with primary expertise in commodity futures. NFA believes that requiring persons that market commodity funds to the retail public and whose funds engage in more than a *de minimis* amount of futures trading or investment to be registered as commodity pool operators ("CPOs") furthers that goal.

III. Supporting Arguments

CFTC Regulation 4.5 currently makes available to eligible persons an exclusion from the definition of CPO with respect to the operation of certain qualifying entities (e.g. registered investment companies) that would otherwise constitute commodity pools but that are already subject to extensive federal and/or state operating requirements. Prior to 2003, eligible persons claiming this exclusion were required to represent that commodity futures and option contracts were used solely for *bona fide* hedging purposes, and that for positions in commodity futures and option contracts that were not used for *bona fide* hedging purposes, the aggregate initial margin and premiums do not exceed 5% of the liquidating value of the qualifying entity's portfolio after taking into account unrealized profits and losses. In addition, eligible persons were required to represent that the qualifying entity will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets.

In March 2003, the Commission proposed amendments to Regulation 4.5 to eliminate the limitation on non-hedge trading. At the same time, the Commission proposed formally adopting CFTC Regulation 4.13(a)(4) to provide an additional exemption from CPO registration based *solely* on a pool participant's purported sophistication, without any requirement that the pool operator must be subject to another regulatory scheme and without any restriction whatsoever on the purpose and scope of the pool's commodity interest trading. The Commission further stated that "since the eligible persons and qualifying entities of Rule 4.5 are, as stated in the title of the rule, 'otherwise regulated,' the Commission believes that, like the unregulated CPOs for whom it is proposing relief below, these persons and entities may not need to be subject to any commodity interest trading criteria to qualify for relief under Rule 4.5."[1]

At this time, the Commission also stated its view that Regulation 4.5's "no-marketing" restriction should remain in place. The Commission noted that eligible persons should remain prohibited from marketing a qualifying entity as a commodity pool or otherwise as a vehicle to trade commodity interests and indicated that this restriction was necessary because members of the retail public may participate in the trading vehicles subject to a Regulation 4.5 exclusion. The Commission nonetheless requested comment on the merits of maintaining this marketing prohibition.[2]

By letter dated May 1, 2003 to the CFTC, NFA supported maintaining Regulation 4.5's "no marketing" restriction. In particular, NFA stated that "current and proposed Rule 4.5 both provide that the exclusion is not available if the vehicles are marketed as commodity pools. Since Rule 4.5 is an exclusion rather than an exemption, the anti-fraud provisions of Section 4(o) of the CEA do not apply. Investments in these vehicles can be - and often are - sold to unsophisticated customers. While the sale of these investment vehicles is subject to the anti-fraud provisions in other statutes, unsophisticated customers should also have the benefit of Section 4(o) if the investment is marketed as a commodity pool. Therefore, we agree that the exclusion should not be available if the vehicles are marketed as commodity pools." NFA felt that

[1] See 68 Fed. Reg. 12622,12626 (March 17, 2003).

[2] See Id.

with this "no-marketing" restriction in place, it made sense to eliminate the limitation on non-hedge commodity trading due to certain concerns regarding margin levels expressed at that time.

In August 2003, after receiving comments that supported eliminating both the limitation on non-hedge commodity trading and the prohibition on marketing these qualifying entities, the Commission adopted amendments to Regulation 4.5 to eliminate both these provisions. In doing so, the Commission stated that "one commenter agreed with the proposed retention of the 'no marketing' criterion (and with the Commission's rationale therefore) but several commenters disagreed with it. The Commission noted, in part, that these commenters claimed that, in the absence of any trading restriction, the "otherwise regulated nature" of the qualifying entities specified in Regulation 4.5 would provide adequate customer protection.[3]

Recently, NFA has become aware of at least three entities filing for exclusions under Regulation 4.5 with respect to certain qualifying entities (i.e. registered investment companies) that they operate. These mutual funds are marketed to customers, including retail investors, as commodity futures investments and are indirectly invested substantially in derivatives and futures products. In fact, although these funds are structured differently than public commodity pools and conduct the futures trading through a subsidiary for tax and mutual fund regulatory purposes, their aim is the same—targeting retail investors with in some cases minimum investment amounts of as little as $1,000 who want exposure to actively managed futures strategies.

Customers may use an electronic brokerage account to trade one of these mutual funds, which are sold by broker/dealers on internet platforms in which retail investors, without regard to their expertise and qualification, only need to point and click to either buy or redeem shares in a fund that offers exposure to an actively managed futures product. NFA staff has reviewed the prospectuses and promotional material

[3] See 68 Fed. Reg. 47221, 47223 (August 8, 2003).

prepared for these funds.[4] One fund's prospectus indicates that it pursues its investment strategy by mainly investing in a combination of exchange traded futures and options contracts, forward contracts, swaps, and other over the counter derivatives and fixed income securities, often referred to as a "managed futures strategy."[5]

This fund's promotional material indicates that the fund's inception date was December 31, 2009, and the fund has a minimum investment amount of $2,500 (subsequent investments of $500) and offers two share classes, A and C. Class A has a maximum sales charge of 5.75% and a net expense ratio of 2.20% and Class C has no sales charge but a net expense ratio of 2.95%.[6] The fund's promotional material also states that the fund is "A Pioneering Managed Futures Investment" that is accessible, comprehensive, innovative, and has proven management.[7] The material also specifically notes that the fund has a "lower cost structure than most retail managed futures funds" and is "the first mutual fund to generate managed futures returns through net-long, actively managed CTAs." The fund's assets are traded pursuant to five managed futures trading programs.

[4] See Frontier Fund—http://mutualhedge.com/default.aspx; AQR Fund—http://www.aqrfunds.com/Our_Funds/Individual/FundID_12/Overview/Managed_Futures_Strategy_Fund.fs; and Highbridge Fund—https://www.jpmorganfunds.com/cm/Satellite?pagename=jpmfVanityWrapper&UserFriendlyURL=fundoverview&cusip=48121A696

[5] A second fund's prospectus states that in order to pursue its investment objective, the fund invests in futures contracts and futures-related instruments including, but not limited to, equity index futures, currency forwards, commodity futures, swaps on commodity futures, fixed income futures, bond futures and swaps on bond futures (collectively, the Instruments) either by investing directly in those Instruments, or indirectly by investing in a subsidiary that invests in those Instruments. The third fund's prospectus states that the fund seeks to achieve its objective by investing in a diversified portfolio of commodity-linked derivatives and fixed income securities. The prospectus additionally states that the fund invests in commodity-linked derivative instruments, such as commodity-linked notes, swap agreements, commodity options, futures and options on futures that provide exposure to the investment returns of the commodities markets without investing directly in physical commodities.

[6] The other two funds also commenced in January 2010 and these also have various share classes with minimum investment amounts ranging from $5,000 to $1 million and $1,000 to $1 million, respectively.

[7] A second fund's Fact Sheet makes similar statements and indicates that "The Fund delivers an active long/short Managed Futures strategy in a mutual fund vehicle." The fund's investment objective states the fund "seeks to generate positive absolute returns."

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Recently, NFA has become aware of at least three entities filing for exclusions under Regulation 4.5 with respect to certain qualifying entities (i.e. registered investment companies) that they operate. These mutual funds are marketed to customers, including retail investors, as commodity futures investments and are indirectly invested substantially in derivatives and futures products. In fact, although these funds are structured differently than public commodity pools and conduct the futures trading through a subsidiary for tax and mutual fund regulatory purposes, their aim is the same—targeting retail investors with in some cases minimum investment amounts of as little as $1,000 who want exposure to actively managed futures strategies.

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This fund's promotional material indicates that the fund's inception date was December 31, 2009, and the fund has a minimum investment amount of $2,500 (subsequent investments of $500) and offers two share classes, A and C. Class A has a maximum sales charge of 5.75% and a net expense ratio of 2.20% and Class C has no sales charge but a net expense ratio of 2.95%.[6] The fund's promotional material also states that the fund is "A Pioneering Managed Futures Investment" that is accessible, comprehensive, innovative, and has proven management.[7] The material also specifically notes that the fund has a "lower cost structure than most retail managed futures funds" and is "the first mutual fund to generate managed futures returns through net-long, actively managed CTAs." The fund's assets are traded pursuant to five managed futures trading programs.

[4] See Frontier Fund—http://mutualhedge.com/default.aspx; AQR Fund—http://www.aqrfunds.com/Our_Funds/Individual/FundID_12/Overview/Managed_Futures_Strategy_Fund.fs; and Highbridge Fund—https://www.jpmorganfunds.com/cm/Satellite?pagename=jpmfVanityWrapper&UserFriendlyURL=fundoverview&cusip=48121A696

[5] A second fund's prospectus states that in order to pursue its investment objective, the fund invests in futures contracts and futures-related instruments including, but not limited to, equity index futures, currency forwards, commodity futures, swaps on commodity futures, fixed income futures, bond futures and swaps on bond futures (collectively, the Instruments) either by investing directly in those Instruments, or indirectly by investing in a subsidiary that invests in those Instruments. The third fund's prospectus states that the fund seeks to achieve its objective by investing in a diversified portfolio of commodity-linked derivatives and fixed income securities. The prospectus additionally states that the fund invests in commodity-linked derivative instruments, such as commodity-linked notes, swap agreements, commodity options, futures and options on futures that provide exposure to the investment returns of the commodities markets without investing directly in physical commodities.

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[7] A second fund's Fact Sheet makes similar statements and indicates that "The Fund delivers an active long/short Managed Futures strategy in a mutual fund vehicle." The fund's investment objective states the fund "seeks to generate positive absolute returns."

Importantly, these three funds invest in commodity futures instruments and/or other managed futures trading programs through a wholly-owned and controlled subsidiary, in which the fund invests up to 25% of its total assets. By leveraging assets at a 4 to 1 ratio, a fund is able to achieve a managed futures exposure equal to the full net value of the fund. The aforementioned fund's prospectus states that the subsidiary's investment adviser (which is also the fund's adviser) expects to invest the assets of the subsidiary in a manner designed to provide exposure to five global macro programs. The trading mangers for these five programs are paid management and incentive fees by the subsidiary similar to which institutional clients of CTAs would pay. The fund pays a management fee to the adviser, calculated daily but paid monthly, at an annual rate of 1.45% of the average daily net assets of the fund. The adviser, however, waived this fee in an amount equal to the management fee paid to the adviser by the subsidiary.

Regulation 4.5 does not place any qualification standards on the type of customer who may invest in a qualifying entity, and these mutual funds are marketed and sold to customers, including retail investors, who may be unsophisticated in commodity futures investments. NFA believes that any commodity futures investment that is marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading or investing in (or otherwise seeking exposure to) the commodity futures or commodity options markets should be subject to the regulatory requirements and protections contained in the CFTC's Part 4 regulations.

In reviewing these funds' prospectuses, NFA found that the offering material omits substantial disclosures that would otherwise be mandated by Part 4. Among other things, the prospectuses do not include the CFTC required risk disclosure statement, a break-even analysis, detailed information about the fund's futures commission merchants and potential conflicts of interest, and performance information for the fund (assuming it has three months performance) or other funds operated by the investment adviser. Additionally, to the extent the funds' prospectuses state that the fund and/or subsidiary will invest in other actively managed futures trading programs, the prospectuses provide little information about these managed futures trading programs, these programs' fee structures, and the past performance results of their trading managers.

NFA has customer protection concerns relating to these mutual funds' use of a wholly-owned and controlled subsidiary to invest in commodity futures transactions on behalf of the fund. NFA understands from reviewing some of these funds' prospectuses that the funds' investment in a subsidiary is intended to provide the funds with exposure to futures and commodities in a manner consistent with the limitations of the federal tax requirements in Sub-chapter M of the IRS Code. Sub-chapter M requires, in part, that at least 90% of a fund's income be derived from securities or derived with respect to its business of investment in securities (i.e., qualifying income). The funds rely upon IRS private letter rulings to other mutual funds, which indicate income from a fund's investment in a subsidiary will constitute qualifying income.

However, while these funds' offering materials indicate that the subsidiaries are subject to certain investment restrictions applicable to the funds themselves, these subsidiaries are neither commodity pools regulated by the CFTC and NFA nor registered investment companies. Additionally, the prospectuses make clear that the subsidiaries are not subject to the Investment Company Act of 1940's customer protection regime. The vast majority of the regulated funds' holdings appear to be money market instruments to serve as collateral for the subsidiaries' derivatives positions; yet, the subsidiaries' daily operations, including their actual derivatives positions (including the positions' leverage amounts) and fees charged are not entirely transparent.

Given these funds' offerings, NFA proposes the aforementioned amendments to Regulation 4.5 since we believe the premises underlying the Commission's elimination in 2003 of the "no-marketing" and "five-percent trading test" limitations may no longer be valid. To the extent the Commission used proposed Regulation 4.13(a)(4) as a rationale to eliminate the "five-percent trading test", NFA believes that the Commission should review whether this rationale remains appropriate in light of these actively managed retail futures funds.[8]

[8] NFA recognizes that registered investment companies may need to engage in futures transactions for bona fide hedging purposes and believes they should be permitted to engage a *de minimis* amount of speculative futures trading without the necessity to be registered with and regulated by the CFTC.

NFA believes at this time that Regulation 4.13(a)(4)'s exemption from CPO registration does not support the 2003 elimination of the "five-percent trading test." Specifically, although Regulation 4.13(a)(4) does not contain any restriction on the purpose or scope of a pool's commodity interest trading, we believe a critical distinction between a Regulation 4.5 qualifying entity and a Regulation 4.13(a)(4) pool is the qualifications of the fund participants[9]—Regulation 4.13(a)(4)(ii)(A) requires every natural person pool participant to be a "qualified eligible person" as defined in Commission Regulation 4.7(a)(2). In contrast, Regulation 4.5 has no qualification requirement for customers who may invest in a qualifying entity. Moreover, NFA strongly believes that in circumstances in which no qualification requirement exists for fund participants, then NFA and the CFTC should have regulatory oversight of collective investment vehicles that engage in more than a *de minimis* amount of futures trading. [10]

Additionally, to the extent that the Commission's 2003 amendments to Regulation 4.5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid. As noted above, despite the fact that these registered investment companies are marketed to retail customers as an actively managed futures fund, they are not subject to customer protection rules comparable to the CFTC's Part 4 Regulations and NFA's Compliance Rules. NFA believes that any investment fund that is marketed, in part, to unsophisticated retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking exposure to) the commodity futures or commodity options markets or

[9] Another distinction is interests in Regulation 4.13(a)(4) pools are exempt from registration under the Securities Act of 1933 while Regulation 4.5 qualifying entities are operated by otherwise regulated persons. For the reasons explained in this letter, however, NFA believes that to the extent that the Commission's 2003 amendments to Regulation 4 5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid.

[10] NFA notes that Commission Regulation 4.13(a)(3) provides an exemption from CPO registration, which requires a pool to meet one of two tests with respect to its commodity interest positions, including positions in security futures products, whether entered into for bona fide hedging purposes or otherwise—the aggregate initial margin and premiums required to establish such positions will not exceed 5% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into or the aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into. Moreover, CFTC Regulation 4.13(a)(3)(iii) requires natural person pool participants to at least meet the accredited investor qualification standards.

that engages in more than a *de minimis* amount of non-hedge futures trading should be subject to the CFTC's Part 4 regulatory requirements and protections, and the oversight of the CFTC and NFA who have the experience and expertise in regulating managed retail futures products. The CFTC has the Congressional mandate to regulate retail managed futures trading and products.

Additionally, NFA is deeply concerned that a number of CPOs that currently operate public pools will avail themselves of this alternative registered investment company structure. Given our concern with these registered investment company structures and the lack of adequate retail customer protections comparable to those afforded prospective investors in a public commodity pool subject to Part 4, NFA does not believe that retail futures customers would be served well if this migration were to occur.

For these reasons, NFA respectfully requests that the Commission amend Regulation 4.5(c) to require a person claiming an exclusion from the definition of the term "commodity pool operator" to represent in the notice of eligibility that the person will operate the qualifying entity such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for bona fide hedging purposes and, with respect to positions that may be held by the qualifying entity only for non-bona fide hedging purposes the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

Lastly, NFA recognizes that, if adopted, the proposed amendments to Regulation 4.5 will impose the same operating restrictions on qualifying entities that were in place prior to 2003. Obviously, since 2003, a number of persons have filed notices of eligibility pursuant to Regulation 4.5(c) on behalf of qualifying entities, and those entities may no longer be eligible for exclusion from CPO registration in the future if the proposed amendments are adopted. Therefore, NFA encourages the Commission to provide adequate time for these registered investment companies to comply with the Commission's applicable regulations or seek the appropriate relief therefrom.

NFA

Additionally, to the extent that the Commission has granted operational relief from certain Part 4 Regulations (e.g. disclosure document and reporting and recordkeeping) to exchange traded funds—that are commodity pools organized as Delaware statutory trusts—NFA encourages the CFTC to determine whether it is appropriate to grant similar and/or other relief to public commodity pools and listed pools that may want to continue operating as registered investment companies. If the Commission desires, NFA is willing to participate in discussions in the future with Commission staff to achieve this result, which may necessitate harmonizing CFTC and SEC regulatory requirements.

NFA respectfully petitions the Commission to amend Regulations 4.5 as described above.

Very truly yours,

Thomas W. Sexton, III
Senior Vice President
and General Counsel

cc: Via Email:
Honorable Gary Gensler, CFTC Chairman
Honorable Michael Dunn, CFTC Commissioner
Honorable Scott O'Malia, CFTC Commissioner
Honorable Jill E. Sommers, CFTC Commissioner
Honorable Bart Chilton, CFTC Commissioner
Mr. Ananda Radhakrishnan, CFTC Director
Mr. William Penner, CFTC Deputy Director

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NFA NATIONAL FUTURES ASSOCIATION

August 18, 2010

C.F.T.C.
OFFICE OF THE SECRETARIAT
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Via E-Mail and Overnight Mail

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 4.5

Dear Mr. Stawick:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 4.5, which provides an exclusion from the definition of the term "commodity pool operator" for otherwise regulated persons operating certain qualifying entities.[1] Prior to 2003, persons claiming this exclusion had to file a notice of eligibility pursuant to CFTC Regulation 4.5(c) and represent, in part, that the person will operate the qualifying entity such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for *bona fide* hedging purposes and, with respect to positions held for non-*bona fide* hedging purposes the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

For the reasons set forth below, we request that the CFTC amend Regulation 4.5(c) to restore operating restrictions on registered investment companies that are substantially similar to those in effect prior to 2003. The information required by CFTC Regulation 13.2 follows:

[1] NFA withdrew its June 29, 2010 Petition for Rulemaking to Amend CFTC Regulation 4.5 by separate letter dated August 18, 2010.

I. Text of Proposed Rule Amendments [additions are underlined]

Part 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

4.5 Exclusion from the definition of the term "commodity pool operator."

* * *

(c)

* * *

(2) The notice of eligibility must contain representations that such person will operate the qualifying entity specified therein in a manner such that the qualifying entity:

(i) Will disclose in writing to each participant, whether existing or prospective, that the qualifying entity is operated by a person who has claimed an exclusion from the definition of the term "commodity pool operator" under the Act and, therefore, who is not subject to registration or regulation as a pool operator under the Act; *Provided*, that such disclosure is made in accordance with the requirements of any other federal or state regulatory authority to which the qualifying entity is subject. The qualifying entity may make such disclosure by including the information in any document that its other federal or state regulator requires to be furnished routinely to participants or, if no such document is furnished routinely, the information may be disclosed in any instrument establishing the entity's investment policies and objectives that the other regulator requires to be made available to the entity's participants; and

(ii) Will submit to such special calls as the Commission may make to require the qualifying entity to demonstrate compliance with the provision of this § 4.5(c);

(iii) Furthermore, if the person claiming the exclusion is an investment company registered under the Investment Company Act of 1940, then the notice of

eligibility must also contain representations that such person will operate the qualifying entity as described in § 4.5(b)(1) in a manner such that the qualifying entity:

(a) Will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1); *Provided, however,* That in addition, with respect to positions in commodity futures or commodity option contracts that may be held by a qualifying entity only which do not come within the meaning and intent of § 1.3(z)(1), a qualifying entity may represent that the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; and, *Provided further,* That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such 5 percent;

(b) Will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets;

Provided further, however, That the making of such representations shall not be deemed a substitute for compliance with any criteria applicable to commodity futures or commodity options trading established by any regulator to which such person or qualifying entity is subject.

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. One of NFA's primary purposes is to ensure the protection of customers participating in the commodity futures markets. Recently, NFA has become aware of at least three entities filing for exclusions under Regulation 4.5 with respect to registered investment companies that they operate. These mutual funds are marketed to customers, including retail investors, as commodity futures investments

and are indirectly invested substantially in derivatives and futures products. In fact, although these funds are structured differently than public commodity pools and conduct the futures trading through a subsidiary for tax and mutual fund regulatory purposes, their aim is the same—targeting retail investors with in some cases minimum investment amounts of as little as $1,000 who want exposure to actively managed futures strategies.

Importantly, as noted above, these three funds invest in commodity futures instruments and/or other managed futures trading programs through a wholly-owned and controlled subsidiary. The fund invests up to 25% of its total assets in this subsidiary, and by leveraging assets at a 4 to 1 ratio, a fund is able to achieve a managed futures exposure equal to the full net value of the fund.

NFA is interested in ensuring that registered investment companies that engage in more than a *de minimis* amount of futures trading and that are offered to retail customers or are marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets are subject to the appropriate regulatory requirements and oversight by regulatory bodies with primary expertise in commodity futures. NFA believes that requiring persons that market commodity funds to the retail public and whose funds engage in more than a *de minimis* amount of futures trading or investment to be registered as commodity pool operators ("CPOs") furthers that goal.

III. Supporting Arguments

CFTC Regulation 4.5 currently makes available to eligible persons an exclusion from the definition of CPO with respect to the operation of certain qualifying entities, including registered investment companies, that would otherwise constitute commodity pools but that are already subject to extensive federal and/or state operating requirements. Prior to 2003, eligible persons claiming this exclusion were required to represent that commodity futures and option contracts were used solely for *bona fide* hedging purposes, and that for positions in commodity futures and option contracts that were not used for *bona fide* hedging purposes, the aggregate initial margin and premiums do not exceed 5% of the liquidating value of the qualifying entity's portfolio after taking into account unrealized profits and losses. In addition, eligible persons were

required to represent that the qualifying entity will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets.

In March 2003, the Commission proposed amendments to Regulation 4.5 to eliminate the limitation on non-hedge trading. At the same time, the Commission proposed formally adopting CFTC Regulation 4.13(a)(4) to provide an additional exemption from CPO registration based *solely* on a pool participant's purported sophistication, without any requirement that the pool operator must be subject to another regulatory scheme and without any restriction whatsoever on the purpose and scope of the pool's commodity interest trading. The Commission further stated that "since the eligible persons and qualifying entities of Rule 4.5 are, as stated in the title of the rule, 'otherwise regulated,' the Commission believes that, like the unregulated CPOs for whom it is proposing relief below, these persons and entities may not need to be subject to any commodity interest trading criteria to qualify for relief under Rule 4.5."[2]

At this time, the Commission also stated its view that Regulation 4.5's "no-marketing" restriction should remain in place. The Commission noted that eligible persons should remain prohibited from marketing a qualifying entity as a commodity pool or otherwise as a vehicle to trade commodity interests and indicated that this restriction was necessary because members of the retail public may participate in the trading vehicles subject to a Regulation 4.5 exclusion. The Commission nonetheless requested comment on the merits of maintaining this marketing prohibition.[3]

By letter dated May 1, 2003 to the CFTC, NFA supported maintaining Regulation 4.5's "no marketing" restriction. In particular, NFA stated that "current and proposed Rule 4.5 both provide that the exclusion is not available if the vehicles are marketed as commodity pools. Since Rule 4.5 is an exclusion rather than an exemption, the anti-fraud provisions of Section 4(o) of the CEA do not apply. Investments in these vehicles can be - and often are - sold to unsophisticated customers. While the sale of these investment vehicles is subject to the anti-fraud provisions in other statutes, unsophisticated customers should also have the benefit of Section 4(o) if the investment is marketed as a commodity pool. Therefore, we agree

[2] See 68 Fed. Reg. 12622,12626 (March 17, 2003).
[3] See Id.

that the exclusion should not be available if the vehicles are marketed as commodity pools." NFA felt that with this "no-marketing" restriction in place, it made sense to eliminate the limitation on non-hedge commodity trading due to certain concerns regarding margin levels expressed at that time.

In August 2003, after receiving comments that supported eliminating both the limitation on non-hedge commodity trading and the prohibition on marketing these qualifying entities, the Commission adopted amendments to Regulation 4.5 to eliminate both these provisions. In doing so, the Commission stated that "one commenter agreed with the proposed retention of the 'no marketing' criterion (and with the Commission's rationale therefore) but several commenters disagreed with it. The Commission noted, in part, that these commenters claimed that, in the absence of any trading restriction, the "otherwise regulated nature" of the qualifying entities specified in Regulation 4.5 would provide adequate customer protection.[4]

Over the past several months, at least three entities that previously filed notices for exclusions under Regulation 4.5 with respect to certain registered investment companies launched these mutual funds. These mutual funds are marketed to customers, including retail investors, as commodity futures investments and are indirectly invested via a subsidiary structure substantially in derivatives and futures products. Customers may use an electronic brokerage account to trade one of these mutual funds, which are sold by broker/dealers on internet platforms in which retail investors only need to point and click to either buy or redeem shares in a fund that offers exposure to an actively managed futures product.

NFA staff has reviewed the prospectuses and promotional material prepared for these funds.[5] One fund's prospectus indicates that it pursues its investment strategy by mainly investing in a combination of exchange traded futures

[4] See 68 Fed. Reg. 47221, 47223 (August 8, 2003).

[5] See MutualHedge Frontier Legends Fund—http://mutualhedge.com/default.aspx;
AQR Fund—http://www.aqrfunds.com/
Our_Funds/Individual/FundID_12/Overview/Managed_Futures_Strategy_Fund.fs;and Highbridge Fund—https://www.jpmorganfunds.com/cm/Satellite?pagename=jpmfVanityWrapper&UserFriendlyURL=fundoverview&cusip=48121A696

and options contracts, forward contracts, swaps, and other over the counter derivatives and fixed income securities, often referred to as a "managed futures strategy."[6]

This fund's promotional material indicates that the fund's inception date was December 31, 2009, and the fund has a minimum investment amount of $2,500 (subsequent investments of $500) and offers two share classes, A and C. Class A has a maximum sales charge of 5.75% and a net expense ratio of 2.20% and Class C has no sales charge but a net expense ratio of 2.95%.[7] The fund's promotional material also states that the fund is "A Pioneering Managed Futures Investment" that is accessible, comprehensive, innovative, and has proven management.[8] The material also specifically notes that the fund has a "lower cost structure than most retail managed futures funds" and is "the first mutual fund to generate managed futures returns through net-long, actively managed CTAs." The fund's assets are traded pursuant to five managed futures trading programs. In particular, the fund's prospectus states that the subsidiary's investment adviser (which is also the fund's adviser) expects to invest the assets of the subsidiary in a manner designed to provide exposure to five global macro programs.

In adopting the 2003 changes to Regulation 4.5, the CFTC eliminated the prior "no-marketing" restriction and did not place any qualification standards on the type of customers who may invest in a qualifying entity. Without these types of operating

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[8] A second fund's Fact Sheet makes similar statements and indicates that "The Fund delivers an active long/short Managed Futures strategy in a mutual fund vehicle." The fund's investment objective states the fund "seeks to generate positive absolute returns."

restrictions, these mutual funds are marketed and sold to customers, including retail investors, who may be unsophisticated in commodity futures investments. NFA believes that any commodity futures investment that is marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading or investing in (or otherwise seeking exposure to) the commodity futures or commodity options markets should be subject to the regulatory requirements and protections contained in the CFTC's Part 4 regulations.

In reviewing these funds' prospectuses, NFA found that the offering material omits substantial disclosures that would otherwise be mandated by Part 4. Among other things, the prospectuses do not include detailed information about the fund's futures commission merchants and potential conflicts of interest, and performance information for the fund (assuming it has three months performance) or other funds operated by the investment adviser. Additionally, to the extent the funds' prospectuses state that the fund and/or subsidiary will invest in other actively managed futures trading programs, the prospectuses provide little information about these managed futures trading programs, these programs' fee structures, and the past performance results of their trading managers.

NFA also has customer protection concerns relating to these mutual funds' use of a wholly-owned and controlled subsidiary to invest in commodity futures transactions on behalf of the fund. NFA understands from reviewing some of these funds' prospectuses that the funds' investment in a subsidiary is intended to provide the funds with exposure to futures and commodities in a manner consistent with the limitations of the federal tax requirements in Sub-chapter M of the IRS Code. Sub-chapter M requires, in part, that at least 90% of a fund's income be derived from securities or derived with respect to its business of investment in securities (i.e., qualifying income). The funds rely upon IRS private letter rulings to other mutual funds, which indicate income from a fund's investment in a subsidiary will constitute qualifying income.

However, while these funds' offering materials indicate that the subsidiaries are subject to certain investment restrictions applicable to the funds themselves, these subsidiaries are neither commodity pools regulated by the CFTC and NFA nor registered investment companies. Additionally, the prospectuses make clear that the subsidiaries are not subject to the Investment Company Act of 1940's customer

protection regime. The vast majority of the regulated funds' holdings appear to be money market instruments to serve as collateral for the subsidiaries' derivatives positions; yet, the subsidiaries' daily operations, including their actual derivatives positions (including the positions' leverage amounts) and fees charged are not entirely transparent.

Given these funds' offerings, NFA proposes the aforementioned amendments to Regulation 4.5 since we believe the premises underlying the Commission's elimination in 2003 of the "no-marketing" and "five-percent trading test" limitations as applied to registered investment companies may no longer be valid. To the extent the Commission used proposed Regulation 4.13(a)(4) as a rationale to eliminate the "five-percent trading test", NFA believes that the Commission should review whether this rationale remains appropriate in light of these actively managed retail futures funds.[9]

NFA believes at this time that Regulation 4.13(a)(4)'s exemption from CPO registration does not support the 2003 elimination of the "five-percent trading test." Specifically, although Regulation 4.13(a)(4) does not contain any restriction on the purpose or scope of a pool's commodity interest trading, we believe a critical distinction between a Regulation 4.5 qualifying entity and a Regulation 4.13(a)(4) pool is the qualifications of the fund participants[10]—Regulation 4.13(a)(4)(ii)(A) requires every natural person pool participant to be a "qualified eligible person" as defined in Commission Regulation 4.7(a)(2). In contrast, Regulation 4.5 has no qualification requirement for customers who may invest in a qualifying entity, including a registered investment company. Moreover, NFA strongly believes that in circumstances in which no qualification requirement exists for fund participants, then NFA and the CFTC should

[9] NFA recognizes that registered investment companies may need to engage in futures transactions for bona fide hedging purposes and believes they should be permitted to engage a *de minimis* amount of speculative futures trading without the necessity to be registered with and regulated by the CFTC.

[10] Another distinction is interests in Regulation 4.13(a)(4) pools are exempt from registration under the Securities Act of 1933 while Regulation 4.5 qualifying entities are operated by otherwise regulated persons. For the reasons explained in this letter, however, NFA believes that to the extent that the Commission's 2003 amendments to Regulation 4.5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid.

have regulatory oversight of collective investment vehicles that engage in more than a *de minimis* amount of futures trading.[11]

Additionally, to the extent that the Commission's 2003 amendments to Regulation 4.5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid. As noted above, despite the fact that these registered investment companies are marketed to retail customers as an actively managed futures fund, they are not subject to customer protection rules entirely comparable to the CFTC's Part 4 Regulations and NFA's Compliance Rules. NFA believes that a registered investment company that is marketed, in part, to unsophisticated retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking exposure to) the commodity futures or commodity options markets or that engages in more than a *de minimis* amount of non-hedge futures trading should be subject to the CFTC's Part 4 regulatory requirements and protections, and the oversight of the CFTC and NFA who have the experience and expertise in regulating managed retail futures products. The CFTC alone has the Congressional mandate to regulate retail managed futures trading and products, and over the years has developed the specialized body of skill and knowledge necessary to fulfill this mandate.

Additionally, NFA is deeply concerned that a number of CPOs who currently operate public pools will avail themselves of this alternative registered investment company structure. Given our concern with this registered investment company structure and the lack of adequate retail customer protections in some areas comparable to those afforded prospective investors in a public commodity pool subject to Part 4, NFA does not believe that retail futures customers would be served well if this migration were to occur.

[11] NFA notes that Commission Regulation 4.13(a)(3) provides an exemption from CPO registration, which requires a pool to meet one of two tests with respect to its commodity interest positions, including positions in security futures products, whether entered into for bona fide hedging purposes or otherwise—the aggregate initial margin and premiums required to establish such positions will not exceed 5% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into or the aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into. Moreover, CFTC Regulation 4.13(a)(3)(iii) requires natural person pool participants to at least meet the accredited investor qualification standards.

For these reasons, NFA respectfully requests that the Commission amend Regulation 4.5(c) to require a registered investment company claiming an exclusion from the definition of the term "commodity pool operator" to represent in the notice of eligibility that the qualifying entity (i.e. registered investment company) will be operated such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for bona fide hedging purposes and, with respect to positions that may be held by the qualifying entity only for non-bona fide hedging purposes the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

Lastly, NFA recognizes that, if adopted, the proposed amendments to Regulation 4.5 will impose the same operating restrictions on registered investment companies that were in place prior to 2003. Obviously, since 2003, a number of persons have filed notices of eligibility pursuant to Regulation 4.5(c) on behalf of registered investment companies, and those entities may no longer be eligible for exclusion from CPO registration in the future if the proposed amendments are adopted. Therefore, NFA encourages the Commission to provide adequate time for these registered investment companies to comply with the Commission's applicable regulations or seek the appropriate relief therefrom.

Additionally, to the extent that the Commission has granted operational relief from certain Part 4 Regulations (e.g. disclosure document and reporting and recordkeeping) to exchange traded funds—that are commodity pools organized as Delaware statutory trusts—NFA encourages the CFTC to determine whether it is appropriate to grant similar and/or other relief to public commodity pools and listed pools that may want to continue operating as registered investment companies. If the Commission desires, NFA is willing to participate in discussions in the future with Commission staff to achieve this result, which may necessitate harmonizing CFTC and SEC regulatory requirements.

NFA respectfully petitions the Commission to amend Regulations 4.5 as described above.

Very truly yours,

Thomas W. Sexton, III
Senior Vice President
and General Counsel

cc: Via Email:
Honorable Gary Gensler, CFTC Chairman
Honorable Michael Dunn, CFTC Commissioner
Honorable Scott O'Malia, CFTC Commissioner
Honorable Jill E. Sommers, CFTC Commissioner
Honorable Bart Chilton, CFTC Commissioner
Mr. Ananda Radhakrishnan, CFTC Director
Mr. William Penner, CFTC Deputy Director

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DC10

Dechert
LLP

1095 Avenue of the Americas
New York, NY 10036-6797
+1 212 698 3500 Main
+1 212 698 3599 Fax
www.dechert.com

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September 13, 2010

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OFFICE OF THE SECRETARIAT
C.F.T.C.

VIA E-MAIL AND FIRST CLASS MAIL

David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: NFA Petition for Proposed Rulemaking to Amend CFTC Regulation 4.5

Dear Mr. Stawick:

Further to conversations with Barbara S. Gold, Associate Director, Division of Clearing and Intermediary Oversight, Dechert LLP appreciates the opportunity to submit the comments discussed below in response to a petition for proposed rulemaking ("NFA Petition") submitted by the National Futures Association ("**NFA**") on August 18, 2010 regarding the exclusion of specified entities from the definition of commodity pool operator ("**CPO**") under CFTC Regulation 4.5[1] ("**Rule 4.5**"[2]).

Background

Since its adoption in 1985, Rule 4.5 has made available to certain persons an exclusion from the definition of a CPO with respect to their operation of qualifying entities that would otherwise be treated as commodity pools under the Commodity Exchange Act, as amended (the "Act"), but that are already subject to extensive operating requirements of another federal or state regulator.[3]

[1] Letter from Thomas W. Sexton, III, Senior Vice President and General Counsel, NFA, to David Stawick, Office of the Secretariat, Commodity Futures Trading Commission (August 18, 2010), *available at* http://www.nfa.futures.org/news/newsPetition.asp?ArticleID=3630. The NFA withdrew its original June 29, 2010 Petition for Rulemaking to Amend CFTC Regulation 4.5 by separate letter dated August 18, 2010 and resubmitted its petition on August 18, 2010.

[2] 17 C.F.R. § 4.5.

[3] Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors, 68 Fed. Reg. 12622 (March 17, 2003) (the "**2003 Release**").

Currently, qualifying entities eligible for the exclusion under Rule 4.5 include registered investment companies, insurance companies, banks and ERISA plan fiduciaries.[4]

In its 2003 amendments to Rule 4.5 (the "**2003 Amendments**"), the Commodity Futures Trading Commission (the "**Commission**") sought to "moderniz[e] the requirements for determining who should be excluded from the CPO definition."[5] The 2003 Amendments were also intended to "encourage and facilitate participation in the commodity interest markets by additional collective investment vehicles and their advisers, with the added benefit to all market participants of increased liquidity."[6] The 2003 Amendments expanded the scope of Rule 4.5 by eliminating certain operating restrictions on qualifying entities. In particular, the Commission eliminated a requirement that a qualifying entity use commodity futures or commodity options contracts solely for *bona fide* hedging purposes, *provided, that,* five percent or less of the liquidation value of the qualifying entity's portfolio may be allocated to the aggregate initial margin and premiums necessary to establish non-*bona fide* hedging positions (after taking into account unrealized profits and losses on any existing commodity interest contracts) (the "**five-percent test**"). The Commission also removed a prohibition on a qualifying entity from marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets. In addition to the CFTC's expressed interest in encouraging and facilitating participation in the commodity interest markets, the 2003 Amendments also benefitted investors by permitting mutual funds to purchase commodity futures and options directly in lieu of entering into OTC commodity derivatives. Direct purchases of commodity futures and options enhanced fund transparency, lowered transaction costs and alleviated concerns over counterparty credit risk.

NFA Petition

The NFA has requested that the Commission restore the operating restrictions that were in effect under Rule 4.5 prior to the 2003 Amendments. In addition to fully reinstating the *bona fide* hedging and the five-percent test for non-*bona fide* hedging positions, the NFA Petition also seeks to restore the marketing restrictions while at the same time expanding the scope of these restrictions. The language in Rule 4.5 prior to the 2003 Amendments restricted qualifying entities from marketing participations in a commodity pool or other vehicle "for trading in the commodity futures or commodity options markets." The NFA Petition expands this language by prohibiting

[4] 17 C.F.R. § 4.5(a)(1) – (4).

[5] 2003 Release.

[6] 2003 Release.

the marketing of indirect exposure to the commodity markets through "trading in *(or otherwise seeking investment exposure to)* the commodity futures or commodity options markets" (emphasis supplied). On September 1, 2010, CFTC Commissioner Scott O'Malia issued a statement in support of the NFA Petition, recommending that the "Commission should expeditiously move forward and adopt the proposed changes to [Rule] 4.5 as proposed by the NFA" (the "**O'Malia Statement**").

For the reasons set forth below, we are of the view that the current regulatory language of Rule 4.5 should remain unchanged, as the robust and comprehensive statutory requirements of the Investment Company Act of 1940, as amended (the "**1940 Act**") and the rules and regulations promulgated thereunder have successfully served the best interests of mutual fund investors for 70 years, and the excessive burdens on mutual funds that would result from complying with a revised Rule 4.5 would not be justified by the reasons set forth in the NFA Petition.

Prevalence of Commodity-Based Mutual Funds

The NFA Petition states that it has recently become aware of at least three entities (the "**Commodity Funds**")[7] filing for exclusions under Rule 4.5 with respect to certain registered investment companies investing in the commodity futures and options markets. However, registered investment company sponsors have been offering participations in commodity-based mutual funds for many years.[8] As the Commission has noted in the past, the benefits of diversifying stock and bond portfolios with commodity index investments have been widely recognized.[9] Financial research has shown that the risk/return performance of a portfolio is improved by acquiring uncorrelated or negatively correlated assets, and commodities generally perform that role in a portfolio of other financial assets.[10] For many small investors, mutual funds

[7] The MutualHedge Frontier Legends Fund sponsored by Equinox Fund Management, LLC, Managed Futures Strategy Fund sponsored by AQR Capital Management, LLC and Highbridge Dynamic Commodities Strategy Fund sponsored by J.P. Morgan Asset Management.

[8] *See, e.g.*, Oppenheimer Commodity Strategy Total Return Fund (Inception: 3/31/97), PIMCO CommodityRealReturn Strategy Fund (Inception: 06/28/02), Credit Suisse Commodity Return Strategy Fund (Inception: 12/30/04), DWS Enhanced Commodity Strategy Fund (Inception: 02/14/05) and Rydex Managed Futures Strategy Fund (Inception: 3/2/2007).

[9] Risk Management Exemption from Federal Speculative Position Limits, 72 Fed. Reg. 66097, 66098 (Nov. 27, 2007).

[10] *Id.*

that offer commodity exposure are the most efficient, cost-effective and accessible means of achieving these investment objectives. In response to this demand from retail customers, the mutual fund industry over the years has provided investors with access to this important asset class by offering commodity-based mutual funds. There are now nearly four dozen mutual funds offering commodities exposure, exclusive of exchange-traded funds, with more than $30 billion in total assets - a level of assets under management ("**AUM**") that substantially exceeds the aggregate AUM of public commodity pools subject to filing requirements with the Securities and Exchange Commission ("**SEC**") under the Securities Exchange Act of 1934, as amended.

The NFA Petition expresses particular concern about actively managed futures funds, and the O'Malia Statement notes that "[r]ecently several SEC-registered investment companies have started to offer mutual funds to retail customers that for the most part, if not solely, trade futures."[11] We note that mutual funds that offer retail investors exposure to futures contracts have been in operation for many years. In addition, there is no explanation in the NFA Petition as to why actively managed futures funds are of a particular concern to the NFA or why these funds should be distinguished from mutual funds that track commodity indices. Investors in actively managed futures funds have not suffered any unique harm in recent years, including throughout the financial crisis. These funds offer investors the potential for the outperformance of various commodity indices and benchmarks, much like traditional mutual funds that invest in equities offer investors the potential for outperformance of various equity indices and benchmarks. As with mutual funds that actively manage portfolios of equities, there does not appear to be any need for additional scrutiny or separate regulatory oversight for mutual funds that actively manage portfolios of futures contracts.

Use of Wholly Owned Subsidiaries

The NFA Petition references the use by commodity-based mutual funds of "a subsidiary for tax and mutual fund regulatory purposes." Prior to 2005, many mutual funds obtained exposure to the commodities markets by entering into commodity-linked total return swap agreements or similar swap agreements. In late 2005, the Internal Revenue Service ("**IRS**") issued a revenue ruling that commodity-linked swap agreements did not constitute "securities" and the income from such swaps did not constitute "qualifying income" under Subchapter M of the Internal Revenue Code (the "**Code**"). In a subsequent revenue ruling, the IRS stated that income from alternative investment instruments, including commodity-linked notes, could allow registered investment companies to obtain commodity exposure while complying with the "qualifying income" requirements of Subchapter M. The IRS's revenue ruling had no impact on, and did not

[11] It is worth noting that one of the funds specifically mentioned in the NFA Petition does not invest in futures contracts whatsoever.

affect the scope of, the Commission's 2003 Amendments to Rule 4.5. Instead, the IRS's decision can be seen as a part of an on-going evolutionary process for mutual funds in their migration from OTC derivatives to direct purchases of commodity futures and options.

Following the subsequent revenue ruling, many commodity-based mutual funds applied for and received private letter rulings from the IRS in which the IRS concluded that income from certain leveraged commodity-linked notes would constitute "qualifying income." Many mutual funds also received private letter rulings in which the IRS concluded that an investment in the equity securities of a subsidiary that invests primarily in commodity-linked swaps would constitute "qualifying income." Thereafter, many commodity-based mutual funds began investing in commodity-linked swaps and commodity futures and options through a wholly owned subsidiary ("**Subsidiary**"). Direct purchases of commodity futures and options through a Subsidiary are generally more cost effective and transparent to investors than entering into commodity-linked swaps. Furthermore, direct purchases of commodity futures and options eliminated the counterparty risk inherent in OTC derivative instruments. The financial turmoil of 2008 heightened concerns over counterparty credit risk and eliminated the number of banks, dealers and other financial institutions willing to enter into commodity swap transactions. The combination of greater market turbulence and fewer counterparties increased the cost of entering into commodity swaps and further incentivized mutual funds to directly purchase futures contracts through their Subsidiaries.

The NFA highlights the fact that the Subsidiaries are not themselves subject to the 1940 Act, although they are subject to certain investment restrictions applicable to their parent funds. The NFA's analysis does not include the important fact that private letter rulings from the IRS and the 1940 Act apply investor protections to these Subsidiaries. In order for the income that a Subsidiary generates to constitute "qualifying income," its investing activities must meet the requirements of Section 18(f) of the 1940 Act that prohibit the issuance of senior securities.[12] In short, the Subsidiary must meet the same leverage and coverage restrictions applicable to a registered investment company. This constraint on a Subsidiary's activities addresses arguably the riskiest aspect of commodities investing, the embedded leverage in commodity futures and options contracts.[13]

[12] *See e.g.*, I.R.S. Priv. Ltr. Rul. 200822010 *3(Feb. 12, 2008), I.R.S. Priv. Ltr. Rul. 200840039 *8(June 13, 2008) and I.R.S. Priv. Ltr. Rul. 200842014 *11(July 17, 2008).

[13] We note that, in certain cases, a Subsidiary may invest only in those commodity pools that are already registered with the Commission.

Furthermore, Section 48(a) of the 1940 Act prohibits a registered investment company from engaging indirectly in any act that would otherwise directly violate the 1940 Act or the rules thereunder.[14] Accordingly, a Subsidiary would be prohibited from undertaking any action that would cause its parent fund to violate the 1940 Act. Thus, while the NFA states that Subsidiaries are not subject to the 1940 Act, and while it is true they are not registered under the 1940 Act, as a practical matter Subsidiaries are indirectly subject to the 1940 Act by virtue of their registered investment company parent entities. In fact, we understand that in certain circumstances the SEC has required mutual funds to disclose that the Subsidiary will be governed by, and operated in accordance with, the same 1940 Act rules and regulations applicable to its registered investment company parent. In addition, several SEC no-action letters provide guidance on the proper operation of a Subsidiary in compliance with certain aspects of the 1940 Act, including the avoidance of the layering of sales charges, fees and costs.[15]

Substantive Mutual Fund Disclosure under the 1940 Act

The NFA Petition cites registration statement disclosure as among its primary concerns regarding mutual fund investments in commodities. The NFA, in reviewing the prospectuses of the Commodity Funds, stated that the offering materials omitted "substantial disclosures that would otherwise be mandated by Part 4." As a general matter, all commodity-based mutual funds, because they are excluded under Rule 4.5, omit all such substantial disclosures identified by the NFA.

Registered investment companies, however, are subject to robust disclosure requirements under the 1940 Act that must closely track certain long-standing, comprehensive disclosure forms, such as Form N-1A for open-end investment companies and Form N-2 for closed-end investment companies, and related guidance promulgated by the SEC.[16]

The 1940 Act also requires mutual funds to disclose their principal investment strategies and risks[17] and provide performance data.[18] Although a mutual fund does not provide a break-even

[14] 15 U.S.C. § 80a-48(a).

[15] *South Asia Portfolio* (pub. avail. Mar. 12, 1997), *Templeton Vietnam Opportunities Fund, Inc.* (pub. avail. Sep. 10, 1996), *The Spain Fund, Inc.* (pub. avail. Mar. 28, 1988) and *The Scandinavia Fund* (pub. avail. Nov. 24, 1986).

[16] Since the NFA Petition focuses on three open-end registered investment companies, this letter will only analyze disclosure requirements applicable to open-end funds.

[17] Items 2, 4 and 9 of Form N-1A.

analysis,[19] it is required to provide example disclosure that illustrates how fees and performance may affect an investment in the fund.[20] Mutual funds are further required to provide extensive disclosure regarding the brokers they use to execute portfolio transactions.[21] This is a corollary to the Part 4 requirement regarding the disclosure of information about a commodity pool's futures commission merchants.[22]

While the NFA Petition notes the absence of certain disclosures required by Part 4 in the offering materials of the Commodity Funds, the NFA Petition does not cite a single instance of any harm to any investor in a commodity-based mutual fund. The comprehensive disclosure requirements under the 1940 Act have likely been helpful in allowing investors to fully understand and evaluate the potential risks of investing in commodity-based mutual funds.

Substantive Investor Protections under the 1940 Act

Investors in registered investment companies also enjoy multiple, substantive protections under the 1940 Act and the rules promulgated thereunder. Among the most important of these protections is the limitation on leverage under Section 18(f) of the 1940 Act that requires a mutual fund to "cover" potential future obligations arising from its portfolio management activities, including commodity futures and options trading. Mutual funds cover these obligations by segregating liquid assets or holding off-setting positions.[23]

Other statutory and regulatory protections under the 1940 Act and related rules include requirements regarding liquidity, concentration and diversification of investments, same-day valuation of fund assets, qualified third-party custody of fund assets, limitations on affiliated transactions, auditing of financial statements by independent registered accountants and the

[18] Item 3 of Form N-1A.

[19] 17 C.F.R. § 4.10(j).

[20] Item 3 Example of Form N-1A.

[21] Item 21 of Form N-1A.

[22] 17 C.F.R. § 4.24(e)(6)

[23] *See* Securities Trading Practices of Registered Investment Companies, 44 Fed. Reg. 25128 (Apr. 27, 1979), *Dreyfus Strategic Investing & Dreyfus Strategic Income* (pub. avail June 22, 1987) and *Merrill Lynch Asset Management, L.P.* (pub. avail. July 2, 1996).

oversight of fund operations by a board that includes among its membership independent directors.

Independent boards are also instrumental in protecting investors from excessive fees and expenses. Public and private commodity pools, which generally do not have independent boards, typically charge higher fees than mutual funds. Public and private commodity pools also generally pay materially higher commissions to selling agents than do mutual funds.

The SEC has a long, successful track record of protecting investors in retail investment funds. More than 87 million Americans, representing slightly less than half of all households, own mutual funds.[24] There are currently over 9,000 funds available to investors, offering a wide variety of investment strategies, including commodities, to suit different investment needs.[25] The substantive regulations that have been in place for the past 70 years have long served to protect the millions of retail investors throughout the mutual fund industry, including those investors in the long-established commodity-based mutual fund community. We note that there does not appear to be a single instance in which the SEC has brought an enforcement action against a mutual fund or a registered investment adviser in connection with its operations of a mutual fund that provides commodity exposure to retail investors.

In fact, retail investors have been demanding exposure to commodities specifically through registered investment companies. The number of public commodity pools currently available to retail customers and the aggregate AUM of these funds are far outweighed by the dozens of mutual funds regulated by the SEC that seek investment exposure to commodity investments. Among the reasons for the popularity of commodity-based mutual funds are substantially lower fees, third-party custody, DTCC clearing, daily liquidity and rigorous SEC regulation and oversight. In fact, as noted above, increased liquidity for commodity-based funds was one of the specific reasons articulated by the Commission in its rationale for implementing the 2003 Amendments to Rule 4.5. Finally, fund managers are drawn to the SEC-regulated mutual fund space for sound business reasons, including the significantly lower operational costs and the blue sky law advantages, among other reasons.

Suitability

[24] Mutual Fund Distribution Fees; Confirmations, Investment Company Act Release No. 29367 (July 21, 2010).

[25] *Id.*

A recurring theme throughout the NFA Petition is a concern for "unsophisticated" retail investors. However, while investors in public commodity pools and registered investment companies are protected by SEC and Financial Industry Regulatory Authority ("**FINRA**") suitability requirements, neither the Commission nor the NFA currently imposes suitability restrictions on potential investors in retail commodity pools. By contrast, the SEC has long mandated investor suitability requirements, and under FINRA Rule 2310 a FINRA-registered firm may recommend a transaction to a customer only if the recommendation suits the customer's investment portfolio, financial situation and needs. The firm must make reasonable efforts to obtain the customer's financial status, tax status, investment objectives and any other reasonable information needed to make recommendations to the customer. Moreover, SEC-registered investment advisers, including those that may recommend the purchase of mutual fund shares, are subject to a fiduciary standard of care. The NFA also notes that one of the Commodity Funds discussed in the NFA Petition permits investors simply to "point and click" to buy or redeem shares. While this particular fund may permit self-directed purchases and redemptions, many other mutual funds, including the other Commodity Funds cited in the NFA Petition, only accept purchases from SEC-registered broker/dealers through a subscription network processing platform.

Far from being inadequate or insufficiently restrictive, the investor protections from the SEC and FINRA are likely responsible for the lack of specific incidents or claims related to suitability cited in the NFA Petition and throughout the commodity-based mutual fund industry in general.

Congressional Liberalization of Mutual Fund Commodities Investing

The Regulated Investment Company Modernization Act of 2009, a bill currently pending in the U.S. House of Representatives, would amend the gross income test to include income derived from commodities investing.[26] Were this bill to become law, Subchapter M of the Code would no longer be the controlling statute limiting registered investment company investments in commodities. Absent additional law-making, Section 3(a) of the 1940 Act would control the amount of commodity futures and options investing a mutual fund could permissibly engage in and still be able to register as an investment company. Passage of this bill would result in a significant liberalization of the amount of direct commodities investing a mutual fund could

[26] Regulated Investment Company Modernization Act of 2009, H.R. 4337, 111th Cong. (as referred to the H.R. Comm. on Ways and Means, Dec. 16, 2009). On June 15, 2010, the House Ways and Means Select Revenue Measures Subcommittee held a hearing on the bill. A representative for the Investment Company Institute, Fidelity Investments and a private individual testified—none in opposition to the bill. *See* Regulated Investment Company Modernization Act of 2009: *Hearing on H.R. 4337 Before the H.R. Ways and Means Select Revenue Measures Subcomm.*, 111th Cong. (2010) (statements of William Paul, Stephen Fisher and Joseph Riley).

undertake. The NFA's request to tighten the current restrictions on registered investment company commodity investing would appear to be inconsistent with the purposes of the proposed bill.

Adverse Impact of Adopting the NFA Petition

Finally, if the Commission were to adopt the NFA Petition, potentially all commodity-based mutual funds and their investors would stand to be significantly adversely affected. The NFA Petition focuses on registered investment companies providing commodity exposure generally and those offering actively managed futures strategies specifically. However, its proposed rule amendments would also force commodity index funds to register as CPOs whether those funds were pursuing a purely passive strategy or one with some active futures management component. Even a commodity index fund's passive commodities investing may be unable to qualify as *bona fide* hedging under CFTC Regulation 1.3(z)(1) and current Commission guidance.[27] Other funds that may employ limited commodity futures or commodity options strategies that nonetheless fail the *bona fide* hedging test or five-percent test may forego this important commodity trading activity, leaving investors with a less-diversified portfolio and unmet investment needs. Additionally, every commodity-based registered investment company, regardless of whether its strategy involved passive indexing or actively managed futures investing, would be unable to comply with the NFA's proposed expansion of the Rule 4.5 marketing restrictions without registering as a CPO.

In addition, if mutual funds were required to register as CPOs, the NFA's proposed rule amendments would create excessive, duplicative regulation, forcing registered investment companies to incur significant costs in complying with new and unnecessary disclosure, reporting and recordkeeping requirements.[28] These costs would be passed on to fund investors, affecting the returns these individuals rely upon for retirement, education and other important investment objectives. Adoption of the proposed modification of current Rule 4.5 as described in the NFA Petition would have to be accompanied by harmonization between applicable and conflicting Commission and SEC regulations. For example, the requirement that in some cases a registered

[27] 17 C.F.R. § 1.3(z)(1). Since adopting Rule 1.3(z)(1) in 1977, the Commission has clarified, interpreted and reinterpreted what it means to be engaged in *bona fide* hedging. *See* Background on Position Limits and the Hedge Exemption, Statement of Dan M. Berkovitz, General Counsel, Commodity Futures Trading Commission (Jan. 14, 2010).

[28] Chuck Jaffe, *Financial Reform Won't Make Commodity Funds Safer*, MARKETWATCH (Aug. 8, 2010), *available at* http://www.marketwatch.com/story/financial-reform-wont-make-commodity-funds-safer-2010-08-08.

CPO disclose the performance of its other pools in a disclosure document for a pool with less than three years of performance[29] would likely violate investment adviser regulations under the Investment Advisers Act of 1940, as well as certain form disclosure requirements for mutual fund registration statements.[30]

* * *

We appreciate the opportunity to share our views with the Commission on this important topic. Please contact Matthew K. Kerfoot at 212-641-5694 or matthew.kerfoot@dechert.com if we can provide any additional information that may assist the Commission.

Sincerely,

Matthew K. Kerfoot

cc: Ananda Radhakrishnan
Director
Division of Clearing and Intermediary Oversight

William Penner
Deputy Director, Compliance and Registration
Division of Clearing and Intermediary Oversight

Barbara S. Gold
Associate Director
Division of Clearing and Intermediary Oversight

[29] 17 C.F.R. § 4.25(c).

[30] *See e.g.*, 17 C.F.R. § 275.206(4)-1 and Item 4(b) of Form N-1A.

COMMODITY FUTURES TRADING COMMISSION

Petition of the National Futures Association, Pursuant to Rule 13.2, to the U.S. Commodity Futures Trading Commission to Amend of the Rule 4.5

AGENCY: COMMODITY FUTURES TRADING COMMISSION.

ACTION: NOTICE OF PETITION AND REQUEST FOR COMMENT

SUMMARY: The National Futures Association ("NFA") has petitioned the Commodity Futures Trading Commission ("Commission" or "CFTC") to amend a rule that excludes certain otherwise regulated persons from the definition of the term "commodity pool operator" ("CPO") with respect to certain qualifying entities. The rule presently requires any person desiring to claim the exclusion to file a notice of eligibility with NFA, which must identify the qualifying entity to be operated pursuant to the exclusion.

NFA requests the Commission amend its rule to limit the scope of the exclusion for registered investment companies ("RICs"). Specifically, NFA has requested that any RIC include in its notice of eligibility a representation that the RIC's qualifying entity (1) will use commodity futures or commodity options contracts solely for bona fide hedging purposes, (2) will not have the initial margin and premiums required to establish any commodity futures or commodity options not used for bona fide hedging purposes exceeding five percent (5%) of the liquidation value of the qualifying entity's portfolio, and (3) will not be marketed to the public as a commodity pool or as a vehicle for investment in commodity futures or commodity options.

The Commission seeks comment on NFA's petition and any related questions. Copies of the petition are available for inspection at the Office of the Secretariat, by mail at the address listed below, by telephoning (202) 418-5100, or on the Commission's Web site (http://www.cftc.gov).

DATES: Comments must be received on or before [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Comments must be in English or, if not, accompanied by an English translation.

ADDRESSES: Comments should be sent to David A. Stawick, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581. Comments may be sent by facsimile transmission to (202) 418-5521, or by e-mail to NFAamendrule4.5@cftc.gov . Reference should be made to "National Futures Association Petition to Amend Commission Rule 4.5." Comments may also be submitted by connecting to the Federal eRulemaking Portal at http://www.regulations.gov and following the comment submission instructions. Comments will be published on the Commission's Web site.

FOR FURTHER INFORMATION CONTACT: Kevin P. Walek, Assistant Director, Telephone: (202) 418-5463, E-mail: kwalek@cftc.gov or Daniel S. Konar II, Attorney-Advisor, Telephone: (202) 418-5405, E-mail: dkonar@cftc.gov, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

In 1985, the Commission adopted Rule 4.5, which provides an exclusion from the definition of "CPO" for certain otherwise regulated persons that operated certain qualifying entities.[1] At the time of its adoption, any person seeking to claim the exclusion was required to file with the Commission a notice of eligibility that contained a representation that

> …such person will operate the qualifying entity specified therein in a manner such that the qualifying entity: (i) Will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of §1.3(z)(1)

[1] 50 FR 15868-01 (April 23, 1985).

> [subject to certain provisions]...(ii) Will not enter into commodity futures and commodity options contracts for which the aggregate initial margin and premiums exceed 5 percent of the fair market value of the entity's assets, after taking into account unrealized profits and unrealized losses on any such contracts...and (iii) Will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets.[2]

In 2003, the Commission amended Rule 4.5 by deleting the bona fide hedging requirement, the limitation on aggregate initial margin, and the prohibition on marketing.[3] In proposing these amendments to Rule 4.5, the Commission explained that its decision to delete the hedging requirement and the limitation on aggregate initial margin was driven by the fact that persons and qualifying entities that are otherwise regulated "may not need to be subject to any commodity interest trading criteria to qualify for the exclusion afforded by Rule 4.5."[4] The Commission further explained when adopting the final amendments that its decision to delete the prohibition on marketing was driven by comments claiming that "the 'otherwise regulated' nature of the qualifying entities...would provide adequate customer protection, and, further, that compliance with the subjective nature of the marketing restriction could give rise to the possibility of unequal enforcement where commodity interest trading was restricted."[5]

Rule 4.5 currently requires only that notices of eligibility include representations that

> ...the qualifying entity: (i) Will disclose in writing to each participant, whether existing or prospective, that the qualifying entity is operated be a person who has claimed an exclusion from the definition of the term 'commodity pool operator' under the [Commodity Exchange] Act, and therefore, who is not subject to registration or regulation as a pool operator under the [Commodity Exchange] Act...and (ii) Will submit to special calls as the Commission may require.[6]

[2] *Id.* at 15883.
[3] 68 FR 47221-01, 47223 (Aug. 8, 2003).
[4] 68 FR 12622-02, 12626 (March 17, 2003).
[5] 68 FR 47223.
[6] 17 C.F.R. §4.5(c)(2).

II. NFA's Petition

By letter dated August 18, 2010 ("Petition"), NFA, a registered futures association, petitioned the Commission under Rule 13.2[7] to amend Rule 4.5. Specifically, NFA requested that, in addition to the two current representations required in a person's notice of eligibility, Rule 4.5 should require the following representation:

> (iii) Furthermore, if the person claiming the exclusion is an investment company registered as such under the Investment Company Act of 1940, then the notice of eligibility must also contain representations that such person will operate the qualifying entity as described in [Rule] 4.5(b)(1) in a manner such that the qualifying entity: (a) Will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of [Rule] 1.3(z)(1); *Provided however*, That in addition, with respect to positions in commodity futures or commodity option contracts that may be held by a qualifying entity only which do not come within the meaning and intent of [Rule] 1.3(z)(1), a qualifying entity may represent that the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; and, *Provided further*, That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in [Rule] 190.01(x) may be excluded in computing such [five] percent; (b) Will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets.

III. Request for Comments

The Commission requests public comment on any aspect of the Petition that commenters believe may raise issues under the Commodity Exchange Act or Commission regulations.

* * * *

Issued in Washington, DC, on September 13, 2010 by the Commission.

David A. Stawick,

Secretary of the Commission

[7] 17 C.F.R. §13.2 (enumerating the process by which the Commission may be petitioned for the issuance, amendment or repeal of a rule).

NFA NATIONAL FUTURES ASSOCIATION

August 18, 2010

Via E-Mail and Overnight Mail

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 4.5

Dear Mr. Stawick:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 4.5, which provides an exclusion from the definition of the term "commodity pool operator" for otherwise regulated persons operating certain qualifying entities.[1] Prior to 2003, persons claiming this exclusion had to file a notice of eligibility pursuant to CFTC Regulation 4.5(c) and represent, in part, that the person will operate the qualifying entity such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for *bona fide* hedging purposes and, with respect to positions held for non-*bona fide* hedging purposes the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

For the reasons set forth below, we request that the CFTC amend Regulation 4.5(c) to restore operating restrictions on registered investment companies that are substantially similar to those in effect prior to 2003. The information required by CFTC Regulation 13.2 follows:

[1] NFA withdrew its June 29, 2010 Petition for Rulemaking to Amend CFTC Regulation 4.5 by separate letter dated August 18, 2010.

I. Text of Proposed Rule Amendments [additions are underlined]

Part 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

4.5 Exclusion from the definition of the term "commodity pool operator."

* * *

(c)

* * *

(2) The notice of eligibility must contain representations that such person will operate the qualifying entity specified therein in a manner such that the qualifying entity:

(i) Will disclose in writing to each participant, whether existing or prospective, that the qualifying entity is operated by a person who has claimed an exclusion from the definition of the term "commodity pool operator" under the Act and, therefore, who is not subject to registration or regulation as a pool operator under the Act; *Provided*, that such disclosure is made in accordance with the requirements of any other federal or state regulatory authority to which the qualifying entity is subject. The qualifying entity may make such disclosure by including the information in any document that its other federal or state regulator requires to be furnished routinely to participants or, if no such document is furnished routinely, the information may be disclosed in any instrument establishing the entity's investment policies and objectives that the other regulator requires to be made available to the entity's participants; and

(ii) Will submit to such special calls as the Commission may make to require the qualifying entity to demonstrate compliance with the provision of this § 4.5(c);

(iii) Furthermore, if the person claiming the exclusion is an investment company registered under the Investment Company Act of 1940, then the notice of

eligibility must also contain representations that such person will operate the qualifying entity as described in § 4.5(b)(1) in a manner such that the qualifying entity:

(a) Will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1); *Provided, however*, That in addition, with respect to positions in commodity futures or commodity option contracts that may be held by a qualifying entity only which do not come within the meaning and intent of § 1.3(z)(1), a qualifying entity may represent that the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; and, *Provided further*, That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such 5 percent;

(b) Will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets;

Provided further, however, That the making of such representations shall not be deemed a substitute for compliance with any criteria applicable to commodity futures or commodity options trading established by any regulator to which such person or qualifying entity is subject.

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. One of NFA's primary purposes is to ensure the protection of customers participating in the commodity futures markets. Recently, NFA has become aware of at least three entities filing for exclusions under Regulation 4.5 with respect to registered investment companies that they operate. These mutual funds are marketed to customers, including retail investors, as commodity futures investments

and are indirectly invested substantially in derivatives and futures products. In fact, although these funds are structured differently than public commodity pools and conduct the futures trading through a subsidiary for tax and mutual fund regulatory purposes, their aim is the same—targeting retail investors with in some cases minimum investment amounts of as little as $1,000 who want exposure to actively managed futures strategies.

Importantly, as noted above, these three funds invest in commodity futures instruments and/or other managed futures trading programs through a wholly-owned and controlled subsidiary. The fund invests up to 25% of its total assets in this subsidiary, and by leveraging assets at a 4 to 1 ratio, a fund is able to achieve a managed futures exposure equal to the full net value of the fund.

NFA is interested in ensuring that registered investment companies that engage in more than a *de minimis* amount of futures trading and that are offered to retail customers or are marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets are subject to the appropriate regulatory requirements and oversight by regulatory bodies with primary expertise in commodity futures. NFA believes that requiring persons that market commodity funds to the retail public and whose funds engage in more than a *de minimis* amount of futures trading or investment to be registered as commodity pool operators ("CPOs") furthers that goal.

III. Supporting Arguments

CFTC Regulation 4.5 currently makes available to eligible persons an exclusion from the definition of CPO with respect to the operation of certain qualifying entities, including registered investment companies, that would otherwise constitute commodity pools but that are already subject to extensive federal and/or state operating requirements. Prior to 2003, eligible persons claiming this exclusion were required to represent that commodity futures and option contracts were used solely for *bona fide* hedging purposes, and that for positions in commodity futures and option contracts that were not used for *bona fide* hedging purposes, the aggregate initial margin and premiums do not exceed 5% of the liquidating value of the qualifying entity's portfolio after taking into account unrealized profits and losses. In addition, eligible persons were

required to represent that the qualifying entity will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets.

In March 2003, the Commission proposed amendments to Regulation 4.5 to eliminate the limitation on non-hedge trading. At the same time, the Commission proposed formally adopting CFTC Regulation 4.13(a)(4) to provide an additional exemption from CPO registration based *solely* on a pool participant's purported sophistication, without any requirement that the pool operator must be subject to another regulatory scheme and without any restriction whatsoever on the purpose and scope of the pool's commodity interest trading. The Commission further stated that "since the eligible persons and qualifying entities of Rule 4.5 are, as stated in the title of the rule, 'otherwise regulated,' the Commission believes that, like the unregulated CPOs for whom it is proposing relief below, these persons and entities may not need to be subject to any commodity interest trading criteria to qualify for relief under Rule 4.5."[2]

At this time, the Commission also stated its view that Regulation 4.5's "no-marketing" restriction should remain in place. The Commission noted that eligible persons should remain prohibited from marketing a qualifying entity as a commodity pool or otherwise as a vehicle to trade commodity interests and indicated that this restriction was necessary because members of the retail public may participate in the trading vehicles subject to a Regulation 4.5 exclusion. The Commission nonetheless requested comment on the merits of maintaining this marketing prohibition.[3]

By letter dated May 1, 2003 to the CFTC, NFA supported maintaining Regulation 4.5's "no marketing" restriction. In particular, NFA stated that "current and proposed Rule 4.5 both provide that the exclusion is not available if the vehicles are marketed as commodity pools. Since Rule 4.5 is an exclusion rather than an exemption, the anti-fraud provisions of Section 4(o) of the CEA do not apply. Investments in these vehicles can be - and often are - sold to unsophisticated customers. While the sale of these investment vehicles is subject to the anti-fraud provisions in other statutes, unsophisticated customers should also have the benefit of Section 4(o) if the investment is marketed as a commodity pool. Therefore, we agree

[2] See 68 Fed. Reg. 12622,12626 (March 17, 2003).

[3] See Id.

that the exclusion should not be available if the vehicles are marketed as commodity pools." NFA felt that with this "no-marketing" restriction in place, it made sense to eliminate the limitation on non-hedge commodity trading due to certain concerns regarding margin levels expressed at that time.

In August 2003, after receiving comments that supported eliminating both the limitation on non-hedge commodity trading and the prohibition on marketing these qualifying entities, the Commission adopted amendments to Regulation 4.5 to eliminate both these provisions. In doing so, the Commission stated that "one commenter agreed with the proposed retention of the 'no marketing' criterion (and with the Commission's rationale therefore) but several commenters disagreed with it. The Commission noted, in part, that these commenters claimed that, in the absence of any trading restriction, the "otherwise regulated nature" of the qualifying entities specified in Regulation 4.5 would provide adequate customer protection.[4]

Over the past several months, at least three entities that previously filed notices for exclusions under Regulation 4.5 with respect to certain registered investment companies launched these mutual funds. These mutual funds are marketed to customers, including retail investors, as commodity futures investments and are indirectly invested via a subsidiary structure substantially in derivatives and futures products. Customers may use an electronic brokerage account to trade one of these mutual funds, which are sold by broker/dealers on internet platforms in which retail investors only need to point and click to either buy or redeem shares in a fund that offers exposure to an actively managed futures product.

NFA staff has reviewed the prospectuses and promotional material prepared for these funds.[5] One fund's prospectus indicates that it pursues its investment strategy by mainly investing in a combination of exchange traded futures

[4] See 68 Fed. Reg. 47221, 47223 (August 8, 2003).

[5] See MutualHedge Frontier Legends Fund—http://mutualhedge.com/default.aspx;
AQR Fund—http://www.aqrfunds.com/
Our_Funds/Individual/FundID_12/Overview/Managed_Futures_Strategy_Fund.fs;and Highbridge Fund—
https://www.jpmorganfunds.com/cm/Satellite?pagename=jpmfVanityWrapper&UserFriendlyURL=fundoverview&cusip=48121A696

and options contracts, forward contracts, swaps, and other over the counter derivatives and fixed income securities, often referred to as a "managed futures strategy."[6]

This fund's promotional material indicates that the fund's inception date was December 31, 2009, and the fund has a minimum investment amount of $2,500 (subsequent investments of $500) and offers two share classes, A and C. Class A has a maximum sales charge of 5.75% and a net expense ratio of 2.20% and Class C has no sales charge but a net expense ratio of 2.95%.[7] The fund's promotional material also states that the fund is "A Pioneering Managed Futures Investment" that is accessible, comprehensive, innovative, and has proven management.[8] The material also specifically notes that the fund has a "lower cost structure than most retail managed futures funds" and is "the first mutual fund to generate managed futures returns through net-long, actively managed CTAs." The fund's assets are traded pursuant to five managed futures trading programs. In particular, the fund's prospectus states that the subsidiary's investment adviser (which is also the fund's adviser) expects to invest the assets of the subsidiary in a manner designed to provide exposure to five global macro programs.

In adopting the 2003 changes to Regulation 4.5, the CFTC eliminated the prior "no-marketing" restriction and did not place any qualification standards on the type of customers who may invest in a qualifying entity. Without these types of operating

[6] A second fund's prospectus states that in order to pursue its investment objective, the fund invests in futures contracts and futures-related instruments including, but not limited to, equity index futures, currency forwards, commodity futures, swaps on commodity futures, fixed income futures, bond futures and swaps on bond futures (collectively, the Instruments) either by investing directly in those Instruments, or indirectly by investing in a subsidiary that invests in those Instruments. The third fund's prospectus states that the fund seeks to achieve its objective by investing in a diversified portfolio of commodity-linked derivatives and fixed income securities. The prospectus additionally states that the fund invests in commodity-linked derivative instruments, such as commodity-linked notes, swap agreements, commodity options, futures and options on futures that provide exposure to the investment returns of the commodities markets without investing directly in physical commodities.

[7] The other two funds also commenced in January 2010 and these also have various share classes with minimum investment amounts ranging from $5,000 to $1 million and $1,000 to $1 million, respectively.

[8] A second fund's Fact Sheet makes similar statements and indicates that "The Fund delivers an active long/short Managed Futures strategy in a mutual fund vehicle." The fund's investment objective states the fund "seeks to generate positive absolute returns."

restrictions, these mutual funds are marketed and sold to customers, including retail investors, who may be unsophisticated in commodity futures investments. NFA believes that any commodity futures investment that is marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading or investing in (or otherwise seeking exposure to) the commodity futures or commodity options markets should be subject to the regulatory requirements and protections contained in the CFTC's Part 4 regulations.

In reviewing these funds' prospectuses, NFA found that the offering material omits substantial disclosures that would otherwise be mandated by Part 4. Among other things, the prospectuses do not include detailed information about the fund's futures commission merchants and potential conflicts of interest, and performance information for the fund (assuming it has three months performance) or other funds operated by the investment adviser. Additionally, to the extent the funds' prospectuses state that the fund and/or subsidiary will invest in other actively managed futures trading programs, the prospectuses provide little information about these managed futures trading programs, these programs' fee structures, and the past performance results of their trading managers.

NFA also has customer protection concerns relating to these mutual funds' use of a wholly-owned and controlled subsidiary to invest in commodity futures transactions on behalf of the fund. NFA understands from reviewing some of these funds' prospectuses that the funds' investment in a subsidiary is intended to provide the funds with exposure to futures and commodities in a manner consistent with the limitations of the federal tax requirements in Sub-chapter M of the IRS Code. Sub-chapter M requires, in part, that at least 90% of a fund's income be derived from securities or derived with respect to its business of investment in securities (i.e., qualifying income). The funds rely upon IRS private letter rulings to other mutual funds, which indicate income from a fund's investment in a subsidiary will constitute qualifying income.

However, while these funds' offering materials indicate that the subsidiaries are subject to certain investment restrictions applicable to the funds themselves, these subsidiaries are neither commodity pools regulated by the CFTC and NFA nor registered investment companies. Additionally, the prospectuses make clear that the subsidiaries are not subject to the Investment Company Act of 1940's customer

protection regime. The vast majority of the regulated funds' holdings appear to be money market instruments to serve as collateral for the subsidiaries' derivatives positions; yet, the subsidiaries' daily operations, including their actual derivatives positions (including the positions' leverage amounts) and fees charged are not entirely transparent.

Given these funds' offerings, NFA proposes the aforementioned amendments to Regulation 4.5 since we believe the premises underlying the Commission's elimination in 2003 of the "no-marketing" and "five-percent trading test" limitations as applied to registered investment companies may no longer be valid. To the extent the Commission used proposed Regulation 4.13(a)(4) as a rationale to eliminate the "five-percent trading test", NFA believes that the Commission should review whether this rationale remains appropriate in light of these actively managed retail futures funds.[9]

NFA believes at this time that Regulation 4.13(a)(4)'s exemption from CPO registration does not support the 2003 elimination of the "five-percent trading test." Specifically, although Regulation 4.13(a)(4) does not contain any restriction on the purpose or scope of a pool's commodity interest trading, we believe a critical distinction between a Regulation 4.5 qualifying entity and a Regulation 4.13(a)(4) pool is the qualifications of the fund participants[10]—Regulation 4.13(a)(4)(ii)(A) requires every natural person pool participant to be a "qualified eligible person" as defined in Commission Regulation 4.7(a)(2). In contrast, Regulation 4.5 has no qualification requirement for customers who may invest in a qualifying entity, including a registered investment company. Moreover, NFA strongly believes that in circumstances in which no qualification requirement exists for fund participants, then NFA and the CFTC should

[9] NFA recognizes that registered investment companies may need to engage in futures transactions for bona fide hedging purposes and believes they should be permitted to engage a *de minimis* amount of speculative futures trading without the necessity to be registered with and regulated by the CFTC.

[10] Another distinction is interests in Regulation 4.13(a)(4) pools are exempt from registration under the Securities Act of 1933 while Regulation 4.5 qualifying entities are operated by otherwise regulated persons. For the reasons explained in this letter, however, NFA believes that to the extent that the Commission's 2003 amendments to Regulation 4.5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid.

have regulatory oversight of collective investment vehicles that engage in more than a *de minimis* amount of futures trading. [11]

Additionally, to the extent that the Commission's 2003 amendments to Regulation 4.5 were, in part, premised on the "otherwise regulated nature" of the qualifying entities, this premise may no longer be valid. As noted above, despite the fact that these registered investment companies are marketed to retail customers as an actively managed futures fund, they are not subject to customer protection rules entirely comparable to the CFTC's Part 4 Regulations and NFA's Compliance Rules. NFA believes that a registered investment company that is marketed, in part, to unsophisticated retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking exposure to) the commodity futures or commodity options markets or that engages in more than a *de minimis* amount of non-hedge futures trading should be subject to the CFTC's Part 4 regulatory requirements and protections, and the oversight of the CFTC and NFA who have the experience and expertise in regulating managed retail futures products. The CFTC alone has the Congressional mandate to regulate retail managed futures trading and products, and over the years has developed the specialized body of skill and knowledge necessary to fulfill this mandate.

Additionally, NFA is deeply concerned that a number of CPOs who currently operate public pools will avail themselves of this alternative registered investment company structure. Given our concern with this registered investment company structure and the lack of adequate retail customer protections in some areas comparable to those afforded prospective investors in a public commodity pool subject to Part 4, NFA does not believe that retail futures customers would be served well if this migration were to occur.

[11] NFA notes that Commission Regulation 4.13(a)(3) provides an exemption from CPO registration, which requires a pool to meet one of two tests with respect to its commodity interest positions, including positions in security futures products, whether entered into for bona fide hedging purposes or otherwise—the aggregate initial margin and premiums required to establish such positions will not exceed 5% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into or the aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into. Moreover, CFTC Regulation 4.13(a)(3)(iii) requires natural person pool participants to at least meet the accredited investor qualification standards.

For these reasons, NFA respectfully requests that the Commission amend Regulation 4.5(c) to require a registered investment company claiming an exclusion from the definition of the term "commodity pool operator" to represent in the notice of eligibility that the qualifying entity (i.e. registered investment company) will be operated such that it (1) will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets; and (2) will use commodity futures or commodity options contracts solely for bona fide hedging purposes and, with respect to positions that may be held by the qualifying entity only for non-bona fide hedging purposes the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into.

Lastly, NFA recognizes that, if adopted, the proposed amendments to Regulation 4.5 will impose the same operating restrictions on registered investment companies that were in place prior to 2003. Obviously, since 2003, a number of persons have filed notices of eligibility pursuant to Regulation 4.5(c) on behalf of registered investment companies, and those entities may no longer be eligible for exclusion from CPO registration in the future if the proposed amendments are adopted. Therefore, NFA encourages the Commission to provide adequate time for these registered investment companies to comply with the Commission's applicable regulations or seek the appropriate relief therefrom.

Additionally, to the extent that the Commission has granted operational relief from certain Part 4 Regulations (e.g. disclosure document and reporting and recordkeeping) to exchange traded funds—that are commodity pools organized as Delaware statutory trusts—NFA encourages the CFTC to determine whether it is appropriate to grant similar and/or other relief to public commodity pools and listed pools that may want to continue operating as registered investment companies. If the Commission desires, NFA is willing to participate in discussions in the future with Commission staff to achieve this result, which may necessitate harmonizing CFTC and SEC regulatory requirements.

NFA respectfully petitions the Commission to amend Regulations 4.5 as described above.

Very truly yours,

Thomas W. Sexton, III
Senior Vice President
and General Counsel

cc: Via Email:
Honorable Gary Gensler, CFTC Chairman
Honorable Michael Dunn, CFTC Commissioner
Honorable Scott O'Malia, CFTC Commissioner
Honorable Jill E. Sommers, CFTC Commissioner
Honorable Bart Chilton, CFTC Commissioner
Mr. Ananda Radhakrishnan, CFTC Director
Mr. William Penner, CFTC Deputy Director

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Office of the
Secretariat

Diana L. Preston
Vice President and Senior Counsel
Center for Securities, Trust & Investments
202-663-5253
dpreston@aba.com

LEG 5/36

August 24, 2012

SUBMITTED ELECTRONICALLY

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Ms. Elizabeth M. Murphy
Secretary
Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Petition for Rulemaking on the Definition of Eligible Contract Participant in Commodity Exchange Act Section 1a(18), Interpretive Letter, Exemptive Relief, or Other Guidance

Dear Mr. Stawick and Ms. Murphy,

The American Bankers Association (ABA)[1] is requesting rulemaking, an interpretive letter, exemptive relief, or other guidance from the Commodity Futures Trading Commission (CFTC) and the Securities Exchange Commission (SEC) (together, the Commissions) on the eligible contract participant (ECP) definition in Commodity Exchange Act Section 1a(18), which is incorporated by reference in Securities Exchange Act Section 3(a)(65). This definition is a key component of the new regulatory framework for the swaps markets. As a result of the Dodd-Frank act, only ECPs will be able to enter into over-the-counter (OTC) swaps.

While the definition of final swap dealer and security-based swap dealer (together, swap dealer) definition rule provided some clarity on the ECP definition, it left some significant issues unaddressed. The Commissions listed some of the issues related to the ECP definition that they may consider in the future.[2] We urge the Commissions to act expeditiously to ensure the transition to the new regulatory regime does not unduly disrupt the lending markets.[3]

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees. Learn more at www.aba.com.

[2] See footnote 596 of the Entity Definitions Rule at 77 Fed. Reg. at 30647. These issues include: (i) the ECP status of jointly and severally liable borrowers and counterparties, non-ECPs guaranteed by ECPs, and non-ECP swap collateral providers; (ii) whether bond proceeds count toward the "owns and invests on a discretionary basis $50,000,000 or more in investments" element of the governmental ECP prong; (iii) the relationship between the ECP and eligible commercial entity definitions for purposes of CEA section 1a(18)(A)(vii); (iv) the scope of the "proprietorship" element of the entity prong of the ECP definition in CEA section 1a(18)(A)(v); (v) the meaning of the new "amounts invested on a discretionary basis" element of the individual prong of the ECP definition; (vi) whether persons can be ECPs in anticipation of receiving, but before they have, the necessary assets; and (vii) that

Given the unprecedented depth and breadth of rulemaking required to establish an entirely new framework for regulating the swaps markets, the need for additional rulemaking, exemptive relief, or interpretive guidance is not surprising. However, absent clarity on some threshold issues, banks will be unnecessarily discouraged from offering swaps to customers if it is unclear whether those customers will qualify as ECPs. In many cases, this will limit the availability of credit to borrowers looking to finance their business operations.

It often takes months to negotiate and close a loan, so loan officers are already lacking key guidance on the ECP definition that they need to ensure potential customers can continue using swaps to hedge and mitigate loan risk. In the absence of guidance, the uncertainty is already causing some banks to reconsider whether borrowers with limited cash flows will have the ability, without swaps, to service debt should interest rates rise in the future. The result will be decreased lending – especially to individuals and small and medium-sized businesses – at a time when our country needs access to credit to ensure sustained economic recovery, as well as decreased economic efficiency.

I. Background

Section 2(e) of the Commodity Exchange Act (CEA) and Section 6(l) of the Securities Exchange Act of 1934 will make it illegal to enter into a swap with anyone other than an ECP unless it is done on or subject to the rules of a designated contract market. As a result, it will be illegal to enter into over-the-counter (OTC) swap transactions with a non-ECP after the swap definition implementation date on October 12, 2012.

This deadline is rapidly approaching. Many swaps will still be OTC transactions after that date because they are exempt from clearing or they are customized, so banks and their customers all need guidance about which individuals or entities will be ECPs. Furthermore, the uncertainty is already having an impact on loan negotiations, since many of the loans currently being negotiated will not close until after the implementation date.

If banks and their customers do not have sufficient guidance about which parties are ECPs, then loan officers remain uncertain whether many of their borrowers will be able to use swaps to hedge commercial risks and protect cash flows needed to repay their loans. As a result, they will not have information about the most central components of loan underwriting, the ability to repay. This will not just affect the banks' ability to offer swaps to those customers. It will also affect the banks' ability to lend to those customers because of the impact on the customers' ability to repay the loan and the banks' ability to manage associated risks.

The CFTC did provide assurance that it would not bring enforcement action so long as a party entering into a swap follows "reasonably designed policies and procedures to verify the ECP status

swap dealers are not among the entities listed in CEA section 2(c)(2)(B)(i)(II) as acceptable counterparties to non-ECPs engaging in retail forex transactions.

[3] See Final Order, 76 Fed. Reg. 42508, 42509 (July 19, 2011).

of a swap counterparty."[4] However, the CFTC did not provide any additional clarity about the ECP definition or what might be appropriate verification procedures, especially in the context of lending to borrowers where there are multiple obligors. The SEC has not provided any similar assurances about potential enforcement action or any other relief. In the meantime, banks and their customers are left wondering whether they can engage in certain swap transactions or, if they do, whether the swaps will be subject to rescission and possibly a private right of action in the event that the Commissions later define ECP in a way that does not include certain counterparties. This is having a chilling effect on banks, especially those who lend to medium and small businesses that are so critical to restoring the economic health of our economy.

Accordingly, we urge the Commissions to act expeditiously to issue an interim final rule,[5] provide an interpretive letter,[6] or publish additional guidance on the issues raised in this letter. Alternatively, the CFTC could reconsider the decision not to extend the effective date for Section 2(e) and the SEC could grant exemptive relief until the Commissions have had sufficient time to give these issues further consideration.[7] If none of these is possible or there are other options that will proceed more quickly, then we ask the Commissions to grant alternative relief.

We ask the Commissions to provide guidance throughout this letter because we assume it will be the swiftest course of action. Pursuant to Dodd-Frank Act Sections 712(d)(1), (2), and (4), it appears that the Commissions need to act jointly, after consultation with the Board of Governors, to issue any rule, interpretation, or guidance regarding the ECP definition. While we understand that joint action presents additional challenges, it is imperative that these issues be resolved expeditiously. Accordingly, ABA urges the Commissions to pursue any appropriate alternatives that provide clarity and legal certainty as soon as possible to ensure that the normal course of lending is not disrupted.

II. Discussion

A. Amounts Invested on a Discretionary Basis

Absent certainty as to which assets will qualify as amounts invested on a discretionary basis in order to qualify as an ECP, banks and their customers who are individuals will be unable to determine whether their swaps are legally enforceable. As a result, banks and their individual customers will be less likely to use swaps to hedge and mitigate risk. Banks may also be reluctant to lend or will do so on less advantageous terms that may leave borrowers with few or no options for the long-term, fixed rate, or flexible loans they need to run their businesses.

[4] Second Amendment to July 14, 2011 Order for Swap Regulation, 77 Fed. Reg. 41260, 41263 (July 13, 2012) (hereinafter Second Amendment).

[5] The Commissions have rulemaking authority pursuant to Section 13.2 of the Public Rulemaking Procedures of the Commodity Exchange Act and Section 192(a) of the Securities and Exchange Commission Rules of Practice.

[6] See Commodity Exchange Act Regulation 140.99 and Securities Act Release No. 6269.

[7] See ABA Comment Letter on Effective Date Amendments: Second Amendment to July 14, 2011, Order for Swap Regulation, dated May 30, 2012 and Second Amendment at 41263.

1. Individuals

Individuals will be required to have "amounts invested on a discretionary basis" in excess of $5 million, but do not have guidance about what qualifies as an investment or what "discretionary basis" means. The CFTC has stated that it will not be treating personal property as "assets invested on a discretionary basis." [8] However, the CFTC has not yet clarified what would be considered personal property.

Many individuals have a wide range of assets used to invest for retirement, run a business, or otherwise provide an income or appreciate in value for an investment return. For example, they may own commercial or residential rental real estate or own shares in privately-held businesses. They may have bank deposits, brokerage accounts, money market or mutual fund accounts, or collective investment funds that pool trust account assets. Individuals may also have investments in a wide range of retirement accounts, such as individual retirement accounts (IRAs), Keogh plans for self-employed individuals or unincorporated businesses, or 401(k) plan accounts. They may also have money invested in life insurance policies.

We encourage the Commissions to clarify the definition of investments and what constitutes personal property. The definition of investments at a minimum should include securities and the following if they are held for investment purposes: real estate, commodity interests, physical commodities, financial contracts that are not securities, and cash and cash equivalents (including foreign currencies). Cash and cash equivalents should include bank deposits, certificates of deposit, bankers acceptances and similar bank instruments, and the net cash surrender value of an insurance policy. In addition, the following should be deemed to be held for investment purposes if they are held in connection with the following businesses: (i) real estate if it is owned by an individual who is in the business of investing, trading, or developing real estate; and (ii) commodity interests or physical commodities owned or financial contracts entered into by an individual engaged in the business of investing, reinvesting, or trading them.

2. Joint Investments

Banks also need guidance on how to treat spouses with a joint investment account. For example, if spouses are co-borrowers and are executing the swap to hedge their bank loan, is it sufficient if their joint investment account has more than $5 million? Or does there have to be $10 million in the account because there are two borrowers? The situation would be complicated further if there were a prenuptial agreement providing that the couple's property or investments would go disproportionately to one spouse or the other in the event of divorce. Or the couple might be domiciled in a community property state and one spouse might want to enter into the swap by himself or herself in reliance on a joint account with over $5 million but less than $10 million in investments.

These are real life scenarios and ABA urges the Commissions to provide investors and financial institutions with legal certainty about how to address them so that individuals can continue to enter

[8] Second Amendment at 41263.

into swaps. We encourage the CFTC and SEC to adopt a simple and easily administrable rule that allows spouses to include the following in determining ECP status:

- If an individual is entering into a swap, he or she can include investments in his or her own name and those in which the individual has a joint, community property, or other similar ownership interest; and

- If both spouses are jointly entering into a swap, they can each include investments in their own name, those in their spouse's name, and those in which they have a joint, community property, or other similar ownership interest.

B. Sole Proprietorships

The ECP definition applies asset and net worth tests to proprietorships rather than the "amounts invested on a discretionary basis" test applicable to individuals. The plain reading of the statutory provision would include sole proprietorships. However, ABA is seeking confirmation that it encompasses sole proprietorships, because they typically are not separate legal entities.

Many sole proprietorships have illiquid assets like land, buildings, livestock, or crops and should qualify as ECPs under the asset or net worth test applicable to proprietorships. This issue is particularly important for agricultural borrowers. Since many Midwestern states prohibit corporations, limited liability companies and other corporate enterprises from owning farms, they would suffer disproportionate adverse impact if they have to meet the investments test.

In order to clarify that individual proprietorships may qualify as ECPs using the asset or net worth test, ABA urges the Commissions to allow banks to rely on representations of individual proprietorships that they are doing business as a proprietorship in a state in which individuals may operate a business as a proprietorship, regardless of whether organizational documents are required in that state. Otherwise, sole proprietorships operating in states that do not require separate legal existence will be at a significant disadvantage.

C. Purchase Money Loans, Construction Loans, and Other Asset Financing

ABA also requests that the Commissions provide guidance on the ECP status of borrowers entering into purchase money loans, construction loans, and other asset financing. In the absence of such guidance, the banks and borrowers in these types of loans may not be able to enter into swaps to hedge risk and would be exposed to rising interest rates. Since banks may be unwilling to lend unless borrowers can hedge their interest rate risk, the viability of many commercial real estate acquisitions and construction projects might be at risk.

For example, banks regularly make loans to acquire commercial real estate properties, but the borrowers in these purchase money loans may be unable to qualify as ECPs until after the loan closes and title to the property has passed. Since income from the property to service the debt will be limited, a bank may require the borrower to hedge the loan's interest expense to avoid a default on its debt service if interest rates rise.

Banks also make construction loans that are funded incrementally as construction progresses and payments are made to cover construction costs. Borrowers may need to hedge against rising interest rates as part of the terms of the loan commitment but may not be able to qualify as ECPs until well after the loan closes. In other words, while the completed project may be an asset that exceeds $10 million, these borrowers may be unable to qualify as ECPs under the asset test until the project is completed. These borrowers likely will not be able to hedge using a swap during at least part of the construction phase unless they can qualify using the net worth test, and they are often unable to do so since they are typically single asset entities.

Not only is this an issue for commercial real estate lending – it also affects financing projects subsidized by the Federal government through tax credits for affordable housing and community development.[9]

ABA requests that the CFTC and SEC provide guidance to ensure that borrowers and banks are not exposed to the risks of interest rate increases between the date a commitment is issued for a purchase money loan, construction loan, or other financing of assets and the date the borrower qualifies as an ECP. This is especially important since increases could threaten the viability of the project and a bank's willingness to commit to these facilities. Any borrower should qualify as an ECP by virtue of a financing commitment issued by a financial institution or any of its affiliates if the proceeds of the financing are to be used to acquire or construct assets that can reasonably be expected to have a fair market value in excess of $10 million and the swap is for hedging or mitigating the commercial risk of that financing.

D. Multiple Obligors

The ECP definition contemplates a simple counterparty relationship between two parties. Frequently the lending or credit relationship is more complex between banks and their customers seeking to use swaps to hedge their interest rate, currency, commodity, or other exposures to commercial risk. Banks assess risk and underwrite loans and swaps based on an overall credit relationship with a customer or customers, and the swap exposure is almost always much smaller than the loan exposure.

ABA urges the Commissions to provide clarity about how the new law will apply in the context of these relationships, including loans or extensions of credit that are made by related parties that are jointly and severally liable or are secured by collateral owned jointly by the parties.

[9] For example, the Low Income Housing Tax Credit (LIHTC) program provides tax credits to increase the supply of affordable housing in communities across America and accounts for the majority of all affordable housing development in the United States today. Due to the limited initial equity investment, low asset value during construction, and high loan-to-value financing needed, one party has estimated that 10-15% of LIHTC projects undertaken in 2010 would not have been able to use swaps to hedge during the initial construction phase except for the fact that the swaps qualified under the CFTC's "line of business" test that has been replaced by the ECP definition. Similarly, the New Market Tax Credit (NMTC) program provides tax credit incentives to investors in certified Community Development Entities that invest in low income communities. By one estimate, approximately fifty percent of NMTC deals would not have qualified as ECPs in 2010 absent further CFTC guidance on construction loans.

1. Related Obligors

Borrowers seek to manage loan risk by entering into swaps based on the strength of the same obligors and assets that support the underlying loan or credit. For example, borrowers may include a parent company, its subsidiaries or other affiliates, or associated persons in the case of a partnership. If non-ECP obligors must be excluded, or if their obligations for swaps as co-counterparty, co-owner of collateral or guarantor are potentially unenforceable, this could discourage banks from financing these businesses or offering them swaps to manage their loan exposure. We don't believe Congress meant to interfere with these types of financing, particularly in view of the favorable treatment of swaps entered into in connection with the origination of loans.

In order to ensure that related obligors can continue to hedge their loan risk, they should be able to aggregate their investments, net worth, and assets for purposes of determining their ECP status. There is precedent for this type of treatment – Rule 2a51-1(g)(3) under the Investment Company Act of 1940 permits a parent company and majority-owned subsidiaries to aggregate investments for purposes of determining whether they meet the definition of a qualified purchaser. Aggregate attribution should apply not only to investments, but also to net worth and assets.

Alternatively, if one of the related obligors in a transaction is an ECP, the remaining related obligors should be treated as ECPs for purposes of the transaction and related security arrangements.

2. Multiple Guarantors

Another common credit arrangement involving multiple obligors is a loan and swap with an ECP limited liability company (LLC) that is guaranteed by the LLC owners, who may not all be ECPs. In fact, it is standard bank underwriting practice to require LLC, "S" corporation, and limited liability partnership owners to guarantee the loan and the related swap. This ensures that the owners' interests are aligned and that the owners are responsible for all or their pro rata portion of the debt in the event of default.

In these types of transactions, having a single ECP as an obligor should be sufficient to satisfy the ECP definition. If the LLC is an ECP, then it should be immaterial whether all of the owners may or may not be guarantors or ECPs. In addition, it would be particularly problematic if the owners have to qualify as ECPs under the individual prong of the ECP definition. Congress did not intend to interfere with these ordinary course lending arrangements.

Since the price and other economic terms of a swap take into account all aspects of the credit arrangement, any additional guarantees from ECPs or non-ECPs would benefit the borrower and increase the willingness of banks to lend. Accordingly, if one of the obligors in the transaction is an ECP, whether acting as counterparty or guarantor, then the remaining obligors should be treated as ECPs for purposes of the transaction and related security arrangements.

III. Procedures for Verifying ECP Status

Banks and their customers also need guidance on these threshold issues in order to verify their counterparty's ECP status. The CFTC has stated that it will not bring enforcement action against swap counterparties that make "good faith efforts" to comply by implementing and following reasonable policies and procedures to verify a counterparty's ECP status.[10] ABA asks the Commissions to confirm that receipt of a written representation from the individual or entity that it meets the requisite asset, net worth, or investment test of the ECP definition would be sufficient to establish a reasonable basis of compliance.

The new business conduct rules for swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants would allow them to rely on a customer representation that specifies the provision under which the customer is qualifying as an ECP. If those entities comply with the ECP verification requirements in the new business conduct rules, they should be afforded legal certainty with respect to each transaction. In addition, any other bank that adopts and implements similar policies and procedures appropriate for the size and composition of its swaps portfolio should be able to rely on a comparable customer representation.

Furthermore, the determination as to whether or not an individual or entity meets the ECP definition should be made at the time the party enters into a swap. Market participants have long entered into transactions with persons they believe in good faith to be ECPs, or "eligible swap participants (ESPs) under Part 35 of the CFTC's rules, based on information available to them or on representations provided to them by their counterparties. Thus, when the CFTC adopted Part 35 in 1993, it stated that "it is sufficient that the parties have a reasonable basis to believe that the other party is an eligible swap participant at such time [of entering into the transaction]. . . . An eligible swap participant that has a reasonable basis to believe that its counterparty is also an eligible swap participant when it enters into a master agreement may rely on such representation continuing, absent information to the contrary."[11]

So this approach is consistent with how the swap transaction eligibility has been applied and interpreted previously. An individual or couple that qualifies as an ECP at the time of the swap transaction would not have to requalify or terminate the swap in the event of a change in circumstances such as divorce. Nor would a corporation with $10 million in assets that later loses $1 million in value face uncertainty about its continued ability to hedge its business risks. Absent actual notice of facts that would reasonably put a bank on notice that a counterparty no longer meets the ECP definition, a bank should also be entitled to rely on a representation in a master agreement that is deemed repeated at the time of each related transaction. Any alternative for determining eligibility is untenable, since not only would it would require constant monitoring but it would also expose swap counterparties to unnecessary uncertainty in swaps transactions.

Conclusion

ABA appreciates the Commissions' consideration of our request for rulemaking, interpretive relief, an exemptive letter, or additional guidance on the ECP definition. For the reasons cited above, we strongly urge the Commission to provide relief expeditiously so that loan officers will have the information that they need to continue underwriting loans and there is no undue disruption in lending. Banks cannot move forward to implement the new swaps regulations in October absent

[10] Second Amendment at 41263.

[11] Exemption for Certain Swap Agreements, 58 Fed. Reg. 5587, 5589 (Jan. 22, 1993).

this guidance, and the consequences are severe since it will be illegal to engage in OTC swaps with non-ECPs. The uncertainty is already beginning to have an impact as loan officers consider commitments that may close on or after the October effective date.

If you have any questions or need additional information, please feel free to contact the undersigned at 202-662-5253.

Sincerely,

Diana L. Preston

Diana L. Preston
Vice President and Senior Counsel
Center for Securities, Trust & Investments
American Bankers Association

cc:

Commodity Futures Trading Commission
The Honorable Gary Gensler
The Honorable Jill E. Sommers
The Honorable Bart Chilton
The Honorable Scott O'Malia
The Honorable Mark P. Wetjen
Dan Berkovitz, General Counsel
Eric Juzenas, Senior Counsel to the Chairman
David Aron, Counsel, Office of General Counsel

Securities Exchange Commission
The Honorable Mary L. Schapiro
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
The Honorable Daniel Gallagher
Robert W. Cook, Director, Division of Trading and Markets
Joshua Kans, Senior Special Counsel, Division of Trading and Markets

Board of Governors of the Federal Reserve System
Ms. Jennifer J. Johnson, Secretary

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Office of the
Secretariat

LEG 5/36

September 17, 2012

Via Electronic Submission

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Amendment of CFTC Rules 3.10 and 1.3(ggg)(4)

Dear Mr. Stawick:

The Commodity Markets Council ("CMC") submits this petition pursuant to Rule 13.2 of the Commodity Futures Trading Commission ("CFTC" or "Commission") to amend CFTC Rules 3.10 and 1.3(ggg)(4). See 17 C.F.R. §§ 3.10 and 1.3(ggg)(4). CMC presents this petition on behalf of a group of non-bank, commercial participants, each of whom operates in the physical and financial commodities markets and each of whom faces the prospect of potentially having to register its business or a portion of its business as a swap dealer.

Rule 3.10, read in connection with Rule 1.3(ggg)(4), requires each person who is a swap dealer (or major swap participant) to register with the National Futures Association ("NFA") as early as December 31, 2012 based upon the aggregate gross notional amount of the person's swap dealing activities counted from October 12, 2012 going forward. CMC requests that the Commission delay this registration requirement for non-bank swap dealers -- and specifically the date from which participants must begin to calculate the aggregate gross notional amount of their swap dealing activities -- until the Commission completes all of the rules required to be promulgated under Section 4s of the Commodity Exchange Act ("CEA") ("Section 4s Implementing Regulations") and those rules become effective.

In light of the enormity of the undertaking to register, the Commission is to be commended for clarifying that the above referenced rules allow for an extended timeframe to register.[1] However, the fundamental problem which currently impedes the registration process – namely the lack of sufficient detail about the contours of being a registrant for participants to make an informed decision about whether to continue the business of swap dealing – remains. This is particularly true where the effective date for counting the aggregate gross notional amount of the swap dealing activities that underpin the swap dealer registration mandate remains October 12, 2012.[2] Given this fact, it is still this date by which participants must decide whether

[1] See CFTC Release: PR6348-12 (Sept. 10, 2012).

[2] Further, the Commission has given little guidance to market participants about how the gross notional amount of their swap dealing activity should be calculated, which only increases the regulatory uncertainty companies face when determining their status as swap dealers.

to continue those activities which the Commission may ultimately deem to be swap dealing. It is for this reason that CMC submits this petition.

The Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank Act") will, for the first time, require a number of commercial market participants, who previously were not subject to regulation by the CFTC, to register either as swap dealers ("SD"). Unlike the financial institutions, many of whom already operate as registered entities under the CEA and are therefore familiar with the costs and associated burdens, commercial entities are not as prepared to be regulated in a "bank-like" CFTC regulated environment; they do not have nearly as much of the infrastructure already in place to meet the anticipated regulatory requirements; and they are not capitalized in the same way as a traditional financial intermediary. In fact there are no current regulatory capital requirements that apply to commercial entities. Yet, under the registration rule implemented by the CFTC, participants that meet the criteria for designation as an SD must register with the NFA in an accelerated fashion. More importantly, they must begin counting activity at an even earlier date, and at a point in time that will precede the CFTC's completion of several rules which are integral to the operation of SDs. The most notable of these is the capital requirements, which will define a significant portion of the cost of engaging in such businesses.

The commercial participants on whose behalf CMC files this petition do not seek the requested delay to avoid registration or to postpone the "inevitable." Rather, they seek to extend the registration requirement because, depending on the costs associated with operating as a regulated entity, which remain uncertain, they may simply choose to exit certain businesses in swaps. This would be an unfortunate outcome given that it will further concentrate participation in the swaps markets in the very institutions that Congress perceived to be the cause of the financial crisis in 2008. It is nevertheless a very real possibility, given the preview the Commission has provided through previously finalized swap dealer regulatory requirements of the substantial costs of operating as a swap dealer.

Another important area of necessary relief relates to the date from which participants must begin to calculate the aggregate gross notional amount of their swap dealing activities. This is one of the costliest and high-risk compliance obligations beginning October 12, 2012 and it will apply even to those companies that are unlikely to register as Swap Dealers. The greatest risk is due to the $25 million *de minimis* threshold for activities involving "Special Entities," which include electric municipalities, thus leaving no room for error for commercial firms. The Commission has received petitions to amend, adjust or otherwise provide clarifying guidance relating to the scope of the special entity *de minimis* level, but has not responded to date. Adding to the compliance risk and uncertainty is the fact that the CFTC, despite industry requests, also has not provided clarifying guidance on the appropriate method to calculate notional value for *de minimis* purposes. In order to address the significant compliance risk presented by the *de minimis* calculation commencement in less than 30 days, commercial energy firms of all size and shape, end users and potential dealers alike, are being forced to materially alter business practices and make significant expenditures to establish compliance protocols to track de *minimis*. This impacts not only companies themselves, it also impacts their counterparties, in particular special entity counterparties, and in turn the broader marketplace. Absent clarity on these outstanding issues, it is appropriate that the Commission delay the application of the *de minimis* calculation.

I. Description of the Registration Rule

CFTC Rule 3.10, in conjunction with Rule 1.3(ggg)(4), outlines the time by which a person must register as a swap dealer and the criteria for registration. See 17 C.F.R. §§ 3.10 and 1.3(ggg)(4). "By no later than the latest effective date of the Swap Definitional Regulations, each person who is a swap dealer on that date must apply to be registered as a swap dealer or major swap participant, as the case may be." Id. §3.10(a)(v)(C)(2). As a condition of registration, each applicant must provide such documentation "as may be required to demonstrate compliance with each Section 4s Implementing Regulation, as defined in §3.1(f), as applicable to them . . . ." Id. at § 3.10(a)(v)(A).

In the final registration rule, the Commission acknowledged the likelihood that all of the Section 4s Implementing Regulations would not be completed by the time participants are required to register. See 77 Fed. Reg. 2613, 2616 (Jan. 19, 2012). However, rather than delay registration until those regulations are completed, the Commission instructed that registrants would be required to demonstrate compliance with those regulations as they became finalized. Id. at 2617.[3] Among the rules that remain unfinished and that will not be finalized when registration commences are the capital requirements for non-bank swap dealers and major swap participants. See 76 Fed. Reg. 27801 (May 12, 2011).

In addition to defining the timing and criteria for registration of swap dealers, the Commission outlined the scope of the designation as a swap dealer. In the final rule further defining "swap dealer", the Commission stated, "the final rule retains the standard that a person that satisfies the 'swap dealer' . . . definition in general would be considered a dealer for all types, classes or categories of the person's swaps . . . , or all activities involving swaps . . . ." 77 Fed. Reg. 30596, 30645 (May 23, 2012). Contemporaneously with the application for registration as a swap dealer, a person may submit an application to the Commission for a limited purpose designation. Id. However, pending the Commission's consideration of the application – a process for which there is no time period within which the Commission must consider, and rule upon, the application – the regulatory requirements applicable to swap dealers apply to all of the registrant's swap activities. Thus, although a participant may conclude that only a portion of its business constitutes swap dealing, all of its swaps will be subject to the Section 4s Implementing Regulations upon registration. Additionally, under the final swap dealer registration rule, an entity that registers as a swap dealer must remain registered and subject to all applicable regulations for twelve months from the date on which they register, further complicating the decision to register without all relevant costs known.

[3] The CFTC has extended the dates by which swap dealers and major swap participants will be required to comply with certain of the 4s Implementing Regulations. See "Exemptive Order Regarding Compliance with Certain Swap Regulations," 77 Fed. Reg. 41110 (July 12, 2012); "Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants," 77 Fed. Reg. 55904 (Sept. 11, 2012).

For example, a commercial agricultural firm may be a swap dealer due to some of its business activity in the agricultural markets; however, it will be an end-user for other hedging activities such as interest rate and Fx exposures, as well as managing the risk of its primary business as a merchant in agricultural commodities which it will desire to hedge. Requiring a commercial agricultural firm to follow swap dealer rules for non-dealing activities will impose unnecessary costs on the business, many of which will be passed on to their customers. This will take capital and resources that can be put to productive uses away from them and others in the economy.

II. The Registration Rule, as Drafted, is Inefficient and Unnecessarily Burdensome to Commercial Participants.

By establishing a registration process that commences prior to the Commission's completion of the Section 4s Implementing Regulations, the CFTC will force non-bank commercial participants to decide whether to register as swap dealers without fulsome information about the costs associated with such a designation. This outcome is inefficient, unnecessary, and unfairly burdensome to market participants.

A. The Decision of whether to Engage in the Business of Swap Dealing Depends Heavily on the Cost to Perform Such a Business.

A significant number of commercial participants, including those on whose behalf CMC submits this petition, currently do not conduct their swaps activities through regulated entities within the United States. Therefore, the costs of doing this business are largely a function of the demands of the markets in which they operate (e.g., exchanges versus over-the-counter markets) and the counterparties with whom they transact. Competition acts as a natural check on costs. Moreover, participants can choose in which markets they do business and with which counterparties they transact. However, going forward the costs of doing business as a swap dealer will not be disciplined by this competitive process. Rather, as Congress made clear, these costs will be tied more closely to the risks that dealing activities pose to the overall financial markets. These costs will be significant no matter how the CFTC ultimately measures them.[4] And, if the Commission's proposed rule on capital requirements ("Proposed Capital Rule") is an accurate barometer of the final rule, the costs may be substantial enough to drive certain commercial participants out of the swaps market, at least with respect to potential "dealing" activities.

Notwithstanding this fact, under the CFTC's current registration rule, participants who engage in swap dealing activities above the *de minimis* level after October 12, 2012 will be required to register with the NFA as swap dealers and to subject all of their swaps activities to

[4] NERA Economic Consulting performed a study on the costs associated with the CFTC's proposed rules for the regulation of swap dealers. In that study, NERA found that commercial energy firms will experience total direct costs of $62 million per firm plus $10 million of one-time implementation costs. Costs imposed under the Commission's proposed rule on capital were estimated to be $36 million per year for a stand-alone firm. See NERA Study, Cost-Benefit Analysis of the CFTC's Proposed Swap Dealer Definition Prepared for the Working Group of Commercial Energy Firms, filed with the CFTC on December 20, 2011.

the Section 4s Implementing Regulations *before* the Commission has defined at least the capital requirements of a swap dealer. This is not unlike a real estate agent insisting that a potential homeowner buy a house with the assurance that the agent will tell the buyer the purchase price at a later point in time – not a deal to which many rational buyers would willingly sign on.

Some within the Commission and CFTC staff may respond that this concern is exaggerated and that the Proposed Capital Rule provides an adequate roadmap for the anticipated capital requirements. However, relying on the Proposed Capital Rule in this way would ignore two important facts: *first*, the Commission's view about the swaps activities to be regulated has evolved since it issued the Proposed Capital Rule. See, e.g., final rule further defining swap dealers and major swap participants, which incorporates a trader/dealer distinction.[5] To the extent that the Commission incorporates such learning into the final capital rule -- for example by narrowing the scope of swap transactions that are included in the credit and market risk calculations -- this will likely have a meaningful impact on the scope of the capital requirements going forward. *Second*, through the comment process, participants have identified a number of potential limitations in the Proposed Capital Rule. As but one example, participants in the power markets pointed out that linking the market risk calculation to "spot" prices may overstate risk on a day-to-day basis because spot prices in the physical power markets from hour to hour tend to be volatile when compared with long term prices. To the extent that the Commission addresses these issues, these revisions should similarly have a meaningful impact on the capital requirements.

B. The Commission's Proposal to Exclude Parental Guarantees from the Capital Requirements Calculation Creates Further Uncertainty about the Feasibility of Performing as a Swap Dealer.

It is difficult enough for commercial participants to gauge the potential costs of being a swap dealer in the absence of a final capital rule. This decision is made even more complex by the fact that the Commission proposes to exclude from the capital calculation a primary means by which commercial participants capitalize their operations – namely, parent guarantees.

Under the Proposed Capital Rule, a non-bank swap dealer would not be permitted to consolidate in a single tangible net equity computation the assets and liabilities of a parent corporation even if the parent corporation and the swap dealer have consolidated financial statements and the parent corporation has expressly and unconditionally guaranteed the swap dealer's liabilities. See 76 Fed. Reg. at 27828. CFTC staff have explained that the proposed

[5] In the Proposed Capital Rule, a swap dealer's capital requirements are based on a credit risk and market risk calculation. These risks are based on a participant's swap transactions "that are part of the SD's swap activities." See 76 Fed. Reg. 27802, 27806 (May 12, 2011). Swap activities include swap "dealing" transactions. Id. at n. 23. Swaps entered into "to mitigate risk associated with [] commercial operations," however, are excluded from the market risk calculation. Id. Given that the Proposed Capital Rule preceded the CFTC's final rule further defining swap dealer, there is no mention of the impact, if any, of swaps executed for purposes of "trading."

exclusion derives from a perceived lack of authority over, or access to information residing in, the issuing parent company.[6]

In an effort to address these issues, various participants have engaged with the Commission and CFTC staff to resolve these concerns. Among other suggestions, participants have proposed the implementation of appropriate disclosure requirements on the guarantor and the grant of authority to the Commission to audit the guarantor, thereby allowing the CFTC to "look through" the swap dealer to monitor and analyze the guarantor's financial condition.[7] Both the Commission and CFTC staff appear amendable to trying to find a workable solution to this problem. Discussions, however, are ongoing and it remains unclear whether, and if so when, the Commission will decide to include parent guarantees in the capital calculation.

Parent guarantees are an integral part of the current capitalization of commercial participants. Given their importance and the anticipated impact their inclusion (or exclusion) from the capital calculation will have on participants' decisions whether to engage in the business of swap dealing, the Commission should allow sufficient time to reconsider this important issue.

C. Forcing Participants to Register before Completion of the Section 4s Implementing Regulations will Result in Significant Sunk Costs.

Since the Commission issued the final rule further defining swap dealers and major swap participants in May of this year, commercial entities have devoted significant time and resources in trying to determine whether they fit within (or outside) the regulatory designation. This is not unexpected, given that the Commission chose to avoid a bright line test to determine, for example, who is and who is not a swap dealer, or what activity is and what activity is not swap dealing. Instead, the Commission constructed a facts and circumstances test to determine which transactions an entity enters into will be considered swap dealing in nature, which the Commission understood would require extensive analysis by market participants and interpretive guidance by the Commission:

> COMMISSIONER O'MALIA: Let me say that that is part of my rub on this [final entity definitions] rule and frustration. It isn't very clear. It is going to be facts and circumstances and there's going to be a lot of instances where people are confused. What will be the process if people are confused? How will they appeal to the Commission for certainty? Do we have a process, a standards and exemptive process that we're considering? Are you guys going to set up a hotline?
>
> MR. BERKOVITZ: We've had a process for a number of the rules, for example, the Office of General Counsel or the other appropriate divisions depending on the particular rule. We're available to answer questions about the rules. In this particular rule we've been discussing we haven't put it into place yet a more established interdivisional process

[6] See Letter from Cadwalader, Wickersham & Taft, LLC on behalf of Hess Corporation and Hess Energy Trading Company submitted to the CFTC on May 29, 2012.

[7] Id. at 5-6.

> where the Office of General Counsel or Division of Swap Intermediary Oversight. What we want to is both be available to answer questions and provide guidance and at the same time make sure it's consistent and communicated and we're considering exactly how to do that.

http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission2_041812-trans.pdf. As evidenced by the sheer number of inquiries to Commissioners and their staff, and staff within the different divisions of the CFTC, the analysis has not been straightforward. Indeed, even today, more than three months after the Commission approved the final rule, many interpretive issues remain open and there is much uncertainty surrounding this first step in the regulatory process.[8]

Many firms have attended seminars on the registration process and posed specific questions to the staff of the NFA about how to meet the 4s documentation requirements. In some instances, potential registrants have been advised that the NFA needs to obtain guidance from CFTC Staff. This is understandable as the NFA is acting under delegated authority from the CFTC; however, clarifications and guidance need to be forthcoming promptly as firms need to develop policies and procedures that will demonstrate compliance with the rules. This guidance cannot be circulated to potential registrants at the last minute with the realistic expectation that it can be integrated into internal programs that ensure compliance in time to meet CFTC requirements. In addition, the lack of experience with this process could produce policies and procedures that vary significantly among market participants. Additional time would give registrants and the NFA time to develop reliable standards around meeting the 4s documentation issues.

To compound the problem, with the Commission's recent issuance of the final rule further defining swap, market participants are now forced to marshal teams of internal and external legal, business, compliance, IT, operations and credit personnel, among others, to implement the Section 4s Implementing Regulations, even though they are still unsure (i) whether they have to register; (ii) if so, what part of their business they should register; and (iii) if they register, how much it is going to cost them. The implementation process is very expensive. Of greater concern, companies face the real possibility that the costs associated with this process will have been incurred for no reason, should they choose not to be a swap dealer when they learn the costs of engaging in this business. Set forth below are but a few examples of these potentially "sunk" costs.[9]

[8] Moreover, market participants must perform this analysis at a time when not only the nature of the participants in the markets is changing, but also the marketplace itself. See, e.g., "IntercontinentalExchange to Transition Cleared Energy Swaps to Futures in October," http://ir.theice.com/releasedetail.cfm?ReleaseID=704089 (September 4, 2012).

[9] The Commission anticipated that there will be 125 swap dealer members of the NFA and that dues could range between $125,000-$1 million per member based upon the size and complexity of the firm's swap business. *See* Registration of Swap dealer and Major Swap Participants, 77 Fed. Reg. 2613, 2624 (Jan. 19, 2012). If the expected number of members decreases by one-half due to the new ICE/CME product offerings, the annual dues range could increase to $250,000 to $2 million,

1. There are Substantial Hard Costs to Comply with the Internal Business Conduct Standards.

Upon registration with the NFA, swap dealers must demonstrate compliance with certain internal business conduct standards. See "Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules" ("IBCS"). 77 Fed. Reg. 20128 (Apr. 3, 2012). Among the requirements will be the obligation to keep "full, complete, and systematic records, together with all pertinent data and memoranda" related to its swaps activities. See 17 C.F.R. § 23.202. For example, a swap dealer will have to make and keep daily trading records of all swaps it executes, including all documents on which a swap is originally recorded. Id. at § 23.202(a). Significantly this obligation will extend to pre-execution trade data. Id. at § 23.202(a)(1). For many companies, much of the information that constitutes pre-execution trade data is exchanged with counterparties over the phone. While there is no requirement under the IBCS to use voice recording to create the records referred to above, to the extent that the information constituting pre-execution trade is communicated orally, those communications must be recorded. Further, a swap dealer is required to maintain each transaction record in a manner identifiable and searchable by transaction and by counterparty. Id. at 23.202(a).

For many companies, this will mean investing in voice recording software at significant cost, particularly where the software must have search capability and will have to cover a broad group of individuals within the company.[10] Companies will further have to invest in the infrastructure to preserve such data, to hire additional personnel to manage this infrastructure, and to train their personnel on the retrieval and use of such information.[11] Once incurred, these costs will not be recoverable should the companies decide to shutter their businesses as swap dealers. Indeed, for many of these entities there is no other business or legal reason to employ such technology.

2. Swap Dealers are Required to Re-Document their Trading Relationships with the Majority of their Counterparties.

As an adjunct to the internal business conduct standards, the CEA and the CFTC rules implementing the same require swap dealers to comply with external business conduct standards. See "Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties ("EBCS"). 77 Fed. Reg. 9734 (Feb. 17, 2012). As the name suggests, the EBCS

[10] The IBCS requires swap dealers to maintain daily trading records for "related cash and forward transactions." Id. at 23.202(b). For many participants, it will be difficult to establish at the outset of a physical transaction that the transaction constitutes a "related cash and forward transaction." This uncertainty may result in participants having to record oral communications concerning some physical transactions that do not actually meet the definition of "related cash and forward transaction" in order to avoid the risk of not having the required record of a physical transaction that ultimately meets the definition for being a "related cash and forward transaction."

[11] The IBCS requires the swap dealer to "ensure that its records include all information necessary to conduct a comprehensive and accurate trade reconstruction for each swap." Id. at 23.202(a). To comply with a request by the CFTC for information of this kind, it will not be sufficient for a swap dealer to know that its oral communications are searchable. The swap dealer will further have to invest the time to understand how to search its database of voice recordings to pinpoint where in the oral communication, the counterparties began exchanging "pre-execution information."

focus on a swap dealer's relationships with its counterparties, imposing new "know your counterparty" obligations, pre-trade disclosure requirements, ongoing disclosure requirements, and limitations on the use or disclosure of confidential counterparty information. See 17 C.F.R. §23.400 *et seq*. To satisfy certain of these obligations, the CFTC rules allow a swap dealer to rely on written representations from, or to, its counterparties. For example, a swap dealer may negotiate with its counterparty as to the swap dealer's use of the counterparty's otherwise confidential information.

In an effort to comply with the EBCS, which a swap dealer must do as a condition of registration with the NFA, commercial participants are undertaking to re-paper and, where necessary, re-negotiate their trading documentation with their counterparties. For some companies that face the prospect of registration as a swap dealer, this involves hundreds, and in some instances, thousands of trading relationships. Again, to the extent that a participant decides to shut down its swap dealing business upon learning the costs of engaging in such business, much of this effort will be for naught and the time and resources devoted to this effort will not be recoverable.

III. Conclusion

Pursuant to CFTC Rule 13.2, and for the reasons set forth herein, CMC respectfully requests that the Commission delay the registration requirement for non-bank swap dealers under CFTC Rules 3.10 and 1.3(ggg)(4), and more particularly the date from which participants must begin to count swaps towards the calculation of the aggregate gross notional amount of their swap dealing activities, until 60 days after the Commission completes all of Section 4s Implementing Regulations.

Sincerely,

SJoshipura

Sanjeev Joshipura
President
Commodity Markets Council

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
Facsimile: (202) 418-5521

April 27, 1999

Mr. Craig D. Pardey
TASAS Capital Management, Inc.
4000 S. Eastern Avenue, Suite 240
Las Vegas, NV 89119

Dear Mr. Pardey:

This is in response to your letter to the Chairperson of the Commodity Futures Trading Commission (CFTC). By your letter, you request favorable consideration of proposed changes to CFTC Rule 4.35(a)(7), and you request an exemption from the requirements of Rules 4.35(a)(7) and 4.34(n). Your letter was treated as a Petition for Rulemaking pursuant to Rule 13.2 and has been referred to the Commission.

Based upon the representations made in your letter, the relevant facts are as follows. You are the sole principal of TASAS Capital Management, Inc. ("TASAS"). During 1998, TASAS had only two accounts, both of which were determined during an audit by the National Futures Association ("NFA") on February 1 and 2, 1999, to be proprietary. In one account, opened on January 12, 1998, you contributed $10,000, and your sister contributed $40,000. The other account, opened on April 13, 1998, is an Individual Retirement Account ("IRA") in which you are the sole owner. You indicate that, if these accounts are considered proprietary, it would be very disadvantageous to TASAS because all the accounts for which the performance is disclosed in TASAS' Disclosure Document would be considered proprietary and, as a consequence, that performance would be unusable as promotional material. You seek changes to Rule 4.35(a)(7) which would limit the definition of "proprietary" accounts in such a way as to exclude these two accounts.

The use of proprietary trading results in soliciting customer accounts is a practice which has long been of concern to the Commission. The Commission expressly addressed the issues raised by the inclusion of proprietary trading results in Disclosure Documents in extensive revisions to the disclosure requirements applicable to commodity trading advisors and commodity pool operators (the "Part 4 Revisions") which were adopted effective August 24, 1995.[1]

[1] *See* 60 Fed. Reg. 38146 at 38167-38168 (July 25, 1995). Prior to the Part 4 Revisions, use of proprietary trading results was not specifically referred to in the Commission's rules, although Commission staff had advised registrants that any proprietary trading results presented in a Disclosure Document must be clearly labeled as such and presented in a separate table. *See* 59 Fed. Reg. 25351, 25360 (May 16, 1994).

In proposing and adopting the Part 4 Revisions, the Commission discussed a number of these concerns, noting that proprietary accounts may be traded more aggressively, with higher leverage and greater risk than customer accounts. CTAs may trade proprietary funds to test a new trading strategy before implementing it for customer funds or to establish a track record prior to trading customer funds. Proprietary accounts and customer accounts are frequently subject to different fee schedules. In a proprietary account, or in situations where a portion of the funds in the account belong to the CTA or a relative, the CTA may elect to charge no management or incentive fee and clearing fees may be waived or reduced if the account is cleared by an affiliate. Moreover, where proprietary and customer accounts are combined for purposes of performance presentations, the amount of customer funds that the CTA has attracted is inflated. For these reasons, proprietary trading results may be of little relevance to a prospective pool participant or CTA client in many cases and may be actually misleading in others.[2]

As adopted, Rule 4.35(a)(7)(ii) defines proprietary trading results to include:

> the performance of any account in which fifty percent or more of the beneficial interest is owned or controlled by:
>
> * * *
>
> (B) An affiliate or family member of the commodity trading advisor;

The Commission regulation permits the use of proprietary trading results, subject to certain safeguards to ensure that the presentation is not misleading. Rule 4.34(n)(3)(iii) requires that any proprietary trading results (together with any hypothetical, extracted, pro-forma or simulated trading results) be placed at the end of the Disclosure Document in order to minimize the likelihood that the proprietary results will be afforded undue weight. The Commission noted that this requirement reflects the fact that such data are frequently of relatively low utility to prospective customers and the relatively high potential for confusion of proprietary and customer trading results.[3]

You urge that Regulation 4.35(a)(7)(ii) be "clarified" to indicate that the term "family member" is limited to the spouse or the children of the CTA. You further believe that the regulation should indicate that an IRA account is not considered to be proprietary. You point out that these changes would achieve the benefits of clarifying the term "family," and "officially recogniz[ing] that [the CTA's own] IRAs are the equivalent to client accounts."

When the current rules were adopted, concerns of the nature you present were considered by the Commission. In determining which accounts are proprietary, the test the Commission adopted focuses on issues of "ownership or control." Ownership by the CTA or a relative or affiliate creates the incentive for differential treatment, and control

[2] *See* 60 Fed. Reg. at 38167-38168.

[3] *See* 60 Fed. Reg. at 38167.

creates the means for such treatment. Given this rationale, a retirement account controlled by a CTA should clearly be included as proprietary. Moreover, an account the majority of which is owned and controlled by a close relative, such as a sibling, is also clearly within the intent of the rule.

In adopting the revised rules, the Commission recognized that, for many start-up CTAs, proprietary trading results are the only "track record" available to present to prospective clients. For that reason, the rule as adopted permits the presentation of these results, albeit as the last disclosure.[4] The circumstances presented by your request, involving an IRA account and an account substantially owned by a sibling do not justify a change to or a waiver of the Commission's requirements, particularly since the Commission's rules do not preclude the presentation of proprietary trading results. Consequently, the Commission will not change the rule or grant exemptive relief to enable you to consider these accounts as non-proprietary.

If you have any questions concerning this letter, please contact Robert B. Wasserman, Associate Director, Division of Trading and Markets, at (202) 418-5092.

Very truly yours,

Jean Webb

Jean Webb
Secretary

cc: Daniel A. Driscoll
National Futures Association

[4] 60 Fed. Reg. at 38167. *See* 17 C.F.R. § 4.34(n)(3)(iii).

19990085

RECEIVED
FEB 17
OFFICE

TASAS

CAPITAL MANAGEMENT, INC.

4000 S. EASTERN AVE., SUITE 240 • LAS VEGAS, NV 89119
TEL. (702) 451-2490 • FAX (702) 451-2499

February 16, 1999

1999 FEB 17
RECEIVED

Ms. Brooksley Born
Chairman, Commodity Futures
Trading Commission
Three Lafayette Centre
1155 21st Street Northwest
Washington, D.C. 20581

Dear Ms. Born:

I am writing to bring to your attention a serious problem involving a CFTC regulation.

On February 1 and 2, 1999, the National Futures Association (NFA) examined TASAS Capital Management, Inc. (TASAS). The results of this examination are documented in an NFA letter dated February 9, 1999 (see attachment #1).

The impact of the NFA's interpretation of CFTC Regulation 4.35(a)(7), if left unchanged, will be devastating to TASAS. Specifically, all performance information on page 13 of the TASAS disclosure document dated February 16, 1999 (attachment #3) would be considered proprietary and thus unusable as promotional material.

It is of the utmost importance that TASAS be permitted to provide performance information to managed futures rating services that is representative of the actual performance for the same time period of all reasonably comparable accounts. This includes all information on page 13 of the TASAS disclosure document.

Two accounts were the focus of the NFA letter dated February 9:

(b)(4); (b)(6)

Both of these accounts are individual managed accounts that the NFA believes should be proprietary but I believe should be non-proprietary. Even though the NFA audit team considered the two accounts to be proprietary, the team assured me during their visit that, in effect, the two accounts were representative of the actual performance for the same time period of all reasonably comparable accounts.

Prior to the NFA's visit, TASAS on January 5, 1999 reported performance of 27.00% for 1998 to the following rating services: (1)

Managed Account Reports; (2) Barclay Institutional Report; and (3) Daniel B. Stark & Co., Inc. This information was provided for use in their respective publications.

If the NFA's action stands, TASAS's performance in these publications would change from 27.00% to 0% for 1998. (TASAS had six accounts open as of December 31, 1998, but four of these accounts entered their first trade in January 1999.)

Ambiguities in a CFTC regulation resulted in the NFA's letter dated February 9. To eliminate these ambiguities, I recommend the following changes to CFTC Regulation 4.35(a)(7). Changes are underlined:

(7) Proprietary trading results. (i) Proprietary trading results shall not be included in a Disclosure Document unless such performance is prominently labeled as proprietary and is set forth separately after all disclosures in accordance with para. 4.34(n), together with a discussion of any differences between such performance and the performance of the offered trading program, including, but not limited to, differences in costs, leverage and trading.

(ii) For purposes of para. 4.34(n) and this para 4.35(a), proprietary trading results means the performance of any account in which fifty percent or more of the beneficial interest is owned or controlled by:

(A) The commodity trading advisor or any of its principals;

(B) An affiliate or family member (spouse or children) of the commodity trading advisor; or

(C) Any person providing services to the account.

(D) Exception: An Individual Retirement Account (IRA) is considered to be non-proprietary provided the account is representative of the actual performance for the same time period of all reasonably comparable accounts.

Adopting the above proposed changes to CFTC Regulation 4.35(a)(7) would achieve the following benefits:

(1) Commodity trading advisors would finally have a clear definition for the word "family" in the context of CFTC Regulation 4.35(a)(7). This change would ensure that no CTA will ever again be confronted with this ambiguity.

(2) Commodity trading advisors would clearly be permitted to trade their own Individual Retirement Account (IRA) and have it be considered a non-proprietary account provided the account is representative of the actual performance for the same time period of all reasonably comparable accounts. This is a long overdue change. The change would officially recognize that IRAs are the equivalent to client accounts.

Request favorable consideration of the above proposed changes to CFTC Regulation 4.35(a)(7). In addition, request coordination with the NFA to provide interim relief concerning the instructions contained in their February 9 letter.

Thank you for your consideration.

Sincerely,

Craig O. Pardey

Craig D. Pardey
President

3 Attachments
1. NFA Ltr, Feb. 9, 1999
2. NFA Ltr, Jan. 29, 1999
3. TASAS Disc. Doc., Feb. 16, 1999

cc: Mr. Robert K. Wilmouth, President, NFA
w/atch

NFA NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

February 9, 1999

Craig D. Pardey
President
Tasas Capital Management INC
4000 S. Eastern Ave
Suite 240
Las Vegas, Nevada 89119

Re: 99-CEXM-42
NFA ID#89631

Dear Mr. Pardey:

National Futures Association ("NFA") has concluded its examination of Tasas Capital Management INC ("Tasas"), which began on February 1, 1999. The examination included tests of the books and records and other necessary auditing procedures to provide reasonable assurance that Tasas was in compliance with NFA Rules. Thomas Barrus, Joe Patrick and Emily Morden conducted this examination.

A summary of our findings is listed below. During the exit interview and subsequent telephone conversations, you represented that corrective action will be taken with respect to these items, therefore, no further response is necessary.

- Tasas' performance results are disclosed on a composite basis. However, the performance included in the composite is for proprietary accounts. (CFTC Regulation 4.35(a)(7))

- Tasas' promotional material contained information which caused it to be misleading. Specifically, the firm's promotional material disclosed proprietary performance information that was not identified as such. (NFA Compliance Rule 2-29)

Please be advised that the firm must prepare a revised disclosure document and submit it to the CFTC and NFA for review prior to any further distribution. In addition, the firm must revise all promotional material containing proprietary trading results which are not identified as such.

We would like to take this opportunity to thank you and your staff for your cooperation during the examination. If you have any questions or comments regarding this report or the audit process, please contact me at (312) 658-6805.

Sincerely,

Thomas Barrus
Team Manager, Compliance Dept.

NFA NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

January 29, 1999

Mr. Craig D. Pardey
President
TASAS Capital Management Inc
4000 S Eastern Ave
Suite 240
Las Vegas NV 89119

Re: NFA ID # 0089631

Dear Mr. Pardey:

NFA has reviewed the revised February 16, 1999 Disclosure Document for TASAS Capital Management and has no further comments at this time. As such, effective immediately, the document may be used to solicit clients. Please be advised however, that in the course of our review, NFA has not undertaken to verify any of the statements contained in the document and thus this notice may not preclude NFA or the CFTC from raising compliance issues concerning this document at some future time. If you have any questions concerning this matter, please contact me at (312)781-2237.

Sincerely,

Maria F. McHenry

Maria F. McHenry
Compliance Department

cc: Kevin P. Walek
Commodity Futures Trading Commission

[illegible] # 2

DISCLOSURE DOCUMENT

OF

TASAS CAPITAL MANAGEMENT, INC.

A Nevada corporation registered with the Commodity Futures Trading Commission as a Commodity Trading Advisor and a member of the National Futures Association.

**TASAS CAPITAL MANAGEMENT, INC.
4000 S. EASTERN AVE., SUITE 240
LAS VEGAS, NEVADA 89119
TEL. (702) 451-2490
FAX (702) 451-2499**

THE COMMODITY FUTURES TRADING COMMISSION HAS NOT PASSED UPON THE MERITS OF PARTICIPATING IN THIS TRADING PROGRAM NOR HAS THE COMMISSION PASSED ON THE ADEQUACY OR ACCURACY OF THIS DISCLOSURE DOCUMENT.

**The date of this Disclosure Document is
February 16, 1999**

The information contained in this Disclosure Document is subject to change after the date shown above.

RISK DISCLOSURE STATEMENT

THE RISK OF LOSS IN TRADING COMMODITIES CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. IN CONSIDERING WHETHER TO TRADE OR TO AUTHORIZE SOMEONE ELSE TO TRADE FOR YOU, YOU SHOULD BE AWARE OF THE FOLLOWING:

IF YOU PURCHASE A COMMODITY OPTION, YOU MAY SUSTAIN A TOTAL LOSS OF THE PREMIUM AND OF ALL TRANSACTION COSTS.

IF YOU PURCHASE OR SELL A COMMODITY FUTURE OR SELL A COMMODITY OPTION, YOU MAY SUSTAIN A TOTAL LOSS OF THE INITIAL MARGIN FUNDS AND ANY ADDITIONAL FUNDS THAT YOU DEPOSIT WITH YOUR BROKER TO ESTABLISH OR MAINTAIN YOUR POSITION. IF THE MARKET MOVES AGAINST YOUR POSITION, YOU MAY BE CALLED UPON BY YOUR BROKER TO DEPOSIT A SUBSTANTIAL AMOUNT OF ADDITIONAL MARGIN FUNDS, ON SHORT NOTICE, IN ORDER TO MAINTAIN YOUR POSITION. IF YOU DO NOT PROVIDE THE REQUIRED FUNDS WITHIN THE PRESCRIBED TIME, YOUR POSITION MAY BE LIQUIDATED AT A LOSS, AND YOU WILL BE LIABLE FOR ANY RESULTING DEFICIT IN YOUR ACCOUNT.

UNDER CERTAIN MARKET CONDITIONS, YOU MAY FIND IT DIFFICULT OR IMPOSSIBLE TO LIQUIDATE A POSITION. THIS CAN OCCUR, FOR EXAMPLE, WHEN THE MARKET MAKES A “LIMIT MOVE.”

THE PLACEMENT OF CONTINGENT ORDERS BY YOU OR YOUR TRADING ADVISOR, SUCH AS A “STOP LOSS” OR “STOP LIMIT” ORDER, WILL NOT NECESSARILY LIMIT YOUR LOSSES TO THE INTENDED AMOUNTS, SINCE MARKET CONDITIONS MAY MAKE IT IMPOSSIBLE TO EXECUTE SUCH ORDERS.

A “SPREAD” POSITION MAY NOT BE LESS RISKY THAN A SIMPLE “LONG” OR “SHORT” POSITION.

THE HIGH DEGREE OF LEVERAGE THAT IS OFTEN OBTAINABLE IN COMMODITY TRADING CAN WORK AGAINST YOU AS WELL AS FOR YOU. THE USE OF LEVERAGE CAN LEAD TO LARGE LOSSES AS WELL AS GAINS.

IN SOME CASES, MANAGED COMMODITY ACCOUNTS ARE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT AND ADVISORY FEES. IT MAY BE NECESSARY FOR THOSE ACCOUNTS THAT ARE SUBJECT TO THESE CHARGES TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETION OR EXHAUSTION OF THEIR ASSETS. THIS DISCLOSURE DOCUMENT

CONTAINS, AT PAGE 7, A COMPLETE DESCRIPTION OF EACH FEE TO BE CHARGED TO YOUR ACCOUNT BY THE COMMODITY TRADING ADVISOR.

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND OTHER SIGNIFICANT ASPECTS OF THE COMMODITY MARKETS. YOU SHOULD THEREFORE CAREFULLY STUDY THIS DISCLOSURE DOCUMENT AND COMMODITY TRADING BEFORE YOU TRADE, INCLUDING THE DESCRIPTION OF THE PRINCIPAL RISK FACTORS OF THE INVESTMENT, AT PAGE 6.

THIS COMMODITY TRADING ADVISOR IS PROHIBITED BY LAW FROM ACCEPTING FUNDS IN THE TRADING ADVISOR'S NAME FROM A CLIENT FOR TRADING COMMODITY INTERESTS. YOU MUST PLACE ALL FUNDS FOR TRADING IN THIS TRADING PROGRAM DIRECTLY WITH A FUTURES COMMISSION MERCHANT.

TABLE OF CONTENTS

Introduction 4

The Commodity Trading Advisor 4

The Trading Program 5

Principal Risk Factors 6

Advisory Fees 7

The Commodity Broker and Brokerage Commissions 9

Potential Conflicts of Interest 10

Account Policies 10

Account Reports and Services 12

Performance 12

Account Opening Procedures 15

Acknowledgment of Receipt of Disclosure Document 16

Managed Account Application 17

Managed Account Agreement 21

Commodity Trading Authorization 28

Fee Payment Authorization 29

INTRODUCTION

TASAS Capital Management, Inc. ("TASAS") provides commodity advisory services to clients. A client opens a TASAS managed account with Lind-Waldock & Company as futures commission merchant. TASAS directs all futures trading in such accounts with the goal of capital appreciation.

THE COMMODITY TRADING ADVISOR

TASAS Capital Management, Inc. is a Nevada corporation formed in September 1997. The TASAS business office is located at 4000 S. Eastern Ave., Suite 240, Las Vegas, Nevada 89119, telephone (702) 451-2490.

TASAS has been registered with the Commodity Futures Trading Commission ("CFTC") as a commodity trading advisor and has been a member of the National Futures Association ("NFA") since December 18, 1997.

TASAS intends to use this disclosure document beginning on February 16, 1999 and will not utilize it after November 16, 1999.

Craig D. Pardey is the president and sole principal of TASAS. Mr. Pardey is responsible for all trading decisions made by TASAS.

A brief biography of Mr. Pardey is set forth below:

Mr. Pardey was born on April 12, 1949, in Tacoma, Washington. He was in the U.S. Air Force for fifteen years and was a First Sergeant when he resigned in 1982 to enter the commodities field.

At the time of his departure from the Air Force, Mr. Pardey had studied the stock market for twenty years, commodities for three years, and had finalized his first commodity trading system.

In 1983, Mr. Pardey formed Trading Account System And Services (TASAS) as a sole proprietorship in Seattle, Washington. "The TASAS Newsletter," a weekly commodity advisory newsletter and telephone hotline service, was published from 1983 to 1985. He also directed trading in a TASAS managed account program from 1984 to 1986. While the managed account program was in operation, he was registered with the CFTC as a commodity trading advisor and was a member of the NFA.

In 1986, Mr. Pardey closed his first managed account program. The trading system he had used for his commodity advisory service for three years stopped working.

(Mr. Pardey determined years later that a major change in the futures markets likely caused his first commodity trading system to stop working. His trading system was based on domestic exchanges' price, volume, and open interest data. As the futures markets became global in the mid-1980's, domestic exchanges' volume and open interest data gradually became almost meaningless as indicators.)

From 1986 to 1993, Mr. Pardey was in retirement. Family and hobbies were his primary interests during this period.

In 1987, the Pardey family moved from Seattle to Las Vegas.

In 1993, Mr. Pardey returned to the working world when he started Freedom Video, a video rental store located in Las Vegas. He continues to own and operate Freedom Video.

On November 24, 1996, after three years of research, Mr. Pardey finalized the TASAS trading system described below.

On January 12, 1998, Mr. Pardey commenced trading in the TASAS managed account program.

Approximately 50% of Mr. Pardey's working hours are spent on TASAS activities and 50% on Freedom Video activities.

The TASAS staff includes Jill Lawrence, vice president of account services, and Jennifer Reeves, vice president of administration. Ms. Lawrence and Ms. Reeves are not shareholders of TASAS and are not involved in the trading decisions of TASAS.

There have been no material civil, administrative or criminal proceedings pending, on appeal or concluded against TASAS or its principal in the past five years, or ever.

Performance information concerning TASAS and its principal is set forth on pages 12 through 14.

THE TRADING PROGRAM

The TASAS trading system is a proprietary system finalized in 1996. It is used for all trading in the managed account program.

The following description of the TASAS trading system is general and not intended to be exhaustive:

The trading system is a long-term technical trend following system. The system trades one market – the Japanese yen.

The system is based on Japanese yen price data. It is an always in the market trading system. It is always long or short the yen.

The system consists of a mathematical formula and elements of money management and risk management. The system is 100% mechanical. All trade signals are taken. No discretion is used. No computer is used. All open positions have a reversal price.

All trade signals are given after the close of Japanese yen futures trading on the Chicago Mercantile Exchange ("CME"). When a trade signal is given, an order to buy or sell the yen is executed the following market day. Such orders are executed on the CME at the market opening.

Pyramiding, that is, the use of realized and unrealized profits as margin for additional positions in the Japanese yen, is an integral part of the trading system. Pyramiding is employed regularly in the trading program.

The average margin to equity ratio is 12%. The average annual commission to equity ratio is 0.6%. The average number of round-turn trades per $1 million per year is 280. The average number of trades per year is 5 (excluding contract rollovers to a later delivery month).

The profitability of trend following trading techniques, such as those employed in the trading program, depends on long-term directional price trends in the futures contract being traded. Historically, the Japanese yen has demonstrated favorable trending characteristics. However, there is no assurance that there will be such trends in the future.

This disclosure document does not purport to discuss every trading strategy or money management situation conceivable in the trading program. TASAS may change, at any time, trading strategies and/or money management principles without prior notice to clients. However, any substantial change will be announced to clients in writing within 30 days after the change takes place.

PRINCIPAL RISK FACTORS

Prospective clients should consider all of the risk factors described below and elsewhere in this disclosure document.

Commodity Futures Trading is Volatile. Commodity prices are volatile. Price movements for commodity contracts are influenced by, among other things: Changing supply and demand relationships; weather; agricultural, trade, fiscal, monetary, and exchange control programs and policies of governments; United States and foreign political and economic events and policies; changes in national and international interest rates and rates of inflation; currency devaluations and reevaluations; and emotions of the marketplace. None of these factors can be controlled by TASAS and no assurance can be given that TASAS's advice will result in profitable trades for a client or that a client will not incur losses.

Commodity Futures Trading is Leveraged. The low margin deposits normally required in commodity contract trading (typically between 2% and 20% of the value of the contract purchased or sold) permit a high degree of leverage. Accordingly, a relatively small price movement in a contract may result in immediate and substantial losses to the investor. For example, if at the time of purchase 5% of the price of a futures contract is deposited as margin, a 5% decrease in the price of the contract would, if the contract then closed out, result in a total loss of the margin deposit before any deduction for brokerage commissions. A decrease of more than 5% would result in a loss of more than the total margin deposit. Thus, like other leveraged investments, any trade may result in losses in excess of the amount invested.

Single Market Concentration. TASAS trades the Japanese yen only. Performance results in this trading program may be more volatile when compared with programs trading multiple markets.

Reliance on FCM's Financial Condition. A client participating in this trading program is required to open a commodity trading account with a futures commission merchant ("FCM"). If the FCM became insolvent, the client might incur a loss of all or a portion of the funds on deposit with the firm. Such a loss could occur if the FCM failed to segregate its client funds in violation of CFTC regulations, or if a client failed to pay a deficiency in an account. There is no government insurance for commodity brokerage accounts.

Reliance on Principal. TASAS will have sole responsibility for trading commodity futures contracts for the client's managed account. TASAS is dependent on the services of Craig Pardey. The loss of Mr. Pardey's services would result in the inability of TASAS to advise or trade the client's account. In this event, TASAS or the client would terminate the managed account agreement.

ADVISORY FEES

TASAS will charge a monthly management fee and a monthly incentive fee in exchange for providing commodity advisory services to clients.

The monthly management fee will equal .167 percent (a 2% annual rate) of the account's month-end net asset value.

The monthly incentive fee will equal twenty percent (20%) of the account's trading profits for the month.

The terms "Net Asset Value" and "Trading Profits" are defined below.

The management fee will be paid whether or not the account has a profit. However, the incentive fee is payable only on cumulative profits. For example, if the account incurs losses after an incentive fee payment is made, TASAS will retain the payment but will receive no further incentive fee in subsequent months until trading profits have been earned. Clients with accounts closing due to losses, or for any other reason, are not eligible for a refund of management or incentive fees paid.

"Net Asset Value" is the sum of:

a. The initial assets of the account, including all cash and/or U.S. Treasury bills deposited in the account, increased or decreased by any subsequent additions and withdrawals. U.S. Treasury bills to be calculated at cost.

b. Cumulative profit or loss in the account with open commodity positions calculated at their then market value, which means the settlement price as determined by the exchange on which the transaction is effected.

c. Interest income credited to the account.

d. Less: Brokerage commissions (including accrued commissions on open positions), paid and accrued management fees, paid and accrued incentive fees, and other expenses charged by the broker to the account in the normal course of business.

"Trading Profits" during a month means the excess, if any, of the net asset value at the end of such months over the highest net asset value at the end of any preceding month (i.e., the last month for which an incentive fee was payable). Trading profits include interest income credited to the account.

The management and incentive fees are due and payable on the last business day of each month. If the managed account agreement is terminated on a date other than the last business day of a calendar month, the management fee will be payable to TASAS as though the termination date were the month-end prorated based on the number of days in the month the account was managed by TASAS. Similarly, if the managed account agreement is terminated on a date other than the end of a calendar month, an incentive fee, if applicable, will be payable to TASAS as though the termination date were the last business day of the month.

Shortly after the end of each month, TASAS will prepare a statement setting forth the amount of management and incentive fees payable to TASAS and will furnish such statement to the broker. Upon submission of the statement to the broker, the broker will be authorized by the client to deduct these fees directly from the client's account. TASAS will furnish the client with a copy of the statement presented to the broker. The client agrees to assure payment to TASAS of applicable management and incentive fees within five business days of the date such fees become due and payable.

Because the TASAS trading system signals only 5 trades per year on average (excluding contract rollovers to a later delivery month), a new account may encounter a wait of one or more months for its first trade. In view of this fact, the management and incentive fees described above will become payable beginning on the date the first position in the Japanese yen is opened for the account.

The initial monthly incentive fee will be payable based on cumulative trading profits since the date the managed account was opened.

TASAS employs an always in the market trading system. Therefore, the account will always be long or short the yen after the first position is opened for the account.

THE COMMODITY BROKER AND BROKERAGE COMMISSIONS

TASAS has designated Lind-Waldock & Company ("Lind-Waldock") as the futures commission merchant for all TASAS managed accounts. TASAS clients deposit funds into a segregated customer account opened with Lind-Waldock. TASAS directs all futures trading in such accounts.

TASAS clients pay brokerage commissions and related transaction fees to Lind-Waldock. TASAS receives only monthly management and monthly incentive fees, and does not share in brokerage commissions, directly or indirectly, with respect to TASAS managed accounts.

Both TASAS and Lind-Waldock provide TASAS managed account clients with a monthly statement of equity as well as a record of fees paid to TASAS. Lind-Waldock provides TASAS clients with a confirmation of every trade executed for the client's account, setting forth the realized gain or loss on each liquidated position and brokerage commissions charged.

The Commodity Broker. Lind-Waldock is a clearing member of the Chicago Board of Trade, the Chicago Mercantile Exchange and other principal commodity exchanges. Corporate headquarters of the Commodity Broker is located at 1030 West Van Buren Street, Chicago, Illinois 60607. It is registered with the CFTC as a futures commission merchant and is a member in good standing of NFA.

Lind-Waldock has been continuously doing business as a futures commission merchant since 1965. Lind-Waldock is a clearing member of all principal futures exchanges in the United States. Through affiliations with other international firms, Lind-Waldock has access to all international commodity exchanges.

As a large commodity broker, Lind-Waldock is regularly involved in litigation. In many such cases, such litigation involves allegations that Lind-Waldock has violated the Commodity Exchange Act, CFTC regulations and/or exchange rules. There have been no material civil, administrative or criminal proceedings pending, on appeal or concluded against Lind-Waldock or its principals in the past five years.

POTENTIAL CONFLICTS OF INTEREST

TASAS, its principal and employees may trade futures contracts for their own proprietary accounts. Orders for such proprietary accounts which involve trading Japanese yen futures contracts will be part of a block order which will include orders for client accounts.

Because of price volatility, occasional variations in liquidity, and differences in order execution, it is impossible for TASAS to obtain identical trade execution for all client accounts and proprietary accounts. TASAS uses an allocation procedure for trade fill prices when a block order is filled at different prices. This procedure does not favor proprietary accounts relative to client accounts.

Upon reasonable notice to TASAS, clients will be allowed to inspect the proprietary trading records of TASAS, its principal and employees at the business office of TASAS during normal business hours.

ACCOUNT POLICIES

The Commodity Broker. A client opens a commodity trading account with Lind-Waldock as futures commission merchant. The account becomes a TASAS managed account after all forms required by both TASAS and Lind-Waldock are completed and the client deposits funds with Lind-Waldock.

Minimum Investment. The minimum account size for opening a TASAS managed account is $50,000.

Additions to and Withdrawals from the Account. A client may add funds at any time to, or withdraw funds at any time from, his or her account. No withdrawal, however, will be permitted which would reduce the total account value of the account below $50,000, except a withdrawal in connection with termination of the managed account agreement.

Clients must send written notice to TASAS in advance of additions and withdrawals. Clients may wish to call TASAS for information concerning the impact a withdrawal under consideration may have on their managed account.

Notional Funding. Notional funding, which is an agreement between a commodity trading advisor and a client to trade an account based on a higher level of "equity" than assets actually on deposit in the account, is not permitted in the TASAS program.

Interest Income. Client accounts earn interest on 70% of daily total account value. Interest is computed based on the 30-day U.S. Treasury bill offer rate. Lind-Waldock credits interest income to managed accounts monthly.

Fee Negotiations. Negotiated management fees and incentive fees are not permitted in the TASAS program.

Account Closures. A client may close his or her managed account at any time by notifying TASAS and Lind-Waldock in writing.

ACCOUNT REPORTS AND SERVICES

The following reports and services are provided to clients:

Report/Service	Purpose	Timetable
1. Daily Brokerage Statements	Statement of Daily Account Activity	Mailed When Account Changes Occur
2. Monthly Brokerage Statements	Statement of Monthly Account Activity	Mailed About the 8th of Each Month
3. Account Performance Report	Statement of Monthly Account Performance	Mailed About the 8th of Each Month
4. Account Fee Statement	Statement of Monthly TASAS Fees	Mailed About the 8th of Each Month
5. Monthly Newsletter	Program News	Mailed About the 15th of Each Month
6. Personal Consultations	Opportunity for Clients to Discuss Their Account or J-Yen Market with Mr. Pardey	Fourth Thursday of Every Month
7. New Disclosure Document	Program Update	Mailed Every February and August

PERFORMANCE

The CFTC requires that a commodity trading advisor disclose to prospective clients the past performance of all accounts for which the commodity trading advisor and its principals have had the authority to cause transactions to be effected without clients' specific authorization for the past five years.

TASAS Capital Management, Inc. began trading the TASAS managed account program on January 12, 1998. The Performance Table on page 13 provides the composite performance of all client accounts traded by TASAS and its principal for the past five years.

Performance Table
TASAS Capital Management, Inc.
January 1998 - December 1998
Fully-Funded Subset Method

Commodity Trading Advisor: TASAS Capital Management, Inc.
Name of Trading Program: TASAS Managed Account Program
Inception of Trading: January 1998
Inception of This Program: January 1998
Total Assets Under Management in All Programs as of December 31, 1998: $339,429
Total Assets Under Management in This Program as of December 31, 1998: $339,429
Worst Monthly Drawdown: -13.94%, November 1998
Worst Peak-to-Valley Drawdown: -14.34%, January 1998 - February 1998
Number of Accounts Open: 6
Number of Accounts Closed With Positive Net Performance: 0
Number of Accounts Closed With Negative Net Performance: 0

Please see page 14 for Performance Table Notes.

	Rate of Return					
Month	1998	1997	1996	1995	1994	1993
January	-6.98%					
February	-7.91%					
March	13.40%					
April	0.31%					
May	3.83%					
June	0.67%					
July	5.76%					
August	-5.13%					
September	-3.57%					
October	27.51%					
November	-7.61%					
December	9.40%					
Year	**27.00%**					

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Performance Table (Continued)
TASAS Capital Management, Inc.
January 1998 - December 1998
Fully-Funded Subset Method

Performance Table Notes:

1. The Performance Table reflects data computed using the "fully-funded subset" method of computing rate of return and performance disclosure pursuant to an advisory issued by the CFTC. All TASAS managed accounts are fully funded and are added to this table when they are opened.

2. The monthly rate of return for each month is calculated by dividing net performance (composite of all accounts) by beginning net asset value (composite of all accounts).

3. The year-to-date rate of return is calculated by multiplying each monthly rate of return on a compound basis.

4. Additions and withdrawals are effective the beginning of the month for purposes of computing monthly rate of return.

5. Notional funding is not permitted in the trading program.

6. Negotiated management fees and incentive fees are not permitted in the trading program.

7. Definition of "Worst Monthly Drawdown": The largest monthly loss experienced by any account in the trading program in any calendar month, expressed as a percentage of the total equity in such account.

8. Definition of "Worst Peak-to-Valley Drawdown": The largest cumulative decline in month-end net asset value sustained by any account in the trading program during any period in which the initial month-end net asset value is not equaled or exceeded by a subsequent month-end net asset value, expressed as a percentage of the total equity in such account.

9. The composite rates of return shown in the Performance Table should not be considered representative of the rate of return experienced by any individual account in the trading program. Accounts can have varying investment results for several reasons, including, but not limited to: (a) procedures governing the start of trading and the establishment of a full portfolio for new accounts; and (b) the time period in which individual accounts are traded.

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

ACCOUNT OPENING PROCEDURES

To open a TASAS managed account:

1. Complete and sign the following forms:

   a. Acknowledgment of Receipt of Disclosure Document (page 16).

   b. Managed Account Application (page 17).

   c. Managed Account Agreement (page 21).

   d. Commodity Trading Authorization (page 28).

   e. Fee Payment Authorization (page 29).

2. Mail all forms in step one above to: TASAS Capital Management, Inc., 4000 S. Eastern Ave., Suite 240, Las Vegas, Nevada 89119.

3. Contact Lind-Waldock and request account forms necessary to open a TASAS managed account. Lind-Waldock can be reached at (800) 452-1030, (312) 413-6096, fax (312) 455-3175.

4. Complete and sign all Lind-Waldock account forms.

5. Mail all forms in step four above to: Lind-Waldock & Company, 1030 West Van Buren Street, Chicago, Illinois 60607. Deposit funds with Lind-Waldock.

6. Upon completion of the above steps, TASAS will mail the client a letter advising that his or her managed account is now open.

ACKNOWLEDGMENT OF RECEIPT OF DISCLOSURE DOCUMENT

This is to acknowledge that I have received a copy of the TASAS Capital Management, Inc. Disclosure Document dated February 16, 1999.

	If Joint Account:
Client Signature	Client Signature
Client Name (Print or Type)	Client Name (Print or Type)
Date	Date

If there are more than two joint account owners, please use an additional sheet.

TASAS Capital Management, Inc.
4000 S. Eastern Ave., Suite 240
Las Vegas, Nevada 89119
Tel. (702) 451-2490
Fax (702) 451-2499

MANAGED ACCOUNT APPLICATION

TASAS Capital Management, Inc. is required to obtain certain information from prospective clients. Please assist us by completing this form. If joint account, each owner needs to complete this form.

Type of Account:

____ Individual

____ Joint Tenants with Rights of Survivorship

____ Joint Tenants in Common

____ Other (Please Specify):______________________________

Mr./Mrs./Ms./Miss (Please Circle)

Client Name:____

Home Address (Street, City, State, Zip):__________________________________

____

Home Telephone Number: (_____)____________________

Date of Birth:____

Employer:____

Business Address (Street, City, State, Zip):________________________________

____

Business Telephone Number: (_____)__________________

Business Description:____

Estimated Annual Income:

____ Under $50,000

____ Over $50,000

Estimated Net Worth:

____ Under $50,000

____ $50,000 - $250,000

____ $250,000 - $500,000

____ $500,000 - $1 Million

____ Over $1 Million

Previous Investment Experience:

Stocks:	Yes_____	No_____	Number of Years:________
Bonds:	Yes_____	No_____	Number of Years:________
Mutual Funds:	Yes_____	No_____	Number of Years:________
Commodities:	Yes_____	No_____	Number of Years:________

____
Client Signature

____
Client Name (Print or Type)

____
Date

TASAS Capital Management, Inc.
4000 S. Eastern Ave., Suite 240
Las Vegas, Nevada 89119
Tel. (702) 451-2490
Fax (702) 451-2499

MANAGED ACCOUNT APPLICATION

TASAS Capital Management, Inc. is required to obtain certain information from prospective clients. Please assist us by completing this form. If joint account, each owner needs to complete this form.

Type of Account:

____ Individual

____ Joint Tenants with Rights of Survivorship

____ Joint Tenants in Common

____ Other (Please Specify):______________________

Mr./Mrs./Ms./Miss (Please Circle)

Client Name:______________________

Home Address (Street, City, State, Zip):______________________

____

Home Telephone Number: (_____)______________________

Date of Birth:______________________

Employer:______________________

Business Address (Street, City, State, Zip):______________________

____

Business Telephone Number: (_____)______________________

Business Description:______________________

Estimated Annual Income:

____ Under $50,000

____ Over $50,000

Estimated Net Worth:

____ Under $50,000

____ $50,000 - $250,000

____ $250,000 - $500,000

____ $500,000 - $1 Million

____ Over $1 Million

Previous Investment Experience:

Stocks: Yes_____ No_____ Number of Years:________

Bonds: Yes_____ No_____ Number of Years:________

Mutual Funds: Yes_____ No_____ Number of Years:________

Commodities: Yes_____ No_____ Number of Years:________

____
Client Signature

____
Client Name (Print or Type)

____
Date

TASAS Capital Management, Inc.
4000 S. Eastern Ave., Suite 240
Las Vegas, Nevada 89119
Tel. (702) 451-2490
Fax (702) 451-2499

MANAGED ACCOUNT AGREEMENT

THIS MANAGED ACCOUNT AGREEMENT (the "Agreement") is made between TASAS CAPITAL MANAGEMENT, INC., a Nevada corporation (the "Advisor") and ______________________________ (the "Client").

WHEREAS, Client hereby acknowledges to Advisor that Client has received, read and understood, and carefully considered the risks outlined in the Disclosure Document, dated February 16, 1999, of Advisor and no person is authorized by the Advisor to make statements inconsistent with those contained in such Disclosure Document;

WHEREAS, Client hereby represents to Advisor that Client has capital available and desires to invest such capital in speculative investments in "commodity interests," which term shall include, for purposes of this Agreement, contracts on and for physical commodities, currencies, money market instruments, obligations of the United States government, and any other financial instruments, securities, stock, financial and economic indices and items which are now, or may hereafter be, the subject of futures contract trading, including futures contracts, options on futures contracts, cash and forward contracts, foreign exchange commitments, deferred delivery contracts, leverage contracts and other commodity-related contracts, agreements and transactions and securities (such as United States Treasury bills) approved by the U.S. Commodity Futures Trading Commission ("CFTC") for investment of customer funds;

WHEREAS, Client, if an individual, hereby represents to Advisor that Client is of full legal age in the jurisdiction in which Client resides and is legally competent to execute and deliver this Agreement and to purchase, sell, trade and own commodity interests as contemplated by this Agreement;

WHEREAS, Client, if a corporation, partnership, trust or other entity or association, hereby represents to Advisor that Client has full power and authority to execute and deliver this Agreement and to purchase, sell, trade and own commodity interests as contemplated by this Agreement and the individual executing and delivering this Agreement for and on behalf of Client is of full legal age in the jurisdiction in which such individual resides and is legally competent and has full power and authority to do so on behalf of Client and its shareholders, partners and beneficiaries;

WHEREAS, Client is aware of the risks involved in opening an Account including, without limitations, the speculative character of trading in commodities, the possibility that an entire investment may be lost and that in the case of futures, liability could exceed the assets in the Client's Account, the fact that the Account will be subject to brokerage commissions and management fees regardless of whether profits are earned; and that even if best efforts are used to close out all positions in the Account at a particular time, there is no assurance that any such open positions will be closed out without incurring substantial additional losses. The Client further represents that he/she has the financial capacity to undertake such risks;

WHEREAS, Client desires to retain Advisor as Client's commodity trading advisor pursuant to the terms and conditions set forth in this Agreement, and Advisor desires to provide commodity advisory services to Client pursuant to such terms and conditions;

NOW THEREFORE, in consideration of the premises set forth above, the parties hereto do hereby agree as follows:

1. CLIENT'S ACCOUNT. Client shall open a commodity trading account (the "Account") with Lind-Waldock & Company (the "Broker"), with an initial deposit of $________________________. The initial deposit, all subsequent deposits to and withdrawals from the Account and all transactions effected in the Account shall be subject to this Agreement.

2. REPRESENTATION OF ADVISOR. Advisor represents and Client acknowledges that Advisor is currently registered with the CFTC as a commodity trading advisor and is a member of the National Futures Association.

3. AUTHORIZATION FOR ADVISOR TO ENTER ORDERS FOR THE ACCOUNT. Client appoints Advisor as his/her sole attorney-in-fact with respect to the Account to buy, sell or otherwise trade in commodity interests through the Broker pursuant to the Advisor's trading program. Client hereby gives and grants to Advisor full power and authority to act for Client and on Client's behalf to do every act and thing whatsoever requisite, necessary or appropriate to be done in connection with this power of attorney as fully and in the same manner and with the same force and effect as Client might do or could do if personally present, and Client hereby ratifies all that Advisor may lawfully do or cause to be done by virtue of this power of attorney. Client hereby ratifies and confirms any and all transactions made by Advisor for the Account and agrees that the rights and obligations of Client in respect thereof shall be governed by the terms of this Agreement. The Advisor shall have discretionary authority to make all trading decisions for the Account, without prior consultation with Client and without prior notice to Client with respect to such trading decisions. By this Agreement, Client authorizes the Broker to permit the Advisor to enter orders for the Client's Account.

4. ACKNOWLEDGMENT OF RISKS ASSOCIATED WITH COMMODITY TRADING; LACK OF GUARANTEE BY THE ADVISOR; AND INDEMNIFICATION OF THE ADVISOR. Client is aware of the speculative nature and the high risks associated with commodity interest trading (which includes the risk that Client may incur trading losses in excess of the capital contributed to the Account). Client also acknowledges that no "safe" trading system has ever been devised, and that no one can guarantee profits or freedom from loss in commodity interest trading. The Advisor, therefore, cannot and does not imply or guarantee that Client will make a profit and it is expressly agreed that the Advisor will not be held responsible for trading losses in the Account. Further, Client agrees that neither the Advisor nor its principal or employees will be liable to the Client or to others except by reason of acts constituting willful malfeasance, gross negligence or reckless misconduct as to its duties herein and shall have no liability for human or machine errors in orders to trade or not to trade in the Account. In the event the Advisor, its principal or employees are made a party to any claim, dispute, action or proceeding or otherwise incurs any loss or expense in connection with Client's obligations or

liabilities arising from Client's Account or this Agreement, Client shall indemnify and reimburse the Advisor for any such loss, expense, liability or damage, including Advisor's reasonable attorney's fees.

5. ADDITIONS TO AND WITHDRAWALS FROM THE ACCOUNT. The Client may add funds at any time to, or withdraw funds at anytime from, his or her Account. No withdrawal, however, shall be permitted which would reduce the total account value of the Account below $50,000, except a withdrawal in connection with termination of the Agreement. The Client agrees to notify the Advisor in writing in advance of such additions or withdrawals. Client recognizes that the potential profitability of the Account depends on long-term, uninterrupted investment of capital and that withdrawal of assets could materially and adversely affect the potential profitability of the Account.

6. FEES. In consideration of and in compensation for the advisory services to be rendered by the Advisor to the Account under this Agreement, Client shall pay to the Advisor the following fees: (a) a management fee payable monthly equal to .167 percent (a 2% annual rate) of the Account's month-end net asset value (defined below); and (b) an incentive fee payable monthly equal to twenty percent (20%) of the Account's trading profits (defined below) for the month.

The management fee shall be paid whether or not the Account has a profit. However, the incentive fee is payable only on cumulative profits. For example, if the Account incurs losses after an incentive fee payment is made, the Advisor will retain the payment but will receive no further incentive fee in subsequent months until trading profits have been earned. Clients with Accounts closing due to losses, or for any other reason, are not eligible for a refund of management or incentive fees paid.

"Net Asset Value" is the sum of:

a. The initial assets of the Account, including all cash and/or U.S. Treasury bills deposited in the Account, increased or decreased by any subsequent additions and withdrawals. U.S. Treasury bills to be calculated at cost.

b. Cumulative profit or loss in the Account with open commodity positions calculated at their then market value, which means the settlement price as determined by the exchange on which the transaction is effected.

c. Interest income credited to the Account.

d. Less: Brokerage commissions (including accrued commissions on open positions), paid and accrued management fees, paid and accrued incentive fees, and other expenses charged by the Broker to the Account in the normal course of business.

"Trading Profits" during a month means the excess, if any, of the net asset value at the end of such months over the highest net asset value at the end of any preceding month (i.e., the last month for which an incentive fee was payable). Trading profits include interest income credited to the Account.

The management and incentive fees are due and payable on the last business day of each month. If the Agreement is terminated on a date other than the last business day of a calendar month, the management fee shall be payable to the Advisor as though the termination date were the month-end prorated based on the number of days in the month the Account was managed by the Advisor. Similarly, if the Agreement is terminated on a date other than the end of a calendar month, an incentive fee, if applicable, shall be payable to the Advisor as though the termination date were the last business day of the month.

Shortly after the end of each month, the Advisor will prepare a statement setting forth the amount of management and incentive fees payable to the Advisor and will furnish such statement to the Broker. Upon submission of the statement to the Broker, the Broker will be authorized by the Client to deduct these fees directly from the Client's Account. The Advisor will furnish the Client with a copy of the statement presented to the Broker. The Client agrees to assure payment to the Advisor of applicable management and incentive fees within five business days of the date such fees become due and payable.

Because the Advisor's trading system signals only 5 trades per year on average (excluding contract rollovers to a later delivery month), a new Account may encounter a wait of one or more months for its first trade. In view of this fact, the management and incentive fees described above shall become payable beginning on the date the first position in the Japanese yen is opened for the Account.

The initial monthly incentive fee shall be payable based on cumulative trading profits since the date the Account was opened.

The Advisor employs an always in the market trading system. Therefore, the Account will always be long or short the yen after the first position is opened for the Account.

7. RESPONSIBILITIES OF THE BROKER. Client recognizes that the Advisor will transmit orders on the Client's behalf to the Broker but will not execute such orders. The Advisor's responsibilities with respect to any of Client's transactions shall be fulfilled at the time that a complete order has been transmitted to the Broker. The Advisor shall not be responsible for any acts, omissions or errors of the Broker in executing such orders. The Broker will furnish Client with confirmations of all transactions executed in the Account, monthly statements showing information concerning trading activities in the Account and other account statements customarily furnished by the Broker to its customers. The furnishing of such reports shall be the sole responsibility of Broker and Client recognizes that the Advisor is not required to furnish such reports to Client. Client authorizes Broker to forward to Advisor copies of any confirmations, statements or reports sent by Broker to Client. Client understands that Broker, rather than Advisor, will have full custody of Client's funds and commodity interest positions and that Client will be required to pay brokerage commissions to Broker.

8. TERMS AND CONDITIONS FOR TERMINATION. This Agreement shall remain in effect until terminated by the receipt of written notice from either party to the other. The Advisor or Client may terminate this Agreement for any reason. In addition, this Agreement shall terminate upon receipt of written notice to Advisor of the death, legal disability or bankruptcy of Client. The Advisor may terminate this Agreement if the Account is charged a commission rate in excess of $20.00 per round-turn trade. When this Agreement is terminated by either party, Client shall be liable for any losses incurred in liquidating open positions; brokerage expenses; and fees.

9. NOTICES. All written notices to the Advisor shall be sent to: TASAS Capital Management, Inc., 4000 S. Eastern Ave., Suite 240, Las Vegas, Nevada 89119, fax (702) 451-2499. All written notices to the Client shall be sent to the Client at the address set forth below his or her signature to this Agreement. Either party may change their address by sending written notice to the other party.

10. MANAGEMENT OF OTHER ACCOUNTS BY THE ADVISOR; TRADING BY THE ADVISOR FOR ITS OWN ACCOUNTS. The services rendered hereunder are not exclusive and Client acknowledges and agrees that the Advisor may render similar services to others. The Advisor, its principal and employees may trade commodity interests for their own accounts.

11. CONFIDENTIALITY. The Client hereby acknowledges and agrees that the advice, advisory services and trades made on behalf of the Client by the Advisor and all information and data pertaining thereto is the proprietary property and confidential information of the Advisor and shall not be disclosed to third parties without the prior written consent of the Advisor.

12. ASSIGNMENT. This Agreement shall not be assignable by Client or the Advisor without the written consent of both parties and shall be binding upon the parties hereto and their respective heirs, executors, administrators, successors and assigns.

13. SECTION HEADINGS. The section headings in the Agreement are for convenience of reference only and shall not be deemed to interpret or modify the provisions of this Agreement.

14. GOVERNING LAW. This Agreement and all transactions subject to this Agreement shall be governed by the Commodity Exchange Act, as amended; the rules, regulations and orders promulgated under such Act by the CFTC; the rules and by-laws of the National Futures Association; and, where applicable, the laws of the State of Nevada applicable to the construction and enforcement of contracts made in that state. If any provision is found unenforceable, then this Agreement shall be enforced and construed as if that invalid portion did not appear.

15. JURISDICTION. The parties hereby agree that any dispute which arises from the Client's Account or any related matters shall be resolved, whether by arbitration or otherwise, within the State of Nevada, U.S.A. Accordingly, the parties consent and submit to the jurisdiction of the federal and state courts located within such state and further agree that any action or proceeding brought by either party to enforce any right, assert any claim or obtain any relief whatsoever in connection with this Agreement shall be commenced by such party exclusively in the federal or state courts, or, if appropriate, before an arbitrator, located within such state.

16. ENTIRE AGREEMENT. This Agreement constitutes the entire Agreement between the parties and supersedes any other Agreements.

IN WITNESS WHEREOF, the parties have caused this Managed Account Agreement to be duly executed as of the ________day of______________________, 19____.

If Joint Account:

______________________________ Client Signature	______________________________ Client Signature
______________________________ Client Name (Print or Type)	______________________________ Client Name (Print or Type)
______________________________ Date	______________________________ Date

If there are more than two joint account owners, please use an additional sheet.

Client's name and address for written notices to Client:

____
Client Name (Print or Type)

____
Address

____
City, State, Zip

By:

__________________________ __________________________
Craig D. Pardey Date
President
TASAS Capital Management, Inc.

TASAS Capital Management, Inc.
4000 S. Eastern Ave., Suite 240
Las Vegas, Nevada 89119
Tel. (702) 451-2490
Fax (702) 451-2499

COMMODITY TRADING AUTHORIZATION

To: TASAS Capital Management, Inc.
4000 S. Eastern Ave., Suite 240
Las Vegas, Nevada 89119

I (We), the undersigned, do hereby make, constitute, and appoint you or your authorized representative as my attorney-in-fact to purchase and sell commodity interests through Lind-Waldock & Company ("Broker"), a futures commission merchant, pursuant to the trading program described in the TASAS Capital Management, Inc. Disclosure Document dated February 16, 1999.

I further authorize the Broker to pay from my account all of your advisory fees upon presentation by you to the Broker of a billing statement. I understand the Broker will also charge me brokerage commissions which will be deducted from my account.

If Joint Account:

Client Signature	Client Signature
Client Name (Print or Type)	Client Name (Print or Type)
Date	Date

If there are more than two joint account owners, please use an additional sheet.

TASAS Capital Management, Inc.
4000 S. Eastern Ave., Suite 240
Las Vegas, Nevada 89119
Tel. (702) 451-2490
Fax (702) 451-2499

FEE PAYMENT AUTHORIZATION

To: Lind-Waldock & Company
1030 West Van Buren Street
Chicago, Illinois 60607

You are hereby authorized to deduct and remit directly to TASAS Capital Management, Inc., (the "Advisor") such management and incentive fees ("Fees") as the Advisor requests on a monthly basis.

The Advisor will inform you of the exact amount due on the agreed upon payment dates. The undersigned acknowledges and agrees that the Advisor is solely responsible for the computation of Fees and authorizes you to rely on remittance instructions submitted by the Advisor completely without regard to amount and without further direction or confirmation from the undersigned. This authorization will continue in effect until you have received written notice terminating it from the undersigned. Such written notice will also be given to the Advisor by the undersigned.

If Joint Account:

Client Signature

Client Signature

Client Name (Print or Type)

Client Name (Print or Type)

Date

Date

If there are more than two joint account owners, please use an additional sheet.

TASAS Capital Management, Inc.
4000 S. Eastern Ave., Suite 240
Las Vegas, Nevada 89119
Tel. (702) 451-2490
Fax (702) 451-2499

For the reasons outlined above, the Division continues to believe that the Company is required to register as a CTA and "A" is required to be listed as a principal and registered as an associated person of the Company.[6] You are advised that failure to comply with the registration requirements for CTAs and the use of misleading marketing materials constitute violations of the Act and the Commission's regulations, and may result in enforcement proceedings or other Commission actions. In addition, the Company, "A" and any persons participating in or aiding or abetting such conduct may be subject to prosecution for violation of the antifraud provisions of Section 4o of the Act,[7] regardless of registration status. Immediate compliance with the Commission's registration requirements does not necessarily preclude the Commission from taking action against the Company, "A" or any other persons for any past, present or future violations of the Act or the Commission's regulations thereunder.

If you have any questions concerning this correspondence, please contact me or Natalie A. Markman, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin

Chief Counsel

[¶ 26,762] CFTC Interpretative Letter No. 96-57. (Re: Rule 4.35(a)((7)—Request to Treat as Non-Proprietary an Account Owned by the Mother of the Commodity Trading Advisor ("CTA") Who Directs Trading of the Account.)

Commodity Futures Trading Commission. Division of Trading and Markets. July 8, 1996. Staff reply in full text.

Interpretations—Account Performance—Proprietary.—A registered CTA's request to treat the performance of an account owned by the CTA's mother as though it were the performance of an ordinary client account, and not proprietary trading results within the meaning of Rule 4.35(a)(7) was denied. The account was the sole account traded pursuant to the trading program for which the CTA wished to present performance as part of the required performance presentation in its disclosure document.

See ¶ 8575, "Reports—Records" division, Volume 1.

This is in response to your recent letter to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission") as supplemented by telephone conversations with Division staff.[1] By your correspondence, you request on behalf of "X", a registered CTA ("X"), relief from the requirements of Commission Rule 4.35(a)(7)[2] with respect to presentation in "X's" Disclosure Document of the past performance of an account owned by your mother, "A". Absent relief, "X" would be required to place the performance data with respect to "A's" account at the end of the Disclosure Document, and prominently to label such performance as proprietary.

Based upon the representations made in your correspondence, we understand the relevant facts to be as follows. "X" began trading its "Y" Program in January 1996. From the date of inception of trading to the present, the sole account traded pursuant to the "Y" Program has been "A's" account. You represent that leveraging in the "Y" Program is moderate and that client accounts will be treated no differently from "A's" account with respect to exposure to volatility and risk. The margin to equity ratio for "A's" account averages twenty percent and approximately the same ratio will be maintained for any client accounts in the "Y" Program. Advisory fees charged to "A's" account (zero percent management fee and twenty percent incentive fee) are the same fees that "X",

[6] However, since it does not appear that they would be directing or guiding accounts, they would not be required to prepare and provide disclosure documents. *See* CFTC Interpretative Letter No. 95-101, [Current Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 26,565 (November 21, 1995).

[7] 7 U.S.C. § 6o (1994). "U" includes statements such as the following that emphasize the huge profit potential of investing in commodity interests by following "X's" advice without an equally prominent statement of the risk of loss:

> If you have not obtained that dream lifestyle yet, I will not only show you how to reach for it, but I will be there to guide you in the right direction, offering support as you need it.
>
> You should easily triple whatever money you have invested on almost every trade. Though there will be some losses, ... those losses will be minimal. Your profits, on the other hand, should be enough to achieve your dreams.

Such statements appear in both "U" and the "V".

[1] Your letter is undated. Division records indicate that it was received May 10, 1996. We note that you met with Division staff on June 4, 1996 to discuss the contents of your letter.

[2] Commission rules referred to herein are found at 17 C.F.R. Ch. I (1995), *as amended by* 60 Fed. Reg. 38146 (July 25, 1995, effective August 24, 1995).

charges its other current account,[3] and that "X" discloses to prospective clients in its Disclosure Document.

You further represent that "A's" account is charged commissions for each round turn of fifteen dollars plus the fees charged by the National Futures Association and exchange fees. "A's" account receives no reduction in commissions by virtue of any agreement or relationship between "X" and the futures commission merchant with which the account is maintained or the introducing broker. This commission rate (which is higher than the rate charged to "X's" other existing account) will be charged each client accepted into the "Y" Program.

You state that "A" has no business interest in "X", and that she has not exerted (and will not in the future exert) "any unnatural or abnormal pressure" on you that might materially affect the manner in which her account is traded. On this basis, you argue that notwithstanding "A's" family relationship with you, her account should be treated as "outside" "X" for purposes of calculating assets under management, and for purposes of presenting past performance information.

Effective August 24, 1995 the Commission adopted extensive revisions to the disclosure requirements applicable to CTAs and commodity pool operators (the "Part 4 Revisions"), in which the Commission expressly addressed the inclusion in Disclosure Documents of proprietary trading results.[4] Acknowledging that for many start-up CTAs, proprietary trading results are the only "track record" available to present to prospective clients, the Commission decided to permit the use of proprietary trading results, subject to certain safeguards. As adopted, Rule 4.35(a)(7)(ii) defines proprietary trading results to include:

> the performance of any account in which fifty percent or more of the beneficial interest is owned or controlled by:
>
> * * *
>
> (B) An affiliate or family member of the commodity trading advisor; ...

Rule 4.34(n)(3)(iii) requires that any proprietary trading results (together with any hypothetical, extracted, pro forma or simulated trading results) be placed at the end of the Disclosure Document. The Commission noted that this requirement "reflects the relatively low utility of such data and the relatively high potential for confusion of proprietary and customer trading results."[5]

In proposing and adopting the Part 4 Revisions, the Commission discussed a number of significant concerns raised by the use of proprietary trading results, noting that proprietary accounts may be traded more aggressively, with higher leverage and greater risk than customer accounts, and that proprietary accounts and customer accounts are usually subject to different fee schedules. Moreover, where proprietary and customer accounts are combined for purposes of performance presentations, the total amount of assets under management is inflated and conceals the actual amount of customer funds being traded.[6]

In your correspondence you argue that the reasons underlying the Commission's special treatment of proprietary trading results do not apply to "A's" account, and that you should be permitted to present the performance of that account as though it were an unaffiliated client account. In support of your position you claim that any outside client accounts that are accepted into the "Y" Program will be charged the same fees and will be traded in the same way and with the same leverage as "A's" account. You contend that because "A" has no business interest in "X", her account is "outside" "X" and cannot be used to inflate assets under management.

We do not, however, believe that these factors justify a waiver of the Commission's requirements, particularly since the Commission's rules do not preclude the presentation of proprietary trading results, but only the treatment of such results as the results of client accounts. The performance of "A's" account clearly fits the definition of a proprietary trading results. Your representations that "A's" account is effectively a "customer" account notwithstanding that "X's" "Y" Program has yet to attract unaffiliated client money do not support, in our view, recharacterization of the account's trading results as customer account data. To the extent that a prospective client were to use "X's" Dis-

[3] "X's" other account is traded pursuant to "X's" "Z" Program.

[4] *See* 60 Fed. Reg. 38146 at 38167-38168 (July 25, 1995). Prior to the Part 4 Revisions, use of proprietary trading results was not specifically referenced in the Commission's rules, although Commission staff had advised registrants that any proprietary trading results presented in a Disclosure Document must be clearly labeled as such and presented in a separate table. *See* 59 Fed. Reg. 25351, 25360 (May 16, 1994). Staff had also required that if fees, expenses, commissions, margin-to-equity ratios, or any other item pertaining to the proprietary trading was materially different from that relevant to the pool or trading program offered to participants or clients the registrant must "pro forma" such items to correspond to those in the pool or program being offered. The Commission continues to require registrants to make such pro-forma adjustments to proprietary trading results.

[5] *See* 60 Fed. Reg. 38146 at 38167.

[6] *See* 60 Fed. Reg. at 38167-38168.

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(July 25, 1995).

[2] The APs ar
"I", "J", "K",
"T", "U" and
are listed as bra

closure Document to evaluate the ability of "X" to attract and retain outside clients, failure to designate "A's" account as proprietary would be misleading.

Accordingly, "X" is required by Rule 4.35(a)(7) clearly to indicate that the performance of "A's" account is proprietary, and if included in "X's" Disclosure Document, such performance must be placed in accordance with Rules 4.35(a)(7) and 4.34(n).

If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, an attorney on my staff, at (202) 418-5445.

Very truly yours,

Susan C. Ervin

Chief Counsel

[¶ 26,763] CFTC Interpretative Letter No. 96-58. (Re: Rule 3.34—Request for Clarification of Ethics Training Requirements for Registered APs Who Do Not Conduct Any Futures or Commodity Interest Business.)

Commodity Futures Trading Commission, Division of Trading and Markets. July 12, 1996. Staff reply in full text.

Interpretations—APs—Ethics Training.—Registered APs must satisfy ethics training requirements even though they do not conduct any futures or commodity interest business. As APs did not attend an ethics training session that would satisfy the requirements of Rule 3.34 by April 26, 1996, they have been and continue to be in violation of Rule 3.34. Accordingly, the APs must complete their ethics training without delay and the firm is obligated to assure that they do so. However, this did not absolve the APs or the firm for any past violations of the CEA or CFTC regulations and the CFTC may proceed against the APs of the firm for any past violations of the CEA or CFTC regulations if the agency determines that such action is appropriate.

See ¶ 7425, "Registration" division, Volume 1.

This is in response to your letter dated June 18, 1996, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations with Division staff. You request clarification of the ethics training requirements set forth in Commission Rule 3.34 [1] on behalf of twenty-two registered associated persons ("APs") employed by "X", a registered futures commission merchant and commodity trading advisor.

Based upon the representations contained in your letter, as supplemented, we understand the relevant facts to be as follows. The twenty-two APs ("22 APs") do not wish to complete ethics training because they do not conduct any futures or other commodity interest business. [2] You represent that "X" has suspended the 22 APs' ability to do any business and has emphasized the importance of completing the required training. The firm would prefer that the 22 APs remain registered, without trading privileges, until they complete the required training. "X" requests guidance on any rules or written procedures describing the actions it should take.

Section 4p(b) of the Commodity Exchange Act ("Act") [3] and Rule 3.34 impose certain ethics training requirements on all Commission registrants. Rule 3.34(d)(5) provides in pertinent part that APs granted registration after April 26, 1993 must attend four hours of initial ethics training within six months from the date registration is granted and one hour of training every three years thereafter. Pursuant to Rule 3.34(d)(4), those persons who were registered when Rule 3.34 became effective on April 26, 1993 were given until April 26, 1996 to attend an initial ethics training session of two hours, with one hour of training every three years thereafter. [4] As the 22 APs did not attend an ethics training session that would satisfy the requirements of Rule 3.34 by April 26, 1996, they have been and continue to be in violation of Rule 3.34.

The Commission's general policy is to require a person registered in a particular capacity to comply with all of the regulations pertaining to that category of registrant, irrespective of whether such person actively engages in all activities permitted by virtue of his or her regis-

[1] Commission rules referred to herein are found at 17 C.F.R. Ch. I (1995), *as amended by* 60 Fed. Reg. 38146 (July 25, 1995).

[2] The APs are: "A", "B", "C", "D", "E", "F", "G", "H", "I", "J", "K", "L", "M", "N", "O", "P", "Q", "R", "S", "T", "U" and "V". "K" and "F", "G", "J", "O" and "V" are listed as branch managers as well.

[3] 7 U.S.C. § 6p(b) (1994).

[4] With the exception of "S", all of the 22 APs were granted registration before April 26, 1993 and were required to attend two hours of initial ethics training by April 26, 1996. "S" was required to attend four hours of such training by the same date since he became registered on October 26, 1995.

federal register

Tuesday
July 25, 1995

Part III

Commodity Futures Trading Commission

17 CFR Parts 1, 4, 30, and 150
Amendments to Commodity Pool Operator and Commodity Trading; Final Rule

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 4, 30, 150

Amendments to Commodity Pool Operator and Commodity Trading Advisor Disclosure Rules

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The Commodity Futures Trading Commission ("Commission") is announcing the adoption of substantial revisions to the disclosure framework applicable to commodity pool operators ("CPOs") and commodity trading advisors ("CTAs"). These amendments are intended to achieve greater simplicity, focus and clarity in performance history; to streamline other required disclosures; to improve the presentation and understandability of disclosures to investors; and to create a more concise and readable format for Disclosure Documents.

EFFECTIVE DATE: August 24, 1995.

FOR FURTHER INFORMATION CONTACT: Susan C. Ervin, Deputy Director/Chief Counsel, Barbara Stern Gold, Assistant Chief Counsel, or Christopher W. Cummings, Attorney/Advisor, Division of Trading and Markets, Commodity Futures Trading Commission, 2033 K Street, NW., Washington, DC 20581. Telephone: (202) 254–8955.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background
A. Development of Proposed Part 4 Revisions
B. National Futures Association Proposals
C. April 25, 1995 Roundtable Discussion
D. Review of Public Comments
II. Transitional Provisions
III. Summary of Rule Changes
A. Definitions
B. Required Performance Disclosures
C. Required Non-Performance Disclosures
D. Non-Required Disclosures
E. Format Improvements to Enhance Readability
F. Other Revisions
G. Distribution Table
IV. Definitions
A. Major Commodity Trading Advisor: Rule 4.10(i)
B. Major Investee Pool: Rule 4.10(d)(5)
C. Multi-Advisor Pool: Rule 4.10(d)(2)
D. Principal-Protected Pool: Rule 4.10(d)(3)
E. Trading Manager: Rule 4.10(h)
F. Trading Principal: Rule 4.10(e)(2)
G. Break-Even Point: Rule 4.10(j)
H. Draw-Down and Worst Peak-To-Valley Draw-Down: Rules 4.10(k) and (l)
V. Performance Disclosures: Section-by-Section Analysis
A. Introduction
B. Required Performance Disclosures
1. *Required Performance Disclosures in CPO Disclosure Documents: Rule 4.25*
a. *Capsule Performance Presentation: Rule 4.25(a)(1)*
b. *Pools With Three or More Years Operating History that Meet Contribution Criteria: Rule 4.25(b)*
c. *Pools With Less Than A Three-Year Operating History: Rule 4.25(c)*
2. *Required Past Performance Disclosure in CTA Disclosure Documents: Rule 4.35*
3. *Time Period for Which Required Past Performance Disclosure Must Be Made: Rules 4.25(a)(5) for CPOs and 4.35(a)(5) for CTAs*
4. *Composite Performance Presentations: Rules 4.25 (a)(3) and (a)(4) for CPOs and Rule 4.35(a)(3) for CTAs*
a. CPO Disclosure Documents
b. CTA Disclosure Documents
c. Substantiating Composite Presentations
5. *Order of Required Performance Disclosures: Rules 4.25(a)(2), (a)(3)(i) and (a)(3)(ii) for CPOs and 4.35 (a)(1) and (a)(2) for CTAs*
6. *Required Performance Legends*
a. *Legends Relating to Lack of Trading Experience: Rules 4.25(c) for CPOs and 4.35(b) for CTAs*
b. *Legends Relating to Predictive Value of Past Performance: Rules 4.25(a)(8) for CPOs and 4.35(a)(8) for CTAs*
7. *Summary Tables*
a. *Performance Disclosure Requirements*
b. *Sample Capsule Performance Presentations*
c. *Sample Bar Chart/Graph of Monthly Rates of Return*
C. Non-Required Performance Disclosures
1. *Voluntary and Supplemental Performance Disclosures: Rules 4.24(v) for CPOs and 4.34(n) for CTAs*
2. *Proprietary Trading Results: Rules 4.25(a)(8) for CPOs and 4.35(a)(7) for CTAs*
3. *Pro-Forma, Hypothetical and Extracted Performance Results*
VI. Non-Performance Disclosures: Section-by-Section Analysis
A. Introduction
1. *Disclosures Concerning a Pool's CTAs*
2. *Disclosures Concerning Investee Pools*
B. Required Non-Performance Disclosures
1. *Prescribed Non-Performance Statements, Table of Contents and Forepart Information: Rules 4.24 (a) through (d) for CPOs and 4.34 (a) through (d) for CTAs*
a. *Cautionary Statement*
b. *Risk Disclosure Statement*
c. *Table of Contents*
d. *Information To Be Included in Forepart*
e. *Persons To Be Identified*
2. *Business Background: Rules 4.24(f) for CPOs and 4.34(f) for CTAs*
3. *Principal Risk Factors: Rules 4.24(g) for CPOs and 4.34(g) for CTAs*
4. *Investment Program and Use of Proceeds: Rule 4.24(h) for CPOs*
5. *Fees and Expenses; "Break-even" Analysis: Rules 4.24(i) for CPOs and 4.34(i) for CTAs*
6. *Conflicts of Interest: Rules 4.24(j) for CPOs and 4.34(j) for CTAs; Related Party Transactions: Rule 4.24(k) for CPOs*
a. *Conflicts of Interests—CPOs*
b. *Conflicts of Interests—CTAs*
c. *Related Party Transactions*
7. *Litigation: Rules 4.24(l) for CPOs and 4.34(k) for CTAs*
8. *Principal-Protected Pools: Rule 4.24(o) for CPOs*
C. Supplemental and Voluntary Disclosures: Rules 4.24(v) for CPOs and 4.34(m) for CTAs
VII. Other Changes
A. Deletion of Negative Disclosures
B. Use, Amendment and Filing of Disclosure Documents: Rules 4.26 for CPOs and 4.36 for CTAs
C. Disclosure Document Delivery Requirements
1. *Notice of Intended Offering and Term Sheet*
2. *Acknowledgment of Disclosure Document*
D. Conforming Changes
VIII. Related Matters
A. Regulatory Flexibility Act
B. Paperwork Reduction Act

I. Background

A. Development of Proposed Part 4 Revisions

On May 5, 1994, the Commission proposed comprehensive revisions to the disclosure framework for CPOs and CTAs ("Proposing Release").[1] This proposal followed more than fifteen years of experience in administering the part 4 disclosure framework and reflected a comprehensive review of the disclosure requirements for CPOs and CTAs designed to identify aspects of the regulatory structure that could be streamlined or simplified, while enhancing appropriate customer protection. The first phase of this review resulted in the adoption of Rules 4.7 and 4.8 in 1992.[2] The adoption of the rules set forth herein is part of the second phase of the Commission's review of part 4.[3] As the Commission

[1] 59 FR 25351 (May 16, 1994). The initial sixty-day period for public comment on the Proposing Release expired on July 15, 1994 but was extended to August 17, 1994. The proposed amendments included conforming changes to other rules, e.g., to Rule 30.6, which pertains to disclosures required of CPOs and CTAs offering pools or accounts, respectively, to trade in foreign futures contracts as defined in Rule 30.1. 59 FR 37189 (July 21, 1994).

The Commission's rules governing the operations of CPOs and CTAs are set forth in part 4 of the Commission's regulations, 17 CFR part 4 (1994). All other Commission rules referred to herein are found at 17 CFR Ch. I (1994).

[2] Rule 4.7 provides relief from certain disclosure, reporting and recordkeeping requirements applicable to CPOs for pools offered and sold only to "qualified eligible participants" and CTAs providing commodity interest trading advice to "qualified eligible clients," as defined therein, and who satisfy other specified criteria for relief. Rule 4.8 provides relief from the twenty-one day Disclosure Document pre-filing requirement (now contained in new Rule 4.26(d)(1)) for CPOs of certain privately-offered pools.

[3] This second phase will also consider, in consultation with the Securities and Exchange

stated in the Proposing Release, the purposes of these revisions are: (1) Simplification of past performance disclosures; (2) reduction of required disclosures concerning matters of secondary relevance; and (3) clarification and modernization of various requirements.[4]

In announcing the adoption of part 4 in 1979, the Commission stated that the Disclosure Document requirement for CPOs was intended "to protect pool participants—particularly those who are unsophisticated in financial matters—by ensuring that they are informed about the material facts regarding the pool before they commit their funds."[5] Similarly, the Disclosure Document requirement for CTAs was premised, in part, upon the view that "a prospective [CTA] client or subscriber should be aware of the advisor's commodity and general business experience if he is to make an informed decision as to whether or not to avail himself of the advisor's services."[6]

In the Proposing Release, the Commission noted that since the original adoption of the part 4 rules, the number of registered CPOs had more than doubled and the number of CTAs had increased nearly threefold;[7] assets under the management of CPOs had grown dramatically;[8] and the range of available futures and option contracts had increased substantially.[9] In addition, during the past decade, trading structures and investment portfolios have become increasingly diverse and complex. A single commodity pool may engage multiple CTAs and invest in multiple commodity pools ("investee pools")[10] or securities funds in order to access the services of particular traders or advisors, employ multiple trading strategies or programs, or diversify its portfolio.[11] Further, commodity pools frequently retain "trading managers" to recommend or select CTAs to manage, or funds in which to invest, the pool's assets[12] and may employ dynamic asset allocation strategies entailing periodic replacement of, or reallocation of assets among, CTAs for the pool.

In implementing its statutory mandate to regulate the activities of CPOs and CTAs, the Commission has endeavored to refine its rules as appropriate to respond to changing market conditions in a manner consistent with customer protection.[13] The Commission's Division of Trading and Markets ("Division") has issued relief on a case-by-case basis to facilitate application of the disclosure requirements to new market conditions not contemplated by the existing regulatory framework, such as multi-advisor and fund-of-funds structures. The objective in such cases is to apply the rules so as to foster clear and succinct disclosure of material information, especially concerning fees and other aspects of fund operations affected by such structures, taking into account the particular characteristics of the offered investment vehicle.[14] In many cases, strict application of existing disclosure requirements to pools whose CPOs have voluminous performance histories or which invest through multiple CTAs or investee funds could result in undue emphasis upon performance record disclosure and reduced focus upon more germane data. These effects have been mitigated in appropriate circumstances through grants of exemptive or no-action relief.[15]

Thus, the proposal to revise the part 4 rules reflected the Commission's experience in addressing a wide range of CPO and CTA disclosure issues under the prior rules, the evolution of the marketplace, the development of new trading structures and the views of the public and of market participants.

B. National Futures Association Proposals

As detailed in the Proposing Release,[16] on March 15, 1994, the National Futures Association ("NFA") submitted to the Commission proposed amendments to, and interpretations of, NFA's Compliance Rules based upon the recommendations of NFA's Special Committee for the Review of CPO/CTA Disclosure Issues ("NFA's Submission"). NFA's Submission consisted of several parts, including: Proposals concerning presentation of past performance data, including proposed capsule formats for CPO and CTA performance; proposed requirements for calculation and disclosure of break-even analyses by CPOs; proposed rules for the use of hypothetical trading results by NFA members in promotional material; and proposals dealing with the use of "nominal" or "notionally funded" accounts. The proposals requiring, and providing instructions for, break-even analyses were published for public comment and subsequently approved by the Commission on April 26, 1995, substantially as proposed.[17] Rule 4.10(j)

Commission and the states, the appropriateness of a two-part format for pool Disclosure documents. *See* 59 FR 25351.

[4] 59 FR 25351. These revisions do not, however, affect the basic organizational structure of part 4. Thus, the subparts thereunder continue to apply as follows: subpart A, to definitions and exemptions (Rule 4.1 *et seq.*); subpart B, to the operations and activities of CPOs (Rule 4.20 *et seq.*); subpart C, to the operations and activities of CTAs (Rule 4.30 *et seq.*); and subpart D, to advertising (Rule 4.40 *et seq.*).

[5] 44 FR 1918, 1920 (January 8, 1979).

[6] 42 FR 9266, 9270 (February 15, 1977).

[7] 59 FR 25351, 25352 and n.7.

[8] 59 FR 25351, 25352 and n.8.

[9] 59 FR 25351, 25352 and n.9.

[10] Rule 4.10(d)(4) defines the term "investee pool," discussed more fully below.

[11] 59 FR 25351, 25353 and n.11.

[12] 59 FR 25351, 25353; Rule 4.10(h) defines the term "trading manager," as discussed more fully below.

[13] *See, e.g.*, Rules 4.8, 4.12(b) and 4.7, adopted in 1985, 1987 and 1992, respectively, and the discussion of those rules at 59 FR 25351, 25353.

[14] 59 FR 25351, 25353–25354. In reviewing Disclosure Documents for fund-of-funds structures, Division comment letters previously have stated that although pool documents should provide all information required by (former) Rule 4.21 for each investee pool, "generally at the same level of detail as though the investee pool were providing its own separate disclosure document," nevertheless reduced disclosures are appropriate where less than twenty-five percent of the assets of the offered pool would be invested in an investee pool. The Division has also provided guidance through interpretative statements and advisories with respect to past performance presentations in Disclosure Documents. *See, e.g.*, CFTC Advisory 87–2, [1986–1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,624 (June 2, 1987), defining the term "beginning net asset value" for rate of return calculations; CFTC Advisory (unnumbered, dated February 27, 1991), [1990–1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,005, permitting CPOs and CTAs to use alternative rate of return computation methods to more accurately reflect the return on funds available for trading during the period; and CFTC Advisory 93–13, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,594 (February 12, 1993), permitting the use of an alternative method for computing CTAs' rates of return.

As noted below (*see* n.15), the staff addresses specific requests for relief on a case-by-case basis.

[15] *See, e.g.*, CFTC Interpretative Letter No. 94–12, [Current Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 25,963 (December 27, 1993) (capsule performance disclosure permitted for CPO's other pools; CFTC Interpretative Letter No. 94–10, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,961 (December 16, 1993) (capsule performance disclosure permitted); CFTC Interpretative Letter No. 93–107, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,896 (October 26, 1993) (CPO permitted to omit disclosures concerning its single advisor pools in Disclosure Document for a multi-advisor pool under certain conditions); CFTC Interpretative Letter No. 92–12, [1990–1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,343 (July 24, 1992) (CPO permitted to omit required disclosures concerning CTAs and investee pools allocated less than 10% of pool's assets under certain conditions); and CFTC Interpretative Letter No. 92–8, [1990–1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,300 (June 1, 1992) (CPO permitted to use two-part Disclosure Document with past performance of CTAs in second part delivered contemporaneously with first part) and Advisory 27–92 (June 2, 1992) (Commission has no objection to use of two-part Disclosure Document subject to conditions set forth in Interpretative Letter 92–8), issued in connection therewith. The foregoing generally are discussed at 59 FR 25351, 25353–54.

[16] *See* 59 FR 25351, 25354.

[17] NFA Compliance Rule 2–13(b) and Interpretive Notice to Compliance Rule 2–13(b). The "break-

Continued

incorporates by reference NFA's instructions for calculating the "break-even" point. The portion of NFA's Submission concerning hypothetical trading results[18] was modified by NFA in response to Commission and public comments and remains under consideration.[19] Rule 4.41, revised as discussed herein, permits persons to follow either the Commission or rules adopted by NFA.

NFA's Submission included proposed rules with respect to past performance presentations, which were considered by the Commission in preparing the recommendations set forth in the Proposing Release. As noted in the Proposing Release, the portion of NFA's Submission addressing the use of "nominal" or "notionally funded" accounts was remitted to the NFA for further explanation and documentation. The Commission is not addressing the issue of "nominal" or "notional" account size in this release.

C. April 25, 1995 Roundtable Discussion

On April 25, 1995, the Commission convened a roundtable discussion led by Chairman Mary L. Schapiro, entitled "Rethinking Past Performance Disclosure," to elicit input from industry, academic, end-user, regulatory and other sources with respect to public policy issues relevant to past performance disclosure, as well as technical and pragmatic aspects of past performance presentations. A number of the speakers expressed the view that past performance data alone are not directly predictive of future trading results but that past performance data provide information that is important in evaluating a contemplated pool offering or trading program. For example, patterns of volatility and other trading patterns in various market conditions may be evident.

Participants also noted the tendency for past performance data to have a potent persuasive effect, which some viewed as significantly exceeding the usefulness of such information as a basis for an investment decision. Speakers discussed the effect of such factors as the volume of performance data and the format in which performance information is provided, the utility of monthly as opposed to annual rates of return, and the extent to which meaningful benchmarks or standards are available to measure performance.[20]

D. Review of Public Comments

The Commission received thirty comment letters in response to the Proposing Release: three from persons registered as CTAs; five from persons registered as both a CPO and a CTA; two from persons registered as both a CTA and an introducing broker ("IB"); two from persons registered as futures commission merchants ("FCMs"); two from self-regulatory organizations; two from a futures industry trade organization; two from certified public accountants; nine from law firms; two from bar associations; and one from an academician.

The commenters strongly supported the rulemaking in general. Many commenters, however, advocated changes in various aspects of the proposed rules. The Commission has carefully considered the comments received and, based upon its review of the comments and its own reconsideration of the proposed amendments, has determined to adopt the revisions contained in the Proposing Release, with certain modifications, as discussed below. Comments received on the proposed amendments are discussed below in the context of the particular provisions to which they relate.

The Commission believes that the revised rules, as adopted, not only respond to the concerns of the commenters but, also, meet the regulatory objectives of this rulemaking. Notwithstanding the adoption of the rule amendments discussed herein, the Commission intends that the staff will continue to respond to requests for relief from the Part 4 rules on a case-by-case basis consistent with the objectives and principles of this rulemaking. The Commission also is exploring possible mechanisms for addressing additional CPO and CTA disclosure issues with the benefit of industry and other external input, including input from other federal and state regulators, on an ongoing basis.

II. Transitional Provisions

The revisions being announced today will become effective thirty days from the date hereof, but Disclosure Documents may be prepared, filed and used in accordance with the revised rules prior to the effective date. To facilitate the transition to compliance with the revised rules adopted herein, the Commission has determined that, for a period of six months after the effective date, it will not take enforcement action against any person solely on the basis of such person's use of a Disclosure Document prepared pursuant to the former rules rather than the revised rules. For pools that are continuously offered, amendment of the Disclosure Document is not required solely due to the rule revisions announced herein, and operators of such pools may make conforming changes as part of their next regular update.

Persons to whom the Division previously has granted exemptive or no-action relief permitting them to prepare Disclosure Documents in accordance with certain provisions of the proposed rules set forth in the Proposing Release are reminded that such relief is superseded by the revisions adopted herein, and any Disclosure Document used by any such person subsequent to the effective date of these revisions must comply with the revised rules.

III. Summary of Rule Changes

The following summary is intended to provide interested persons with information concerning significant changes to the Commission's disclosure framework and the manner in which those changes vary, if at all, from the Commission's proposals. These and all other changes to part 4 and other Commission rules are discussed below in the section-by-section analysis. For purposes of this release, the rules as in effect prior to the amendments discussed herein are referred to as the "former" rules.

A. Definitions[21]

Many of the proposed amendments set forth in the Proposing Release introduced new concepts into the rules. As a consequence, the Proposing Release contained several new definitions designed to modernize the rules in light of marketplace developments and to aid in implementation of the revised rules. Several of these new definitions have been adopted with modifications: "multi-advisor pool" (Rule 4.10(d)(2)); "principal-protected pool," which was proposed as "limited risk pool" (Rule 4.10(d)(3)); "trading manager" (Rule 4.10(h)); "major commodity trading advisor" (Rule 4.10(i)); "major investee pool" (Rule 4.10(d)(5)); "trading principal" (Rule 4.10(e)(2)); and "break-even point" (Rule 4.10(j)). Two of the proposed definitions have been

even" analysis is a computation of the trading profit that a pool must realize in the first year of an investor's participation for the investor to recoup his or her initial investment.

[18] Proposed NFA Compliance Rule 2-29(c).

[19] Separately, the Commission contemplates further review of the subject of hypothetical performance presentations to assure adequate safeguards against the misuse of such disclosure.

[20] A summary of the roundtable discussion is on file with the Commission's Office of the Secretariat.

[21] The section-by-section analysis of revised and new definitions is set forth in Section IV below.

eliminated,[22] and three additional definitions which were not included in the Proposing Release have been added: "investee pool" (Rule 4.10(d)(4)), "draw-down" (Rule 4.10(k)), and "worst peak-to-valley draw-down" (Rule 4.10(*l*)). As adopted, the new definitions are included in Rule 4.10, and where appropriate, related definitions have been made part of the same paragraph.[23]

B. Required Performance Disclosures [24]

1. CPO Disclosure Documents

Rule 4.25 of the amended rules creates a simplified structure for the presentation of required past performance by CPOs. In each case, the presentation must cover the five most recent calendar years and year-to-date, or the entire life of the subject pool, account or trading program, whichever is shorter. (Rule 4.25(a)(5)).

a. All required past performance presentations for pools are reduced to a summary, capsule format containing specified core information. (Rule 4.25(a)(1)). In a change from the proposal, CPOs may present monthly rates of return required for the offered pool for five calendar years and year-to-date either in tabular form or in a bar graph. (Rules 4.25(a)(1) and (a)(2)).

b. For an offered pool which meets the following criteria, the past performance record of only the offered pool itself is required to be presented in the Disclosure Document: (1) The pool has at least a three-year history of trading commodity interests; and (2) during that minimum three-year period at least seventy-five percent of the pool's assets were contributed by persons not affiliated with the CPO, trading manager, CTA or FCM for the pool, or their respective principals. (Rule 4.25(b)).

c. For offered pools which do not meet the three-year operating history criteria of Rule 4.25(b), past performance data for the offered pool, for other pools operated by (or accounts traded by) the CPO and trading manager, and for each "major" CTA or "major" investee pool is required.[25] If the CPO or trading manager has less than a three-year history in trading pools for which at least seventy-five percent of pool contributions were made by persons not affiliated with the CPO, trading manager, or CTA for the pool or their respective principals, the past performance of the CPO's (and trading manager's) trading principals [26] is required to be presented unless that performance does not differ materially from the performance of the offered pool and the CPO of the offered pool. (Rule 4.25(c)(2)).

d. The requirement in proposed Rule 4.25(c)(3)(iii) to disclose certain information under the designation "adverse performance" has not been adopted. However, the terms "major commodity trading advisor" and "major investee pool" have been redefined to include CTAs and investee pools with ten percent, rather than twenty-five percent, allocations of pool assets and a narrative discussion of the performance history of non-major CTAs and investee pools is required. (Rule 4.25(c)(5)).

2. CTA Disclosure Documents

Under proposed Rule 4.34(a)(1), CTAs would have been required to continue to present the performance of the offered trading program in the full multi-column tabular format previously required under Rule 4.31(a)(3). Performance of all other trading programs directed by the CTA would have been presented in the new capsule format used in CPO Disclosure Documents. As adopted, Rule 4.35(a)(1) permits CTAs to use a capsule format (similar to the capsule format adopted for CPOs) for all programs. The offered trading program's capsule must include monthly rates of return and the numbers of profitable and losing accounts in the trading program. The required monthly rates of return may be presented either in tabular form or as a bar graph, as is the case for the offered pool in a CPO Disclosure Document. As with CPO Documents, all required performance is to be presented for the five most recent calendar years and year-to-date or for the life of the trading program, whichever is shorter. (Rule 4.35(a)(5)).

C. Required Non-Performance Disclosures [27]

Required non-performance disclosures are revised as follows.

1. *Break-Even Point.* CPOs are required to disclose the pool's break-even point, indicating the trading profit the pool must realize in order for a participant to recover his entire initial investment if he redeems his interest after one year. (Rules 4.10(j), 4.24(d)(5) and 4.24(i)(6) for CPOs). The break-even point is required to be calculated in accordance with rules promulgated by a registered futures association pursuant to section 17(j) of the Commodity Exchange Act (the "Act").[28]

2. *Material Litigation.* Actions adjudicated on the merits in favor of persons whose litigation history is required need not be disclosed. Required disclosures concerning actions against FCMs and IBs are significantly reduced. (Rules 4.24(*l*) for CPOs and 4.34(k) for CTAs).

3. *Principal Risk Factors.* CPOs and CTAs must discuss the principal risk factors of the pool or trading program, including but not limited to volatility, leverage, liquidity and counter-party creditworthiness. (Rules 4.24(g) for CPOs and 4.34(g) for CTAs).

4. *Business Background.* Disclosure of the business backgrounds of principals is limited to principals (including officers and directors) who participate in making trading or operational decisions for the pool or CTA (or who supervise persons so engaged). Disclosure of CTA and investee pool operator business backgrounds in CPO Disclosure Documents is limited to major CTAs and major investee pools. (Rules 4.24(f) for CPOs and 4.34(f) for CTAs).

5. *Conflicts of Interest.* Rule 4.24(j) calls for a full description of actual and potential conflicts involving the CPO, the trading manager, major CTA or major pool operator and any principal thereof, as well as any person providing services to the pool or soliciting participants for the pool. The rule also calls for the disclosure of any other material conflict of interest involving the pool. Disclosure with respect to payment for order flow, soft dollar arrangements and similar arrangements is specifically called for. Rule 4.34(j) for CTAs also specifically references payment for order flow and soft dollar arrangements.

6. *Fees and Expenses.* Rule 4.24(i) requires the CPO to describe the expenses incurred in the previous year and to be incurred in the current year and to disclose fees and commissions in connection with pool solicitations. The rule also specifies significant expense categories not previously enumerated in Rule 4.21 and requires an explanation of

[22] The definition of "adverse performance," which was included in proposed Rule 4.25(a)(6), and the definition of "trading program," which was included in proposed Rule 4.34(a)(5), have not been adopted.

[23] Pool-related definitions are now sub-paragraphs of Rule 4.10(d) and the definition of "trading principal" has been included as a sub-paragraph of Rule 4.10(e).

[24] The section-by-section analysis of required performance disclosure revisions is set forth in Section V below.

[25] Rules 4.10(i) and 4.10(d)(5) define the terms "major commodity trading advisor" and "major investee pool," respectively.

[26] The term "trading principal" is defined in Rule 4.10(e)(2).

[27] A section-by-section analysis of required non-performance disclosure revisions is set forth in Section VI below.

[28] 7 U.S.C. 1 et seq. (1994). As noted above, NFA rules governing calculations of the break-even point are included in an Interpretive Notice accompanying NFA Compliance Rule 2-13(b), which Rule and Notice the Commission approved on April 26, 1995.

the calculation of t[illegible] break-even point. If a fee is de[illegible] reference to a base amount, [illegible] which the base amount is [illegible] be disclosed.[29] (Rules [illegible]d)(5) and 4.24(i) for CP[illegible](i) for CTAs).

D. Non-Required [illegible]

1. *Proprietary T*[illegible]ults. As proposed and as a[illegible] rules provide that prop[illegible]ing results presented in eithe[illegible] CTA Disclosure Docum[illegible] labelled as such and plac[illegible] of the document. (Rules [illegible] 4.25(a)(8) for CPOs, and 4.3[illegible]5(a)(7) for CTAs).

2. *Supplementa*[illegible] Proposed Rules 4.[illegible]33(d) generally would [illegible]d that information not s[illegible] called for by Commission ru[illegible]al or state securities laws or [illegible] could only appear following [illegible] required disclosure. The [illegible] adopted require that any [illegible]lly provided perform[illegible]tion be presented after the [illegible]uired performance pres[illegible]. Supplemental non[illegible] information relat[illegible]ed disclosures may b[illegible] with the respective related [illegible] disclosures. Other supplemen[illegible]tion is required to follow [illegible] required disclosure, and an[illegible]y, hypothetical, sim[illegible] pro forma[31] trading results m[illegible]d at the end of the Disclosure [illegible]. Supplemental inf[illegible] must not mislead or obscu[illegible]ish in prominence any [illegible] disclosure. (Rules 4.24(v) for [illegible] 4.34(n) for CTAs).

E. Format Improv[illegible] Enhance Readability[32]

A number of re[illegible] the rules are intended to enhance [illegible]ssibility and prominence [illegible] disclosures. Disclosure Docu[illegible] now required to contain a table of [illegible]. Further, the number and [illegible] of various previously require[illegible] "boilerplate" risk [illegible] statements has been [illegible]. Certain core information, [illegible] the break-even point, is required to be set forth in the forepart of the document. (Rules 4.24(a) through (d) for CPOs and 4.34(a) through (d) for CTAs).

A significant change from the Proposing Release is the renumbering of the CTA disclosure rules to correspond to the numbering of the CPO disclosure rules. To accomplish this, proposed Rules 4.32, 4.33, 4.34 and 4.35 have been adopted as Rules 4.33, 4.34, 4.35 and 4.36, respectively, and Rule 4.32 has been reserved.

Subject	CPO rule	CTA rule
Required delivery of Disclosure Document	4.21	4.31
Report to pool participants	4.22	———
Recordkeeping	4.23	4.33
General disclosures required	4.24	4.34
Performance disclosures	4.25	4.35
Use, amendment and filing of Disclosure Document	4.26	4.36

F. Other Revisions[33]

The rule amendments also are designed to facilitate pool offerings, particularly with respect to areas of overlap or potential inconsistency with the rules of the Securities and Exchange Commission ("SEC"). Thus, CPOs and CTAs may now update Disclosure Documents every nine months, rather than every six months as formerly required. (Rules 4.26(a) for CPOs and 4.36(a) for CTAs.) In addition, CPOs may provide accredited investors with a notice of intended offering and statement of the terms of the proposed offering, prior to delivery of a Disclosure Document. (Revised Rule 4.21(a) for CPOs.)

G. Distribution Table

In light of the extensive substantive and organizational revisions to the content of Disclosure Documents, and therefore to the part 4 rules, the Commission is setting forth below a distribution table to assist interested persons in complying with the new disclosure framework for CPOs and CTAs.

DISTRIBUTION TABLE

Old section	New section
4.10(d)	1.55(a)(1)(iii) 4.10(d)(1) 4.10(d)(2)–(d)(5)
4.10(e)	4.10(e)(1) 4.10(e)(2) 4.10(h)–(i)
4.21(a)	4.21(a) 4.24(c) 4.24(d)
4.21(a)(1)(i)–(1)(vii)	4.24(d)(1)–(d)(2), 4.24(e)
4.21(a)(1)(viii)	4.24(h) 4.24(d)(3), 4.24(d)(5)
4.21(a)(2)	4.24(f) 4.24(g)
4.21(a)(3)	4.24(j)
4.21(a)(4)	4.24(n), 4.25
4.21(a)(5)	4.24(n), 4.25
4.21(a)(6)	4.24(t)
4.21(a)(7)	4.24(i)(i)–(i)(4)
4.21(a)(8)	4.24(s)
4.21(a)(9)	4.24(h)(4) 4.24(o)
4.21(a)(10)	4.24(p)
4.21(a)(11)	4.24(q)
4.21(a)(12)	4.24(r) 4.24(k)
4.21(a)(13)	4.24(l)
4.21(a)(14)	4.24(i)(5)
4.21(a)(15)	4.24(m)
4.21(a)(16)	4.24(u) 4.24(v)
4.21(a)(17)	4.24(b)
4.21(a)(18)	4.24(a)
4.21(b)	4.26(c)
4.21(c)	4.24(d)(4)
4.21(d)	4.21(b)
4.21(e)	4.26(a)
4.21(f)	4.26(b)
4.21(g)	4.26(d)
4.21(h)	4.24(w)
4.31(a)	4.31(a) 4.34(c) 4.34(d)
4.31(a)(1)(i)	4.34(d)(1)
4.31(a)(1)(ii), 4.31(a)(iv).	4.34(e)
4.31(a)(1)(iii)	4.34(h)
4.31(a)(2)	4.34(f) 4.34(g)
4.31(a)(3)	4.34(m), 4.35
4.31(a)(4)	4.34(i)
4.31(a)(5)	4.34(j)
4.31(a)(6)	4.34(l)
4.31(a)(7)	4.34(k) 4.34(n)
4.31(a)(8)	4.34(b)
4.31(a)(9)	4.34(a)
4.31(b)	4.36(c)
4.31(c)	4.34(d)(2)
4.31(d)	4.31(b)
4.31(e)	4.36(a)
4.31(f)	4.36(d)
4.31(g)	4.34(o)
4.32	4.33
4.41(b)(1)	4.41(b)(1)(A)–(b)(1)(B)

IV. Definitions

A. Major Commodity Trading Advisor: Rule 4.10(i)

In proposed Rule 4.10(k), the term "major commodity trading advisor"

[29] Except for this provision, Rule 4.34(i) for CTAs is unchanged from the former rule.

[30] A detailed discussion of the required disclosures is included in Sections V and VI below.

[31] However, pro forma adjustments to performance data are required for certain purposes and such adjustments are not affected by the restrictions upon placement of supplemental information. *See* Section V.C.3. *infra*.

[32] The section-by-section analysis of format improvement revisions is set forth in paragraph B.6. of Section V and in Section VI below.

[33] The section-by-section analysis of other revisions (including: Deletion of certain requirements to state that a disclosable situation does not exist; changes to the Disclosure Document amendment, filing and use requirements; and technical conforming changes) is set forth in Section VII below.

would have been defined as a CTA allocated or intended to be allocated at least twenty-five percent of the pool's aggregate initial margin and premiums for futures and commodity option contracts. The Commission requested comment concerning this proposed definition, specifically as to the use of a percentage of the pool's aggregate initial margin and premiums for futures and commodity option contracts as compared to a percentage of the pool's total assets, which was proposed in Rule 4.10(*l*) as the basis for determining whether an investee pool would be a major investee pool. The Commission asked whether the proposed distinction between the definition of major CTA and major investee pool would appropriately reflect the relative risks of direct futures trading as compared to trading through vehicles which limit the risk of loss to the initial investment.

The majority of the commenters on the major CTA definition recommended that the definition be based on the percentage of the pool's net asset value allocated to the CTA, rather than on the percentage of the pool's aggregate initial margin and option premiums. Commenters stated that it would be difficult to determine how much of the assets allocated to a CTA would be used for margin and premiums, noted that pool operators do not base allocations to CTAs on margins and premiums, and urged that the amount of assets allocated to a CTA better indicates the CTA's potential impact on the pool's performance. Several commenters suggested substitute benchmarks, including standards based on the CTA's "trading level," *i.e.*, the portion of the pool's "market exposure" allocated to the CTA and the portion of the pool's assets committed to trading that had been allocated to the CTA. The Commission was also urged to provide expressly that pool assets allocated to a CTA include notional equity, since otherwise the standard may fail to reflect the actual portion of the pool's assets at risk with the CTA, and to use the percentage of pool assets allocated to an advisor specified in the written agreement between the advisor and the pool operator to measure the allocation amount, regardless of how such allocations are drawn upon by advisors from time to time for margin and premiums. A number of commenters expressed agreement with the proposed twenty-five percent threshold amount (while urging that it be based on pool assets).

The Commission agrees with the concept advanced or implicit in several of the comment letters that a key objective of defining major CTAs is to gauge the ability of the various CTAs for the pool to place the assets of the pool at risk. To further this objective, the Commission has adopted a revised definition of major CTA in Rule 4.10(i). Under the revised definition, the determination as to whether a CTA is a major CTA is based upon the percentage allocation to the CTA of the pool's aggregate net assets or the aggregate value of the net assets allocated to the pool's trading advisors, whichever is smaller, as determined by the agreement between the CPO and the CTA. These alternate measures are designed to assure that the major CTA definition identifies CTAs which have the ability to expose the pool's assets to significant risk because the amount of funds over which they have trading authority represents a significant proportion either of the pool's net asset value or of the aggregate value of the assets allocated to the pool's trading advisors, whichever is less.[34] As discussed more fully below, the Commission has determined to use a lower percentage threshold of ten percent in lieu of the proposed twenty-five percent threshold as part of a restructuring of the CTA and investee pool performance disclosure requirements of Rule 4.25 to eliminate the proposed category of "adverse performance," which would have applied to CTAs with allocations of ten percent to twenty-five percent of the pool's futures margins and commodity option premiums.

Thus, under the alternate test being adopted in Rule 4.10(i), if, for example, the total dollar value allocated to advisors for commodity interest trading represented fifty percent of the net asset value of the pool, a trading advisor allocated ten percent of the total dollar value allocated to advisors, even though that amount would represent less than ten percent of the pool's assets, would be a major CTA.[35] This result is appropriate because the major CTA definition is designed to include CTAs who hold authority over a substantial portion of the pool's commodity interest trading, even if the absolute dollar value of the funds allocated to the CTA is relatively small compared to the total assets of the pool. Conversely, in the unlikely scenario of a CTA having an allocation that, although insignificant compared to the aggregate allocations to CTAs, is significant relative to the assets of the pool, that CTA should also be considered major. This scenario could occur if CTAs collectively are allocated more than the net asset value of the pool;[36] in such a case, a CTA might, in effect, be trading more than ten percent of the pool's assets even though his allocation represented less than ten percent of total CTA allocations. In such a case, the CTA should be considered a major CTA, thus potentially resulting in a pool having more than ten major CTAs, based upon the level of exposure of pool assets.

Because the major CTA definition is intended to identify advisors whose trading is significant to the pool in terms of overall risk, any percentage allocation figure based upon a single benchmark such as funds allocated by written or other agreement is likely to provide only a rough comparative measure. This is so because trading advisors' programs may lead to different degrees of futures or other risk exposure and different volatility patterns despite the same quantitative allocation of funds. Consequently, in determining whether a trading advisor's performance should be disclosed as material information, even if the trading advisor would not constitute a major CTA under the definition set forth in Rule 4.10(i), the pool operator should assess the likelihood that the CTA's trading, given the leverage used, may expose significantly more of the fund's net asset value in a worst case scenario than his percentage allocation level would indicate. Such a case may warrant inclusion of capsule performance information for the CTA even if his allocation does not exceed the ten percent threshold. In most cases, however, a textual discussion will suffice, and the Commission has emphasized the requirement for this type of supplementary disclosure as to non-major CTAs generally by adopting Rule 4.25(c)(5), discussed *infra*. Further, a CTA's performance may be marketed in such a manner as to render more comprehensive disclosure of his performance material, *e.g.*, the CTA may be accorded "major" importance by

[34] Adoption of this standard for determining a major CTA is not intended to address or relate to the use of so-called "notional" or "nominal" account sizes for purposes of calculation of rates of return.

[35] The standards discussed herein do not affect the scope of the existing exemption available under Rule 4.12(b), which provides an exemption from, *inter alia*, past performance disclosure, for pools that commit no more than ten percent of the fair market value of their assets to establish commodity interest positions and trade such commodity interests in a manner solely incidental to their securities trading.

[36] The Commission does not encourage such allocations and notes that the leverage inherent in such vehicles creates corresponding risks, which must be appropriately disclosed. The Commission notes the recent heightened recognition in the domestic and foreign regulatory communities of the risks inherent in leveraged instruments and trading vehicles.

virtue of prominent references to such CTA in promotional material.

The comments indicated, and the Commission would generally expect, that allocations to CTAs would generally be evidenced by written agreement, between the CPO (or the trading manager, if any) on behalf of the pool and the CTA, assigning a particular dollar amount of the pool's assets to be traded by the CTA. This dollar amount would be converted into a percentage using the alternate standards in Rule 4.10(i). CPOs should be prepared to document their determinations as to the status of CTAs as major or non-major for audit purposes but, in most cases, the written agreement should be sufficient.

Proposed Rules 4.10(k) and 4.10(*l*) would have required that "major" CTA and investee pool status be determined at the time the Disclosure Document is prepared[37] and on an ongoing basis.[38] As the Commission explained in the Proposing Release, the "major commodity trading advisor" and "major investee pool" definitions are intended to include CTAs or investee pools to whom the CPO of a pool that has not commenced trading intends to make allocations at or above the specified thresholds.[39] Similarly, any CTA or investee pool to whom the CPO of an operating pool intends to reallocate assets such that the allocations to such CTA or investee pool will total ten percent or more also would be included. One commenter recommended that the asset allocations which determine major CTA or major investee pool status only be required to be accurate as of a date not more than ninety days prior to the date of the Disclosure Document. In response, the Commission notes that, pursuant to Rule 4.26(c), the CPO must notify existing participants of changes in major CTAs and investee pools, to the extent they represent material changes, within twenty-one days and must so notify previously solicited prospective participants prior to accepting or receiving funds from such prospective participants. This can be accomplished by formally amending the Disclosure Document, "stickering" the document, including information in an Account Statement, or other similar means. Whether a given major CTA or investee pool change is material would depend upon a variety of factors such as the overall distribution of pool assets to CTAs and investee pools, the historical frequency of such changes and the pool's overall trading program. Substitutions of, and reallocations to, CTAs or investee pools are more likely to be material changes for a pool with one or two trading advisors, than for a pool that accesses a variety of advisors and investee pools and that redirects its assets frequently in response to changes in market conditions.

B. Major Investee Pool: Rule 4.10(d)(5)

Proposed Rule 4.10(*l*) would have defined "major investee pool" as an investee pool allocated or intended to be allocated at least twenty-five percent of the assets of a pool. As noted above, in contrast to the proposed definition of major CTA, which would have relied upon a percentage of the pool's initial futures margin and commodity option premiums, the major investee pool definition was based upon the percentage of the assets of the investor pool allocated to the investee pool. This distinction in the basis for determining allocations to pools was based upon the fact that investments in other pools generally expose the investor pool only to loss of the initial investment and that the full amount of the investment is required to be paid at the inception of the investment. The relative importance of investee pools to prospective pool participants is thus appropriately determined by reference to the proportion of the pool's total assets actually invested in the investee pool, and the major investee pool definition did not appear to present the same issues concerning quantification of relative risk exposure as the major CTA definition.

Commenters who addressed the major investee pool definition pointed out that "investee pool" was not defined in the Proposing Release or in existing Commission rules. The Commission is adopting in Rule 4.10(d)(4) a definition of "investee pool" as "any pool in which another pool participates or invests, *e.g.*, as a limited partner thereof." The Commission is adopting as Rule 4.10(d)(5) a definition of "major investee pool" that differs from the proposal in that it specifies that the allocation threshold is ten percent of the *net asset value* of the pool, instead of twenty-five percent of the assets of the pool. This modification was made in order to make the allocation measure consistent with the capsule performance format, which calls for net asset value. As in the case of the major CTA definition, the proposed twenty-five percent threshold has been reduced to ten percent in light of the elimination of the proposed "adverse performance" disclosure requirement for CTAs and investee pools with allocations ranging from ten to twenty-five percent. One commenter noted that in determining the percentage of a pool's assets allocated to an investee pool, as with CTA allocations, notional equity should be included in order to capture the risk exposure created by the investee pool's trading. This approach was advocated because the percentage of the offered pool's assets used to purchase the participation in an investee pool may not reflect the additional risk created where the assets of the investee pool are traded at a leverage factor that results in trading exposure of, for example, twice the actual assets of the investee pool. Although the Commission does not believe that this consideration warrants express treatment in the major investee pool definition, it recognizes that there may be applications of the major investee pool definition, as in the case of CTA allocations, where the basic benchmarks used in the rule do not capture all of the investee pools that may be of major impact on the offered pool. In such cases, i.e., where the investee pool is traded on a highly leveraged basis, the pool operator should be mindful of the obligation to disclose all material information and should take into consideration the nature of the investee pool's trading in determining whether it should be treated as a major investee pool for disclosure purposes.

The time at which major investee pool status is determined is discussed in paragraph A, above.

C. Multi-Advisor Pool: Rule 4.10(d)(2)

Proposed Rule 4.10(h), the multi-advisor pool definition, would have employed a twenty-five percent or *greater* allocation standard based on the pool's aggregate initial margin and premiums for futures and commodity option contracts. Thus, as proposed, the "multi-advisor pool" definition effectively would not have applied if a pool had one major CTA or major investee pool, and the minimum number of CTAs in a multi-advisor pool would have been five. Two commenters asserted that any pool with two or more CTAs should be considered a multi-advisor pool, although one commenter acknowledged that a pool that allocated ninety percent of its assets to one CTA should not qualify as a multi-advisor pool. As adopted, the definition of "multi-advisor pool" in Rule 4.10(d)(2) is a pool in which no CTA is allocated or intended to be allocated more than twenty-five percent of the pool's funds available for commodity interest trading

[37] The definitions adopted in Rules 4.10(l) and 4.10(d)(5) include CTAs and investee pools "allocated or intended to be allocated * * *"

[38] Rule 4.26(c) requires distribution of corrections of any material inaccuracies to all participants within twenty-one days of the date on which the CPO knows or has reason to know of the inaccuracy.

[39] 59 FR 25351, 25357.

and in which no investee pool is allocated or intended to be allocated more than twenty-five percent of the pool's net assets. (Rule 4.10(d)(2)). In determining whether a CTA has been allocated more than twenty-five percent of the pool's funds available for commodity interest trading, the alternate standard in the major CTA definition should be used, *i.e.*, the percentage allocation is the amount of funds allocated to the trading advisor by agreement with the CPO, expressed as a percentage of the lesser of the aggregate value of the assets allocated to the pool's trading advisors or the net assets of the pool at the time of allocation.

D. Principal-Protected Pool: Rule 4.10(d)(3)

The term "limited risk pool" was defined in proposed Rule 4.10(i) as a pool (commonly referred to as a "guaranteed pool") that is designed to limit the loss of the initial investment of its participants. Commenters pointed out that most pools are formed as limited partnerships, thus limiting at least some of the participant's risk. Other commenters offered alternative terms[40] or suggested that the definition specify that loss would be limited by guaranty, letter of credit or other third-party undertaking. As adopted in Rule 4.10(d)(3), the term has been redesignated "principal-protected pool," but the definition is unchanged from that set forth in the Proposing Release.

E. Trading Manager: Rule 4.10(h)

As proposed in Rule 4.10(j), and as adopted in Rule 4.10(h), the "trading manager" of a pool is defined as any person other than the pool's CPO with authority to allocate pool assets to CTAs or investee pools. Rule 4.10(h) further makes clear that sole or partial authority will bring a person within the trading manager definition.

No comments addressing the trading manager definition were received. Commission rules have not previously expressly taken account of pool structures in which a trading manager, rather than the pool's CPO, allocates pool assets. The Commission emphasizes that trading managers are CTAs and are required to be registered as such. Thus, although trading managers do not function as direct traders for the pool, they have the ability to influence the pool's trading to a very significant degree. Due to the importance of the role of trading manager, in a number of contexts the proposed rules would have made disclosure of the trading manager's performance a substitute for that of the CPO. However, as noted below, the Commission has revised the proposed rules to require disclosure both as to a pool's CPO and the trading manager, if any, in a number of contexts, *e.g.*, conflicts of interest, on the ground that in the vast majority of cases, even if the CPO has delegated substantial responsibility to the trading manager to hire and monitor CTAs, the CPO retains ultimate responsibility for operation of the pool. However, with respect to past performance disclosure, if the CPO has completely delegated trading authority to a trading manager and the past performance of the trading manager does not differ materially from that of the commodity pool operator, only the trading manager's past performance is required to be disclosed.

F. Trading Principal: Rule 4.10(e)(2)

A "trading principal" would have been defined in proposed Rule 4.10(m) as a principal of a CPO or CTA who participates in making commodity interest trading decisions for a pool or client or who supervises, or has authority to allocate pool assets to, persons so engaged. The sole commenter who addressed this definition urged that it be limited to principals who make trading decisions, excluding principals who supervise or hire traders. The Commission notes, however, that persons who select or supervise traders effectively determine how a pool's or client's assets will be traded. Accordingly, where disclosure of information concerning traders is appropriate, the same information should be required of those who supervise or hire them. As adopted in Rule 4.10(e)(2) only grammatical changes were made to the definition of "trading principal" in proposed Rule 4.10(m).

G. Break-Even Point: Rule 4.10(j)

In order to make the impact of costs and fees on an investment more understandable to the prospective investor, the Commission proposed that the narrative discussion of fees and expenses be supplemented by presentation of the "break-even point" for an offered pool and a clear explanation of how that break-even point is calculated. Proposed Rule 4.10(n) would have defined "break-even point" as the trading profit that a pool or trading program must realize in its first year to equal all fees and expenses such that a participant or client will recoup its initial investment, as calculated pursuant to rules promulgated by a registered futures association.[41]

Many commenters supported the proposal to require disclosure of a pool's break-even point.[42] However, comments on the break-even point (and the requirement to disclose the relevant calculations) indicated some confusion regarding whether the break-even point is based on the pool's first year of operation or an investor's first year of participation in the pool. For ongoing pool offerings, commenters suggested that the break-even point be optional after the first year of a pool's operation, that it be based on a prior year's actual results, or that a range of break-even points be permitted keyed to various total offering sizes.

As adopted, Rule 4.10(j) defines the term "break-even point" as the trading profit that a pool must realize in the first year of a participant's investment to equal all fees and expenses such that the participant will recoup its initial investment. The break-even point is required to be calculated pursuant to rules promulgated by a registered futures association and it must be expressed both as a dollar amount and as a percentage of the minimum unit of initial investment. The proposed definition referred to the trading profit that a pool or trading program must realize in the pool or trading program's first year, and the break-even point was not expressly required to be presented as a dollar amount.[43]

The Commission is clarifying that the break-even point must present the trading profit that the pool must realize in the first year of an investor's participation in order for the investor to recoup his initial investment, and Rule 4.10(j) as adopted so states. As noted above, Rule 4.10(j) provides that the break-even point must be calculated pursuant to rules promulgated by a registered futures association. NFA's Interpretive Notice accompanying its Compliance Rule 2–13(b) sets forth the manner in which the break-even point must be calculated and includes a sample break-even presentation. The amount of trading profit required for the

[40] Suggested options included "capital protected pools" and "principal return guaranteed pools."

[41] Proposed Rule 4.10(n) would also have required that the break-even point be expressed as a percentage of the minimum unit of initial investment based upon assumed redemption of the initial investment at the end of the first year of investment.

[42] Comments addressing the manner of calculating the break-even point are discussed below with Rule 4.24(i) ("Fees and Expenses") in paragraph B.8. of Section VI.

[43] Rule 4.10(j) omits the reference in the proposed rule to "trading program" and "client." A break-even point is not required for CTA Disclosure Documents, as CTA clients generally are subject to a much simpler fee and expense structure than are pool participants.

net asset value per unit of participation after one year to equal the initial selling price per unit is expressed both as a dollar amount and as a percentage of the initial selling price per unit. The Commission based its approval of NFA's amendment to Compliance Rule 2–13 and accompanying Interpretive Notice on, among other things, the understanding that NFA would amend the Interpretive Notice to clarify that the CPO of a continuously-offered pool must include an updated break-even analysis in the pool's Disclosure Document throughout the pool's existence, such that each new participant would be informed of a break-even point that was accurate as of the date of the Disclosure Document.[44] Revision of the break-even point is thus required for ongoing pool offerings whenever the actual break-even point becomes materially different from that which appears in the Disclosure Document.

H. Draw-Down and Worst Peak-to-Valley Draw-Down: Rules 4.10 (k) and (l)

Commenters noted that although the capsule performance presentation format in proposed Rules 4.25 and 4.34 required registrants to disclose the largest monthly draw-down and the worst continuous peak-to-valley draw-down for the pool or account, the term "draw-down" was not defined. To address this concern, the Commission is adopting as Rule 4.10(k) a definition of "draw-down" as "losses experienced by a pool or account over a specified period." Similarly, the Commission has adopted Rule 4.10(l), which defines the "worst peak-to-valley draw-down,"[45] as the greatest cumulative percentage decline in month-end net asset value due to losses sustained by a pool, account or trading program during a period in which the initial month-end net asset value is not equaled or exceeded by a subsequent month-end net asset value. The worst peak-to-valley draw-down must be expressed as a percentage of the initial month-end net asset value, together with an indication of the months and year(s) of such decline from the initial month-end net asset value to the lowest month-end net asset value of the draw-down. For purposes of Rules 4.25 and 4.35, a peak-to-valley draw-down which began prior to the beginning of the most recent five calendar years is deemed to have occurred during such five-calendar-year period.

V. Performance Disclosures: Section-by-Section Analysis[46]

A. Introduction

As noted above, the Commission is revising and reorganizing the CPO/CTA disclosure rules with a view towards simplification of presentation. Rules 4.21 and 4.31 continue to require CPOs and CTAs, respectively, to deliver a Disclosure Document.[47] Rules 4.24 with respect to CPOs, and 4.34 with respect to CTAs, set forth requirements concerning disclosure of all matters other than past performance, and Rules 4.25 for CPOs and 4.35 for CTAs set forth past performance disclosure requirements.[48]

As proposed and as adopted, past performance disclosure requirements are being substantially condensed with the objective of eliminating required disclosure of performance that is of secondary relevance to the offered pool or trading program. Thus, the revised rules provide a new "capsule" format for performance record presentations that is intended to provide a simple, balanced and succinct overview of performance. Use of the capsule format should substantially reduce the volume of performance data presented without sacrificing material content.

With respect to past performance in CPO Disclosure Documents, the revised rules focus primarily upon the historical performance of the offered pool. Where the offered pool has a three-year trading history and meets certain contribution criteria as specified in Rule 4.25(b), its past performance generally is the only required performance presentation. (Rule 4.25(b)).

Where the offered pool does not have the requisite operating history, the CPO must present performance data for the offered pool, for the CPO (and trading manager, as applicable), and the pool's major CTAs and investee pools. (Rules 4.25 (c)(2) through (c)(4)). A textual discussion of relevant performance factors for non-major CTAs and investee pools also is required. (Rule 4.25(c)(5)). Some performance data may be presented on a composite basis. (Rule 4.25(a)(3)). All performance data may be presented in a capsule format.

With respect to CTA Disclosure Documents, the performance of the offered trading program is the primary focus. (Rules 4.35 (a)(1) and (a)(2)). The performance of accounts traded pursuant to other trading programs of the CTA may be presented in single composite, provided the rates of return are not materially different, material differences among the accounts included in the composite are disclosed, and the composite presentation is not misleading. (Rule 4.35(a)(3)).

As the volume of required performance disclosures for both CPOs and CTAs is being considerably reduced, the time period for these disclosures is being increased from three years to five years in order to provide investors with a better chronological perspective of the performance records presented in the Disclo- sure Document. (Rule 4.25(a)(5) for CPOs and Rule 4.35(a)(5) for CTAs). This approach accords with the views of the NFA Special Committee for Review of CPO/CTA Disclosure Issues.[49]

B. Required Performance Disclosures[50]

1. Required Performance Disclosures in CPO Disclosure Documents: Rule 4.25

The new summary format for presentation of past performance history is intended to capture the most significant information concerning a pool's performance in a reader-friendly, largely nontabular form. This format will generally permit multiple track records to be provided on a single page. The new format is set forth in Rule 4.25(a)(1) for pool documents and Rule 4.35(a)(1) for CTA documents.[51]

[44] The Commission also reminded NFA that in explaining and enforcing member compliance with NFA break-even analysis requirements the fee and expense categories in the Interpretive Notice to Compliance Rule 2–13(b) should not be considered exhaustive or exclusive, and that NFA should ensure that CPOs do not use that listing to avoid including a cost in the pool's break-even analysis. With respect to interest income, the Commission stated its understanding that NFA would require inclusion in the break-even analysis of a projection of a pool's expected interest income at an assumed interest rate reflecting then current cash market conditions, and it stated that to the extent that a person other than a pool participant receives any portion of the pool's interest income, such payment should be disclosed as a fee or expense in the pool's break-even analysis.

[45] As discussed in paragraph B.1. of Section V below, the word "continuous" has been omitted from the capsule item "worst continuous peak-to-valley draw-down" in proposed Rule 4.25(a)(1)(i)(G) and from the item "worst ever continuous peak-to-valley draw-down" in proposed Rule 4.25(a)(1)(ii)(F).

[46] Tables summarizing past performance disclosure requirements under the revised rules and demonstrating the use of the new capsule format are set forth below at paragraph B.7. of this Section V.

[47] Requirements with respect to the use, amendment and filing of the Disclosure Document are now contained in new Rules 4.26 for CPOs and 4.36 for CTAs, discussed more fully below at Section VII.

[48] Captions have been added to the subparagraphs of Rules 4.25 (a), (b) and (c) and Rules 4.35 (a) and (b) to increase ease of reference.

[49] NFA's Submission at 7.

[50] To facilitate understanding of the new performance requirements, paragraph B.7., infra, provides: (1) A table summarizing the past performance requirements of Rules 4.25 and 4.35; and (2) examples of capsule performance presentation under the rules.

[51] As discussed more fully below, the Commission has determined to permit CTA

a. Capsule Performance Presentation: Rule 4.25(a)(1)[52]

CPOs

As proposed in Rule 4.25(a)(1)(i), the capsule for pool performance in CPO Disclosure Documents would have been required to contain the following information: The name of the pool; a statement as to whether the pool is privately offered pursuant to the Securities Act of 1933, as amended (the "Securities Act"),[53] a multi-advisor pool or a principal-protected pool; the date when the pool commenced trading; the aggregate gross capital subscriptions to the pool; the pool's current net asset value; the "largest monthly draw-down"; the "worst continuous peak-to-valley draw-down"; and annual and year-to-date rates of return, computed on a monthly compounded basis,[54] for the preceding five calendar years and year-to-date (or for the life of the pool if shorter). In the case of the offered pool's capsule, monthly rates of return would have been required for the entire performance period.

Similar data would have been required in capsule presentations of the performance of accounts in CPO Disclosure Documents. Proposed Rule 4.25(a)(1)(ii) would have called for inclusion in the capsule format of: The name of the CTA or other person trading the account and the name of the trading program; the date when the CTA began trading client funds and the date of inception of trading for the trading program being disclosed; the number of accounts in the program as of the Disclosure Document date; the total assets under the management of the CTA and in the trading program; the "largest monthly draw-down" for the program; the "worst ever continuous peak-to-valley draw-down" for the trading program; and annual and year-to-date rates of return for the offered trading program (again, computed on a monthly compounded basis).

CTAs

As proposed, Rule 4.34(a)(2) would have required all performance presented in CTA Disclosure Documents, with the exception of the performance of the offered trading program, to follow the capsule format as specified in Rule 4.25(a)(1)(ii) (C) through (G).

Comments. Commenters expressed uniformly strong support for the proposed new capsule format for past performance disclosure. One commenter, however, recommended that the revised rules expressly permit a CPO to continue to present performance in the multi-column tabular format required by former Rule 4.21(a)(4). Many commenters requested that the Commission define the term "draw-down," as used in the proposed capsule format. Commenters also noted that use of the word "continuous" in the capsule item "worst continuous peak-to-valley draw-down" could be read to mean that any intermediate upward movement terminates the draw-down, thus permitting a small "uptick" to disguise the true magnitude of a long draw-down, since the uptick would break the continuity but not the decline in asset value. Suggested alternatives were "worst absolute peak-to-valley draw-down" and "worst peak-to-valley period." One commenter sought confirmation that the proposed rule would require disclosure of the number of successive months during which net asset value failed to exceed the pool's prior high water mark and the total percentage decline over that period.

Numerous commenters criticized the proposed requirement that monthly rates of return be presented for the offered pool over the entire five-year performance period (or for the life of the offered pool if less than five years), claiming that such data would detract from the simplicity and clarity of the capsule format. One commenter contended that monthly rates of return are not relevant to a medium to long-term investment such as managed futures. Various alternative indicators of volatility were proposed in lieu of monthly rates of return, including the pool's standard deviation over its life, the best and worst monthly and annual returns, and the number of profitable and losing months. One commenter recommended that the capsule also include such information as largest monthly increase and greatest valley-to-peak increase in order to provide a balanced presentation. A number of commenters urged the Commission to resolve the issue of the use of notional funds and nominal account sizes in performance presentations.[55]

The Commission requested comment as to whether past performance presentations would provide more meaningful information if they were required to include rates of return on a risk-adjusted basis, that is, reduced by the relevant Treasury Bill rate or comparable interest figure, or to break out trading results from passive interest income. The only commenter specifically addressing this request expressed the view that risk-adjusted rates of return would not make performance presentations more meaningful and contended that indexing performance based upon another form of investment implied that participation in a commodity pool was somehow comparable to such other investment.

Technical Changes to Capsule

The Commission is adopting the capsule format for performance presentations in pool Disclosure Documents, with certain technical modifications as noted below. In adopting the capsule performance format, the Commission stresses that this summary format is designed for purposes of presentation in Disclosure Documents only. CPOs and CTAs must continue to compute performance on the same basis as under the former rules[56] and to maintain records substantiating such computations in accordance with Rule 1.31.[57] The Commission is not adopting at this time a requirement that registrants present past performance on a risk-adjusted basis.

Draw-Down Information

The required draw-down information, which is based upon activity occurring for the most recent five calendar years and year-to-date, is intended to inform prospective participants of the nature of the volatility actually experienced by the pool by demonstrating the significant one-month and sustained declines to which the commodity pool

documents to present the past performance of the offered trading program in the new capsule format.

[52] Rule 4.10(l), which defines the term "draw-down," and Rule 4.25(a)(7), relating to substantiating past performance calculations, are also discussed in this section.

[53] For this purpose private offerings may be pursuant to section 4(2) of the Securities Act of 1933, as amended, 15 U.S.C. 77d(2), or Regulation D thereunder, 17 CFR 230.501–230.506 (1994).

[54] See Rule 4.25(a)(1)(i)(H). Annual rates of return computed on a monthly compounded basis assume reinvestment of accrued profits and therefore the investment base on which rates of return are calculated is effectively adjusted by these amounts.

[55] As noted above, the Commission is reviewing the subject of "notional funds" performance data with the benefit of industry, end-user, regulatory and academic input provided at the Commission's April 25, 1995, roundtable discussion and other available data.

[56] Although only the amounts specified in Rules 4.25(a) (1) and (2), and Rules 4.35(a) (1) and (2) need be set forth in the Disclosure Document, the same performance calculations as previously required must be made, as specified in Rule 4.25(a)(7) for CPOs and Rule 4.35(a)(6) for CTAs, as such rules may be interpreted by the Commission. The corresponding former rules are former Rule 4.21(a)(4)(ii) and former Rule 4.31(a)(2)(ii), respectively.

[57] Among other things, Rule 1.31 requires all books and records to be maintained for a period of five years and to be available for inspection by any representatives of the Commission or the U.S. Department of Justice. CTAs also are subject to those requirements.

has actually been subject. To ensure that the worst long-term draw-down is properly represented, Rules 4.25(a) and 4.35(a), as adopted, require the capsule to include the "worst peak-to-valley draw-down," eliminating the qualification "continuous."[58]

The Commission also is adopting definitions of the terms "draw-down" and "worst peak-to-valley draw-down." Rule 4.10(k) provides that "draw-down" means losses experienced by a pool or account over a specified time period. Thus, a draw-down is a decline in net asset value due to reasons other than redemptions or withdrawals. To assist readers who may not be familiar with industry terminology, the Commission has also added a requirement that the capsule format include, in a footnote or otherwise, a definition of the term "draw-down" that is consistent with the definition set forth in Rule 4.10(k). Rule 4.10(*l*) defines "worst peak-to-valley draw-down" as the greatest cumulative percentage decline in month-end net asset value due to losses sustained by a pool, account or trading program during any period in which the initial month-end net asset value is not equaled or exceeded by a subsequent month-end net asset value. The rule specifies that the worst peak-to-valley draw-down must be expressed as a percentage of the initial month-end net asset value, together with an indication of the months and year(s) of such decline from the initial month-end net asset value to the lowest month-end net asset value of such decline. For purposes of the revised rules, a peak-to-valley draw-down which began prior to the beginning of the most recent five calendar years is deemed to have occurred during such five-calendar-year period.

Both monthly and peak-to-valley draw-down amounts are to be expressed as a percentage of the net asset value at the beginning of the specified period. The largest monthly draw-down indicates the largest net asset loss experienced by the pool in any calendar month, and the month and year in which that loss occurred. The worst peak-to-valley draw-down indicates the largest calendar month-to-calendar month net asset loss experienced by the pool during any period and the months and year in which it occurred. Dating the monthly and peak-to-valley draw-downs permits participants to assess whether the losses were connected to market conditions by comparing the draw-downs of several pools. As explained in the Proposing Release,[59] a peak-to-valley draw-down of 4 to 8–91/25% would indicate that the peak-to-valley lasted from April to August of 1991 and resulted in a twenty-five percent draw-down of the pool's net asset value.

Monthly Rates of Return

The Commission has determined to modify the proposal with respect to monthly rates of return for the offered pool to permit *flexibility* as to the form of presentation. As adopted, Rule 4.25(a)(2) provides that the capsule for the offered pool must contain monthly rates of return for the five most recent calendar years and year-to-date (or the pool's life, if shorter) presented either in tabular form or in a bar graph. If a bar chart is used, the bar chart must clearly indicate monthly rates of return and must also prominently indicate annual rates of return. Rule 4.25(a)(2)(iv) requires that the CPO make available upon request to prospective and existing participants the supporting data necessary to calculate monthly rates of return for the offered pool as specified in Rule 4.25(a)(1).

The Commission notes that registrants may present performance information in the multi-column format specified by former Rule 4.21(a)(4) *in addition to* the capsule format specified by Rule 4.25(a)(1), provided that any performance presented in the superseded format is treated as supplemental information and is placed following all of the required performance disclosures in the Disclosure Document.[60]

Registrants who offer notional programs may disclose monthly rates of return in the capsule disclosure for CTA programs using the fully-funded subset described in Advisory 93–13.[61] Commission staff will provide guidance concerning supplemental data to accompany the capsule disclosure to reflect the range of levels of partial funding and the generic disclosures discussed in Advisory 93–13.

b. Pools With Three or More Years Operating History That Meet Contribution Criteria: Rule 4.25(b)[62]

As proposed, Rule 4.25(b) would have limited required performance disclosures in pool Disclosure Documents to the offered pool's performance if: (1) The pool had traded commodity interests for three years or more, (2) no fewer than fifteen pool participants were unaffiliated with the CPO, and (3) no more than ten percent of the pool's assets were contributed by the CPO. As stated in the Proposing Release, the Commission believes that, generally, "where a pool has an extensive operational history, presentation of the pool's own past performance record should fulfill the objectives of past performance disclosure."[63] If, however, the pool's past performance record was accrued under conditions that differed materially from those which will obtain prospectively, the pool's historical performance record alone may not be sufficient. For example, if the pool's past performance record encompasses periods when the pool was essentially a proprietary trading vehicle investing a relatively small amount of funds contributed by third party sources, the performance record generated may have little or no relevance to a publicly offered pool.[64] Accordingly, to assure that the three-year performance history would not represent the performance of a significantly dissimilar trading vehicle, the Commission proposed to limit past performance disclosure to the past performance of only the offered pool where, and only where, the pool

[58] The word "continuous" is eliminated from Rules 4.25(a)(1)(i)(G) and (ii)(F), and the extraneous word "ever" is eliminated from Rule 4.25(a)(1)(ii)(F).

[59] 59 FR 25351, 25356.

[60] This statement also applies to CTAs. *See* Rule 4.24(v) for CPOs and Rule 4.34(n) for CTAs, concerning supplemental disclosures, discussed in paragraph C.1. of this Section V.

[61] CFTC Advisory 93–13, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,584 (February 12, 1993). Advisory 93–13 requires that CTAs who manage or offer to manage partially-funded ("notionally" funded) accounts present both actual and nominal funds under management and give certain disclosures in connection with partially-funded accounts. The Advisory also provides a method for presenting rates of return for a trading program in a single table on the basis of a "fully funded subset" of accounts within that trading program.

[62] Former Rule 4.21(a)(4) required disclosure of the performance record of the offered pool. If the offered pool had less than a twelve-month performance history, the *performance* of the CPO and of each of its principals was also required to be disclosed. Former Rule 4.21(a)(4) also required disclosure of the past performance of all other accounts directed by the pool's CTA and each of its principals, regardless of the duration of the pool's operating history.

[63] 59 FR 25351, 25356.

[64] *See* Elton, Gruber and Rentzler, *New Public Offerings, Information and Investor Rationality: The Case of Publicly Offered Funds*, 62 J. Bus. 1 (1989); and Edwards and Ma, *Commodity Pool Performance: Is the Information Contained in Pool Prospectuses Useful?*, Working Paper Series No. 16, Center for the Study of Futures Markets, Col. Bus. Sch. (January 1988). *See also*, *Statement of the Commodity Futures Trading Commission Regarding Disclosure by Commodity Pool Operators of Past Performance Records and Pool Expenses and Request for Comments*, 54 FR 5597, (February 6, 1989); and companion release of the Securities and Exchange Commission, *Statement of the Commission Regarding Disclosure by Issuers of Interest in Publicly Offered Commodity Pools*, 54 FR 5600 (February 6, 1989).

had a three-year trading history with at least fifteen unaffiliated participants and no more than ten percent participation by the CPO.

The Commission requested comment as to whether, where the offered pool has a three-year operating history, that performance record is generally sufficient without supplementary performance data concerning the pool's CTAs or other pools operated by the CPO. Three of the nine commenters who responded to the Commission's request agreed with the proposal, stating that if a pool has a three-year history, only its own past performance should be required. Six of the nine recommended that the twelve-month standard of former Rule 4.21(a)(4), which related to the presentation of other pools operated by the CPO, should be used to identify pools for which only the performance of the offered pool is required.

The Commission also sought comment as to whether the offered pool's operating history should be considered for purposes of the three-year minimum if such history was acquired when the pool differed in some material respect from the pool as offered, for example, in cases in which the pool's CTA, types of interests traded or the trading program had been significantly modified or the pool was initially privately offered but subsequently was offered to the public. All but one of the persons who responded to this request stated that material differences should be disclosed but should not disqualify a pool from meeting the three-year criteria of the rule.

Several commenters suggested elimination or modification of the requirement that the requisite three-year operating history be obtained when the pool had at least fifteen unaffiliated participants. Commenters warned that pools with high minimum investments (and few participants) would be unjustly penalized by this restriction. Several commenters recommended that the requirement that the CPO have contributed no more than ten percent of the pool's assets be modified to increase the permissible level of CPO participation, *e.g.*, to fifty percent, and two commenters noted that this would harmonize with the fifty percent standard in proposed Rule 4.25(a)(9) for determining whether past performance results must be treated as proprietary trading results for the purpose of separating such results from other past performance information.[65] Several commenters contended that Rule 4.25 as proposed would have the undesirable effect of discouraging CPOs from investing in the pools they operate. Three commenters proposed adopting either the CPO investment test or the unaffiliated participant test.

The Commission has adopted Rule 4.25(b) with several modifications to afford greater flexibility in its application. The requirement that the pool have had no fewer than fifteen participants unaffiliated with the pool operator has been eliminated and the maximum level of contribution of assets by the CPO has been increased. As adopted, Rule 4.25(b) provides for past performance disclosure to be limited to that of the offered pool if both of the following criteria are met: (1) The pool has traded commodity interests for at least three years; and (2) during the three-year (or greater) period, at least seventy-five percent of the pool's assets were contributed by persons unaffiliated with the CPO, the trading manager (if applicable), the pool's CTAs, or any of their principals.

The performance of an offered pool which has the requisite three-year operating history is required to be disclosed for five full calendar years and year-to-date or, if the pool has less than a five-year history, for the pool's entire operating history,[66] in the specified capsule format.[67] The CPO is free to include additional performance information, subject to the provisions relating to supplemental disclosures.[68]

The Commission notes that the twelve-month standard in former Rule 4.21(a)(4) related only to disclosure of the performance of other pools operated by the CPO and did not affect former Rule 4.21(a)(5)'s requirement to disclose the performance of the CTAs for the pool. Under Rule 4.25(b), if the offered pool has the requisite three-year operating history, neither the performance of the CPO's other pools *nor* the performance of the pool's CTA(s) must be presented. In view of the elimination of all other performance data, including CTA performance under the new disclosure framework, the Commission believes that a three-year rather than a one-year history is the appropriate minimum.

The Commission agrees that material differences in the operation or structure of the pool during the three years, given appropriate disclosure, generally should not disqualify the pool from satisfying the three-year criteria. However, registrants should exercise caution in cases in which such differences exist, taking into account that the requirement to disclose all material information includes past performance disclosure and thus that where significant changes in the offered pool might cause presentation of the offered pool's past performance by itself to be misleading, additional performance disclosure may be required.

The Commission believes that the different purposes of Rule 4.25(a)(8), which defines proprietary trading results and requires appropriate placement and labelling of such results, and of Rule 4.25(b), which identifies pools for which no performance history other than that of the offered pool is required, warrant different standards as to the relevant amount of proprietary participation. A more stringent limitation upon qualifying pools is appropriate for use in Rule 4.25(b), which eliminates the necessity for certain otherwise required disclosures, as compared to that of proposed Rule 4.25(a)(8). Unlike Rule 4.25(b), which identifies pools for which no additional performance data other than that of the offered pool is required, Rule 4.25(a)(8) determines the percentage at which proprietary participation essentially renders a trading vehicle a proprietary vehicle, the trading results for which were obtained under conditions that render the performance data presumptively inappropriate for inclusion with and, indeed, potentially misleading if included with, the performance of the offered pool.

c. Pools With Less Than A Three-Year Operating History: Rule 4.25(c)[69]

Disclosure Documents for offered pools that do not satisfy the criteria of proposed Rule 4.25(b) would have been required under proposed Rule 4.25(c) to include the performance records of the offered pool, each other pool operated or account traded by the CPO (or trading manager), the CPO's (or trading manager's) trading principals if the CPO (or trading manager) had less than a three-year history, and the performance of each "major" CTA and "major"

[65] Proposed Rule 4.25(a)(9), adopted as Rule 4.25(a)(8), is discussed at paragraph C.2. of this Section V.

[66] Rule 4.25(a)(5).

[67] Rule 4.25(b). As adopted, the text of Rules 4.25(b) and 4.25(c) is being amended to clarify that where the offered pool meets the criteria of Rule 4.25(b), the CPO is required to present only the offered pool's performance. Where the offered pool does not meet the Rule 4.25(b) criteria, the CPO must provide additional performance disclosure as detailed in Rule 4.25(c).

[68] See Rule 4.24(v).

[69] Rule 4.25(c) employs certain key terms, "trading manager," "major commodity trading advisor," "major investor pool," and "trading principal," which are defined in Rules 4.10(h), 4.10(i), 4.10(d)(5) and 4.10(e)(2), respectively. These definitions are discussed in detail in Section IV, supra.

investee pool.[70] Disclosure of "adverse performance" results would have been required to be indicated (or in the alternative, capsule performance could have been presented) for non-major CTAs allocated at least ten percent of the pool's initial margins and commodity option premiums and for investee pools allocated at least ten percent of the pool's assets.[71]

Adverse performance was defined in proposed Rule 4.25(a)(8) as "any annual return of one hundred basis points less than the ninety day Treasury Bill rate on December 31 of the calendar year in which the performance occurred or any termination of a pool pursuant to a loss termination provision."

The Commission received comments on various components of Rule 4.25(c). A number of commenters urged the Commission to eliminate the proposed intermediate category for CTAs and investee pools[72] for whom adverse performance disclosure would have been required and to adopt a two-tier system in which full performance disclosure would be made for CTAs (and investee pools) above the threshold, and none for CTAs (and investee pools) below the threshold. Several commenters suggested that where a CPO makes (and is authorized to make) frequent changes in the pool's CTAs and the size of the allocations to those CTAs, required disclosures with respect to CTAs should be eliminated or substantially reduced. The emphasis in such cases, according to these commenters, should be on the CPO/trading manager's performance operating multi-advisor pools. The Commission notes, however, that the distinction between "active allocation" CPOs (or trading managers) and other CPOs (or trading managers) does not appear to be susceptible to a bright line test, as most if not all CPOs and trading managers assume some responsibility for ongoing management and evaluation of CTAs. Consequently, the relative significance of the CPO's or trading manager's asset allocation expertise, as compared to the CTAs' trading program and skills, varies significantly and may not provide an objective basis for distinguishing among pools for past performance disclosure purposes. Accordingly, given the lack of precise standards on which to base a regulatory distinction between dynamically managed multi-advisor pools and other types of pools, the Commission has elected not to employ such a distinction in constructing the past performance disclosure requirements.

As adopted, Rule 4.25(c) reflects several modifications from the proposed rules, principally the elimination of the category of CTAs and investee funds for which disclosure of adverse performance would have been required. Upon consideration of the comments received, the Commission has determined to simplify the disclosure requirements such that all CTAs and investee funds will be either major and capsule format presentations of their past performance required (Rule 4.25 (c)(3) and (c)(4)), or non-major and a narrative discussion of matters relevant to their past performance required. (Rule 4.25(c)(5)). As noted above, the definitions of "major commodity trading advisor" (Rule 4.10(i)) and "major investee pool" (Rule 4.10(d)(5)) have been revised accordingly, such that a ten percent, rather than a twenty-five percent allocation is the operative threshold.

With respect to pools that do not have the requisite three-year operating history with at least seventy-five percent of the pool's assets contributed by persons unaffiliated with the CPO, trading manager, CTAs, or their respective principals, Rule 4.25(c) requires presentation of the past performance records of the offered pool, each other pool operated or account traded by the CPO (and trading manager, if applicable), the CPO's (and trading manager's) trading principals if the CPO (or trading manager) has less than a three-year history, and the performance of each major CTA and major investee pool.[73] If a CTA or investee pool is not "major," a summary description of the performance history of such advisor or pool is required in lieu of capsule performance data. To the extent that performance of principals is required, the revised rules require disclosure of the past performance of "trading principals" only.[74]

(i) *Performance of Major Commodity Trading Advisors: Rule 4.25(c)(3)*

For pools that do not have the three-year operating history specified in Rule 4.25(b), the revised rules require capsule format disclosure of CTA past performance only for "major" CTAs.

As discussed above,[75] the term "major commodity trading advisor" is defined in Rule 4.10(i) as a CTA allocated or intended to be allocated ten percent or more of the smaller of (i) the pool's aggregate net assets, or (ii) the aggregate value of the assets allocated to the pool's trading advisors, as determined based upon the agreement between the CPO and the CTA.

(ii) *Performance of Major Investee Pools: Rule 4.25(c)(4)*

The revised rules also require disclosure of past performance of investee pools constituting "major investee pools," if the offered pool does not meet the standard of Rule 4.25(b). As discussed above,[76] Rule 4.10(d)(5) defines "major investee pool" as an investee pool allocated or intended to be allocated at least ten percent of the net asset value of a pool.[77] A commenter noted that the term "investee pool" was not defined in the former rules or in the proposed revisions. As noted above,[78] the Commission has adopted a definition of "investee pool," set forth in Rule 4.10(d)(4), as "any pool in which another pool or account participates or invests, *e.g.*, as a limited partner thereof."

(iii) *CTAs and Investee Pools That Are Not "Major": Proposed Rules 4.25(a)(8) and 4.25(c)(3)(iii)*

The Commission had proposed in Rule 4.25(c)(3)(iii) to require that the CPO of an offered pool that does not satisfy the criteria of Rule 4.25(b) indicate any "adverse performance" (or, alternatively, provide a complete past performance capsule) with respect to those CTAs and investee pools allocated at least ten but less than twenty-five percent of the pool's assets (initial margins and premiums in the case of CTAs). Under proposed Rule 4.25(a)(8), "adverse performance" would have included: (i) Any annual rate of return that was at least one hundred basis points less than the ninety-day Treasury Bill rate on December 31 of the same

[70] If the pool or such persons did not have a prior trading history, indication of the lack thereof would have been required, using legends set forth in Rule 4.25(c).

[71] Proposed Rule 4.25(c)(3)(iii) would also have required that adverse performance be *indicated* for any account directed, or pool operated, by the CPO, and any trading principal of the CPO or trading manager (if any), unless such person's performance was otherwise required to be disclosed.

[72] The middle tier of the proposed three-tier disclosure scheme consisted of CTAs allocated at least ten, but less than twenty-five, percent of initial futures margin and option premiums, and investee pools allocated at least ten, but less than twenty-five, percent of pool assets.

[73] If the pool or such specified persons do not have a prior trading history, the lack thereof must be indicated by legends set forth in Rule 4.25(c), and discussed below in paragraph B.6. of this Section V.

[74] *See* Rule 4.25(c)(2), and Rule 4.10(e)(2) which defines the term "trading principal," discussed above in Section IV. Former disclosure requirements mandated disclosures concerning all principals.

[75] *See* paragraph A. of Section IV.

[76] *See* paragraph B. of Section IV.

[77] The term "pool" continues to be defined in Rule 4.10(d)(1) as "any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests."

[78] *See* paragraph B. of Section IV.

year; or (ii) the termination of a pool pursuant to a loss termination provision. Adverse performance would have been indicated by giving the year of occurrence, the rate of return, the identity of the CPO or CTA responsible, and that person's relationship to the offered pool.[79] The Commission sought comment with respect to the proposed definition of adverse performance, and in particular, as to whether any additional benchmarks would be appropriate for identifying what past performance was sufficiently "adverse" to warrant disclosure.

Numerous commenters strongly criticized both the adverse performance characterization and the concept of requiring specific disclosure of performance below a selected risk-free rate. In particular, several commenters objected to the adjective "adverse" as unnecessarily pejorative. Several commenters criticized the Treasury Bill benchmark as an inappropriate standard for a managed futures investment, and some commenters proposed alternative triggering events, such as a losing year, or a specified monthly or quarterly draw-down. Commenters asserted that CPOs would generally opt for including the full performance capsule rather than highlight negative results and, thus, that performance presentations would not in fact be streamlined by use of the adverse performance concept. Several commenters suggested a simplified, two-tier allocation standard for CTA and investee pool performance disclosure, with full disclosure for those above a specified percentage (between ten and twenty-five percent) and no performance disclosure for those with lesser allocations.

The Commission agrees with the proposition that material CTA or investee pool performance should be fully disclosed, and it believes that multiple standards can be confusing. Accordingly, the Commission is adopting a two-tier disclosure standard for an offered pool's CTAs and investee pools, rather than the three-level approach set forth in the Proposing Release. Under the adopted standard, full performance disclosure, *i.e.*, capsule performance data, is required with respect to CTAs and investee pools with allocations in excess of the designated benchmark, *i.e.*, "major" CTAs and investee pools. As adopted, the revised rules omit the proposed requirement to indicate adverse performance for CTAs and investee pools with allocations of at least ten percent, but less than twenty five percent.[80] Because this type of individual performance disclosure is being eliminated for non-major CTAs and investee pools, the Commission has determined to reduce the percentage allocation standard for major CTAs and investee pools from twenty-five to ten percent. As discussed more fully below, a narrative summary description is required for CTAs and investee pools with lesser allocations.

(iv) *Past Performance of CTAs and Investee Pools That Are Not Major: Rule 4.25(c)(5)*

As noted above, the Commission has adopted a simplified approach to the disclosure of past performance under which capsule performance data would be required for CTAs and investee pools with ten percent or greater allocations and an intermediate category of CTAs and investee funds would exist for which "adverse performance" would be disclosable. The Commission recognizes, however, that any simple quantitative standard such as the ten percent allocation standard can provide only a convenient point of reference to assure a minimum level of performance disclosure, but that pools may be structured, or their assets traded in such a manner, that use of the ten percent allocation standard will not be sufficient to identify all potentially relevant past performance data. Consequently, to supplement the required performance data for major CTAs and investee pools, the Commission is requiring in Rule 4.25(c)(5) a summary description of the performance history of non-major CTAs and investee pools, including monthly return parameters, *i.e.*, highest and lowest monthly rates of return, historical volatility information, an explanation of the degree of leverage used in the trading of such CTA or investee pool, and an identification of any material differences between the performance of such advisors and pools and that of the offered pool's major trading advisors and investee pools.

This requirement for summary performance disclosure of non-major CTAs and investee pools reflects the fact that the trading of pool assets may be distributed among multiple CTAs and investee funds, such that a substantial portion of the pool's assets, all of the pool's assets, or even a multiple of the pool's assets, may effectively be allocated to CTAs or investee pools which are not "major" and about whom performance data and other information may not generally be presented. Nonetheless, such advisors and investee pools collectively may determine the success or failure of the pool. It also reflects the fact that quantitative allocation figures alone may not be adequate to identify the extent of a particular advisor's or investee pool's impact upon the offered pool. For example, a CTA with a five percent allocation may have such an aggressive trading strategy that the impact of its trading results on the overall return of the pool may be greater than the impact of a trading advisor with an equivalent or larger allocation who follows a less aggressive trading strategy. Under Rule 4.25(c)(5), CPOs will be able to devise individualized approaches to conveying the historical volatility and other pertinent characteristics of the past performance of non-major CTAs and investee pools.

(v) *Updating Past Performance Information for Certain Persons: Proposed Rules 4.22(a)(4) and 4.26(c) for CPOs*[81]

The Commission proposed to add a new paragraph (a)(4) to Rule 4.22, which would have required the periodic Account Statement that a CPO must deliver to pool participants to include the names of all of the pool's CTAs and investee funds (including investee pools), together with the percentage of pool assets each is allocated, regardless of the amount of pool assets so allocated.[82] Rule 4.22(a)(4) would also have required that the Account Statement include past performance disclosure with respect to each new major CTA or major investee pool for whom past performance data was not previously provided in the Disclosure Document, *i.e.*, CTAs and investee funds previously allocated less than ten percent of the pool's futures margins or assets, respectively.

Commenters criticized the proposed inclusion of performance information in Account Statements as unreasonably expensive and burdensome. Some commenters contended that Account Statements are essentially financial statements subject to audit and should

[79] Unless their past performance was otherwise disclosed, Rule 4.25(c)(3)(iii) would also have required an indication of adverse performance with respect to accounts (including pools) traded by the CPO, the trading principals of the CPO (or trading manager), trading principals of major CTAs that had no prior trading history, and the trading principals of major investee pools that had no prior trading history.

[80] The requirement in proposed Rule 4.25(c)(3)(iii) to indicate adverse performance on the part of accounts (including pools) directed or operated by the offered pool's CPO, any trading principal of the CPO or any trading principal of the trading manager is also being eliminated.

[81] Because of the differences between CPOs and CTAs, CTAs have no corresponding requirements.

[82] Rule 4.22(b) states that the Account Statement must be distributed at least monthly in the case of pools with net assets of more than $500,000 at the beginning of the pool's fiscal year, and otherwise at least quarterly.

not include performance information. Still others argued that Account Statements should not be used to update or amend Disclosure Documents. Other commenters criticized the requirement to identify all CTAs and investee pools, while under proposed Rules 4.24 (e)(3) and (e)(4) only those allocated ten percent or more of pool assets would be required to be identified in the Disclosure Document.

The Commission notes that the proposed expansion of the data to be included in Account Statements was designed largely in response to concerns expressed by CPOs as to how to efficiently update Disclosure Documents to include new CTAs and in response to claims that disclosure of the names of investee funds was less onerous and more appropriate in communications with existing pool participants than in Disclosure Documents. Further, such CTA and investee pool information would not be required to be certified by the pool's accountants. Thus, as proposed, the rule would have provided a convenient mechanism for providing a complete, current picture of the pool's CTAs and investee pools.

Nonetheless, since the commenters appeared to find the proposed modifications of Rule 4.22 burdensome rather than helpful, the Commission has determined not to amend Rule 4.22. Instead, the existing updating requirements for Disclosure Documents will continue to apply, except as noted below with respect to the periodic update requirement. When a pool acquires a new major CTA or major investee pool, if such event is of material significance, the CPO will be required to notify pool participants and to provide the relevant information including performance records, as required by Rule 4.26(c),[63] within twenty-one calendar days after the CPO knows or should know of this occurrence. As was the case under the former rules, correction of Disclosure Documents may be accomplished by way of an amended Disclosure Document, Account Statement, a sticker on the Disclosure Document, or other similar means.

(vi) *Trading Managers: Rule 4.25(c)(2)*

The revised rules take into account arrangements in which a CPO delegates authority to a trading manager to select CTAs or investee pools to which the pool's assets will be allocated.[64] The term "trading manager" is defined in new Rule 4.10(h) as any person, other than the pool's CPO, with authority to allocate pool assets to CTAs or investee pools.[65] Rule 4.25(c)(2) requires trading manager performance in addition to CPO performance if the pool has a trading manager. In such cases, the trading manager is, in effect, a supervisory CTA and the performance of such manager is clearly material. As discussed *supra*, the requirement has been changed from an alternate one, *i.e.*, CPO or trading manager's performance, to include performance of both on the basis that even where a trading manager has been appointed, generally the CPO will continue to exercise ultimate control over the pool's operations. However, in cases where the trading manager has been given complete authority over the pool's trading and the performance of the trading manager does not differ materially from that of the pool operator, Rule 4.25(c)(2) provides that performance data for the pool operator may be omitted.

2. Required Past Performance Disclosure in CTA Disclosure Documents: Rule 4.35

Proposed Rule 4.34(a)(1) would have required CTAs to continue to present past performance of the offered trading program in the full multi-columnar format required by former Rule 4.31(a)(3). Most commenters strongly urged that CTAs be permitted to use the new capsule format. Some argued that if the offered trading program's performance must be presented in the multi-column format, the CTA will be forced to produce a separate Disclosure Document for each program he offers or to include all past performance in the multi-columnar format. One commenter suggested permitting use of the capsule format for the CTA's offered trading program but requiring monthly rates of return.

The Commission has determined to modify proposed Rule 4.34(a) to provide that the past performance of the CTA's offered trading program be presented in capsule format.[66] The capsule will include the names of the CTA and the trading program, the dates on which the CTA began trading client accounts and on which accounts were first traded pursuant to the trading program, the number of accounts traded pursuant to the trading program, and the total assets under management by the CTA and total assets traded pursuant to the trading program. The worst monthly and peak-to valley draw-downs experienced by the trading program are also required. Like the offered pool's performance in a CPO Disclosure Document, the capsule for a CTA's offered program is required to include monthly rates of return. The offered trading program's monthly rates of return may be presented either in a table or in a bar graph or chart. (Rule 4.35(a)(2) (ii) and (iii)). The offered program's capsule must also include the number of accounts closed with positive net performance during the most recent five calendar years and year-to-date, as well as the number of accounts closed with negative net performance during the same period. (Rule 4.35(a)(1)(viii)). CTAs will be required to provide prospective and existing clients, upon request, with the offered trading program's performance in the multi-column format previously required. (Rule 4.35(a)(2)(iv)).

The Commission believes that with the specified additional requirements for the offered trading program, this modification of the proposal will result in simplified CTA Disclosure Documents, while providing prospective clients with material information regarding trading program volatility.

3. Time Period for Which Required Past Performance Disclosures Must Be Made: Rules 4.25(a)(5) for CPOs and 4.35(a)(5) for CTAs[67]

Proposed Rules 4.25(a)(7) and 4.34(a)(4) would have extended the time period for which performance must be disclosed from three years to five years (or the life of the pool or account, if less than five years). As stated in the Proposing Release, the Commission believes that requiring performance to

[63] Rule 4.26(c), discussed below at paragraph B of Section VII, sets forth the requirements for amending pool Disclosure Documents to reflect a material change in the document. This requirement previously was found in former Rule 4.21(b).

[64] *See, e.g.*, Rule 4.25 (c)(2).

[65] As the Commission noted in the Proposing Release, the practice of retaining trading managers to select and monitor the performance of CTAs and investee pools to which pool assets will be committed has become commonplace. CPOs commonly seek to maximize pool returns by allocating pool assets based on analysis of the returns achieved by CTAs retained for the pool and investee pools in which the pool has invested in light of their aggregate results, market conditions, and the performance of other CTAs and investee pools. CPOs frequently rely on trading managers to continuously review the performance of CTAs and investee pools and allocate and reallocate pool funds. Because of the importance of the trading manager and the fact that the trading manager is a CTA for the pool, when a pool has a trading manager, the trading manger's performance is generally required in addition to that of the CPO. 60 FR 25351, 25357.

[66] With respect to CTAs calculating rates of return on the basis permitted by Advisory 93-13, as discussed *supra*, the capsule must include rates of return for the fully-funded subset and Commission staff will provide guidance concerning supplemental data to accompany the capsule disclosure to reflect the range of levels of partial funding and the generic disclosures discussed in Advisory 93-13.

[67] Former Rules 4.21 (a)(4) and (a)(5) for CPOs and 4.31(a)(3) for CTAs generally required past performance to be presented for a three-year period.

be disclosed for a period longer than three years will make the timespan covered by performance disclosures more uniform and will better portray the evolution of performance over time, including positive and negative fluctuations in returns.[88] Two commenters supported the proposed five-year timeframe, noting that if all registrants may use the capsule format, investors will be provided with material information without increasing the volume of performance disclosure. One commenter, however, claimed that extending performance from three to five years would work against streamlining and reducing the volume of disclosure and would not enhance investor understanding.

The Commission is adopting Rules 4.25(a)(7) and 4.34(a)(4) as proposed (proposed Rule 4.34(a)(4) has been renumbered Rule 4.35(a)(5), however). As noted in the Proposing Release, under the new summary format for performance disclosure, performance presentations are substantially condensed and multiple tables in the new summary format can be included on a single page. Consequently, adoption of a five-year disclosure period should not entail any significant increase in the volume of performance disclosures. The Commission believes that the benefits of this additional disclosure outweigh any minor resulting increase in the quantity of data disclosed.[89]

4. Composite Performance Presentations: Rules 4.25(a)(3) and (a)(4) for CPOs and Rule 4.35(a)(3) for CTAs[90]

As noted in the Proposing Release, the Commission has carefully considered the benefits and disadvantages that may accrue from the use of composites.[91] Thus, as proposed and as adopted, the new rules employ an approach designed to realize the benefits of reducing the volume of performance data created by the use of composites while minimizing the potential for misleading past performance presentations.

a. CPO Disclosure Documents

*Proposed Rule 4.25(a)(3) would have required that past performance data for the offered pool and for pools similar to the offered pool be separately disclosed, on a pool-by-pool basis. (Rule 4.25(a)(3)(i)). Pools of a different type from the offered pool could be presented in composites with other pools of the same class, provided that such presentations were not misleading, that the manner in which the composite was developed was disclosed, and that the CPO was able to justify the inclusion of pools in a composite. (Rule 4.25(a)(3)(ii)). As proposed, Rule 4.25(a)(3)(iii) listed a non-exclusive set of five specific class distinctions requiring separate rather than composite presentation but recognized that additional factors might warrant creation of additional composite categories.[92] In addition, Rule 4.25(a)(3)(iv) would have required that material differences among the pools for which past performance is presented must be disclosed.

Numerous comments were received on proposed Rule 4.25(a)(3), several of which urged the adoption of three categories for composite performance presentation: guaranteed pools, non-guaranteed multi-advisor pools and non-guaranteed single-advisor pools.[93] Several commenters asserted that the distinction between public and privately offered pools can be eliminated by pro forma adjustments for cost differences. One commenter remarked that since virtually all pools use different trading programs, composite presentations might be precluded altogether under the proposed rule. Other commenters contended that some of the listed pool categories were too broadly worded. Still other commenters criticized use of the concept of specified pool classes for purposes of determining what pools may be combined in a single composite or the particular categories proposed by the Commission, suggesting either a general materiality standard for determining whether differences among pools require separate composites or inclusion in a single composite of all pools operated by the CPO and structured similarly to the offered pool. Some commenters contended that even pools similar to the offered pool should be included in one composite, instead of separately presented.[94] One commenter urged that CPOs not be under an obligation to be prepared to justify the inclusion of pools in a composite but, rather, that the CPO be permitted to exercise reasonable discretion in this matter.

The Commission specifically requested comment as to the costs and benefits of a general requirement of separate rather than composite presentations of pool performance in lieu of a qualified approach of the nature proposed. Commenters stated that greater use of composite presentations should be permitted, e.g., composite presentation of performance for pools of the *same* class as the offered pool or inclusion of all of a CPO's prior pools in one composite.

Rule 4.25(a)(3) has been adopted as proposed with certain modifications. Pools with materially different rates of return may not be included in the same composite, regardless of class. (Rule 4.25(a)(3)(ii)(B)). The Commission believes that separate presentation of the performance of other pools of the same class as the offered pool provides useful information to the reader since such pools should provide the most comparable performance content and has thus retained this requirement. However, the Commission has simplified the criteria for determining what types of pools may be included in a composite capsule. The Commission has determined to delete two of the distinctions specified in proposed Rule 4.25(a)(3)(iii) ("pools using different leverages" and "pools using different trading programs"), on the ground that

[88] 59 FR 25351, 25358.

[89] As noted above, the NFA Special Committee for the Review of CPO/CTA Disclosure Issues suggested that the capsule include at least five years of performance history.

[90] Former Rule 4.21(a)(4)(iv) permitted the performance of pools operated by each person for whose performance was required to be disclosed to be presented on a composite basis, provided that the performance of the offered pool was separately disclosed, the CPO described how each composite was developed, and the composite was not misleading. Former Rule 4.31(a)(3)(iii) also permitted composite presentation of the performance of accounts directed by the CTA and each of its principals, provided that material differences among the accounts and the manner in which the composite was developed were described.

[91] 59 FR 25351, 25358. Specifically, the Commission noted that:

> Composite presentations have the obvious advantage of reducing the volume of past performance data presented. However, composite presentations raise a number of regulatory concerns precisely because they supplant individualized presentations of potentially quite different types of pools and trading programs and may smooth or camouflage actual rates of return. Composite results not only fail to reflect differences among the pools and accounts whose results are presented but also merge potentially disparate trading results into average trading results and thus fail to reflect the actual dispersion of returns as well as the volatility of individual pools and accounts. *Id.*

[92] The distinctions set forth in proposed Rule 4.25(a)(3)(iii) are: Pools privately offered pursuant to Regulation D under the Securities Act of 1933 and publicly offered pools; pools using materially different leverages; pools using different trading programs; pools with a guarantee feature and pools without such a feature; and multi-advisor pools and non-multi-advisor pools. The CPO would have discretion to use additional criteria and would be required to do so where use of a composite would be misleading. *See* Rule 4.24(w), which requires disclosure of all material information.

[93] NFA's Submission had proposed the same three categories.

[94] One commenter suggested that performance of all pools other than the pool being offered should be presented in the second part of a two-part Disclosure Document. The Commission will take this comment into consideration in the course of its review of other issues raised by the bifurcated disclosure format.

they may be difficult to apply and thus may preclude the use of composites in most or all cases, and otherwise to adopt Rule 4.25(a)(3) essentially as proposed.[95] Two pools that use different trading programs or different degrees of leverage could therefore be included in the same composite, provided that material differences among the pools are disclosed and provided that such pools' rates of return are not materially different.

The Commission is retaining two of the remaining pool categories specified in proposed Rule 4.25(a)(3), *i.e.*, pools privately offered pursuant to the Securities Act[96] and public offerings; and principal-protected and non-principal-protected pools. With respect to the proposed differentiation between multi-advisor pools as defined in Rule 4.10(d)(2) and non-multi-advisor pools, the Commission is adopting a more flexible approach pursuant to which multi-advisor pools will be presumed to have rates of return that are materially different from those of non-multi-advisor pools and thus may not be included in the same composite, absent clear evidence to the contrary. The Commission believes that this qualified approach is warranted because multi-advisor pools will tend to have different fee structures and risk/reward profiles than non-multi-advisor pools, yet, in part due to the definitional complexity of the multi-advisor pool concept, this may not be true in all cases.

As adopted, Rule 4.25(a)(3) retains the proposed requirements regarding separate and composite performance presentations for the CPO's other pools. First, pools of the same class as the offered pool must be presented separately, following the offered pool's performance. Second, performance of any remaining pools must be presented less prominently, and may be presented in composites. Third, only pools belonging to the same class, and that do not differ materially from each other in their rates of return, may be included in the same composite. Finally, material differences among pools for which performance is presented must be disclosed. The Commission reiterates that the categories specified in Rule 4.25(a)(3)(iii) are illustrative and not exclusive.

In deciding not to permit general compositizing of the CPO's other pools that differ from the offered pool, the Commission notes that while composites condense voluminous material into digestible units, overly inclusive composites tend to flatten performance fluctuations and thus may obscure variations in rates of return and volatility among pools. Registrants therefore must use care in constructing composites, and material differences between and among pools (including the distinctions set forth in Rule 4.25(a)(3)(iii)) are ordinarily indications against composite presentation.[97]

As the Commission noted in the Proposing Release, there may be instances in which even composites of pools of the same class may be misleading, such as where differences between or among the trading results of the pools are so great that a composite would materially distort their results.[98] The express restriction against inclusion of pools with materially different rates of return in the same composite addresses this concern to some extent, but other types of differences, *e.g.*, different volatility levels, could be material. The proviso in Rule 4.25(a)(3)(ii) that results may be presented in composite form "unless such presentation would be misleading" is intended to ensure that composites are carefully reviewed to protect against any material distortion that may result from use of this format.

To present capsule performance of pools in a composite, the CPO must name all pools included in the composite, set forth the classes of these pools (which, as discussed above, would be the same for each pool in the composite), including at a minimum and, as applicable, the classes specified in Rule 4.25(a)(3)(iii) and specify the date on which each pool commenced trading. For composite capsule performance purposes, the aggregate gross capital subscriptions are the total subscriptions for all pools in the composite, the draw-down figures are the worst experienced by any one of the pools included in the composite and the rate of return is the weighted average rate of return for all pools included.

Proposed Rule 4.25(a)(4) would have required that the past performance of accounts be presented in capsule format on a program-by-program basis. As adopted, Rule 4.25(a)(4) permits program-by-program presentation unless such a presentation would be misleading. In addition, accounts with materially different rates of return may not be included in the same composite, and the CPO must discuss all material differences among accounts included in a composite.

b. CTA Disclosure Documents

Proposed Rule 4.34(a)(5) would have provided that the performance of accounts traded pursuant to the same trading program could be presented in the same composite, unless to do so would be misleading, provided that the CTA describes how the composite performance information was calculated. Under proposed Rule 4.34(a)(5), "trading program" would have been defined as a trading strategy differentiated from other trading strategies by commodity trading methodology, degree of risk or degree of leverage. Commenters stated that "trading program" was already defined in existing Rule 4.10(g)[99] and argued that the Commission's proposal would have conflicted with the existing rule.

In adopting Rule 4.34(a)(5), renumbered as Rule 4.35(a)(3), the Commission has revised the text to eliminate the proposed definition of trading program as a trading strategy differentiated from other such strategies by trading methodology, degree of risk or degree of leverage. Instead, Rule 4.35(a)(3), like the parallel provision for CPO Disclosure Documents, provides that unless such a presentation would be misleading, past performance of accounts may be presented in a composite form on a program-by-program basis and that accounts that differ materially with respect to rates of return may not be presented in the same composite. In determining which accounts may be included in a single composite, the factors set forth in the proposed rule, trading methodology, degree of risk and degree of leverage, are ones that should be taken into consideration. Like Rule 4.25(a)(4) for CPOs, Rule 4.35(a)(3) for CTAs contains a proviso that results may be presented in composite form "unless such presentation would be misleading." Further, CTAs are cautioned that other material differences among accounts may make presentation in the same composite misleading. As with

[95] The text of Rule 4.25(a)(3)(iii) is affected by the change of the term "limited risk pool" to "principal-protected pool" in Rule 4.10(d)(3) and the changed definition of "multi-advisor pool" in Rule 4.10(d)(2).

[96] *See* Section 4(2) of the Securities Act and Regulation D thereunder, 17 CFR 230.501–230.508 (1994).

[97] Material differences among the pools for which past performance is disclosed must be described. Rule 4.25(a)(3)(iv).

[98] 59 FR 25351, 25356. For example, two multi-advisor pools with no guarantee feature using the same CTAs could show widely disparate results unless each CTA were allocated substantially the same portion of each pool's assets. Also, two single-advisor pools with different CTAs may achieve very different results.

[99] The term "trading program" continues to be defined in existing Rule 4.10(g) as "the program pursuant to which a [CTA] (1) directs a client's commodity interest account, or (2) guides the client's commodity interest trading by means of a systematic program that recommends specific transactions."

composite presentations of pool performance, the draw-down figures in a composite in a CTA Disclosure Documents are the worst experienced by any one of the accounts included in the composite.

c. Substantiating Composite Presentations

Rules 4.25(a)(7) and 4.35(a)(6) require that records be maintained substantiating the performance data set forth in CPO and CTA Disclosure Documents, respectively, and documenting the underlying calculations, in accordance with Rule 1.31. Naturally, this requirement also applies with respect to composite presentations. Although not specified in Rule 4.25(a)(3)(ii), as adopted, a CPO must be prepared to justify the inclusion of a given pool's past performance results in a composite.

5. Order of Required Performance Disclosures: Rules 4.25(a)(2), (a)(3)(i) and (a)(3)(ii) for CPOs and 4.35(a)(1) and (a)(2) for CTAs[100]

Proposed Rule 4.25(a)(2) for CPO Disclosure Documents would have required that the performance of the offered pool be identified as such, presented separately, and included before any other performance information.[101] Thus, if presentation of past performance in addition to that of the offered pool was required because the offered pool did not have the requisite three-year operating history under Rule 4.25(b), the offered pool's performance must be presented separately from, and prior to, any such other required performance data.[102] Under proposed Rule 4.25(a)(3), performance data for pools of the same class as the offered pool would be presented on a pool-by-pool, non-composite basis, after the performance history of the offered pool. The performance histories of pools of a different class from the offered pool would be presented after, and less prominently than, the performance records of pools of the same class as the offered pool. Proposed Rule 4.25(a)(1)(i)(H) specified that required performance disclosure for pools other than the offered pool must provide annual and year-to-date rates of return.[103] Similarly, for CTAs, proposed Rules 4.34(a)(1) and (a)(2) would have required that the performance of the offered trading program be displayed first and the performance of all other programs after that presentation.

The Commission is adopting the required order of performance presentation specified in proposed Rules 4.25(a)(2), (a)(3)(i) and (a)(3)(ii) for CPOs and in proposed Rules 4.34(a)(1) and (a)(2) for CTAs. Registrants are reminded that disclosure of performance information not required by Commission rules, federal or state laws or regulations, self-regulatory agency rules or laws of non-United States jurisdictions is subject to the rules on supplemental information, *i.e.*, it may not be misleading and it must follow the entire presentation of required performance information (except that proprietary, hypothetical, extracted, pro forma[104] or simulated trading results must be placed at the end of the Disclosure Document).[105]

6. Required Performance Legends

a. Legends Relating to Lack of Trading Experience: Rules 4.25(c) for CPOs and 4.35(b) for CTAs[106]

The proposed rules would have continued to require the inclusion of prescribed legends in specific circumstances, alerting prospective pool participants and discretionary account clients to the lack of performance history on the part of specified persons. In the case of pool Disclosure Documents, the proposed rules would have required legends with respect to the absence of performance history, where applicable, on the part of the pool, the CPO (or trading manager) and its trading principals, major CTAs and major investee pools. In CTA Documents, such legends would be required, if applicable, on the part of the CTA and its trading principals. In the interest of simplification and readability, the Commission proposed substantial revisions of the legends required by the former rules, generally to shorten them and to sharpen their focus upon the matters most pertinent to investors.[107]

The Commission received several comments favoring the proposed shortening of the required legends. The revised legends in proposed Rules 4.25(c) and 4.34(b) are being adopted as proposed (with Rule 4.34(b) being renumbered as Rule 4.35(b)) to provide and highlight important information in a more concise and comprehensible manner.[108] Prescribed legends in pool Disclosure Documents apply only where the offered pool does not meet the trading history criteria of Rule 4.25(b).[109] The prescribed legends have been shortened by eliminating introductory language stating that disclosure of the referenced information is required by the Commission. This focuses attention upon the primary point to be conveyed, e.g., the fact that the CPO and its principals have not previously operated any commodity pools. Thus, the legend relating to the lack of trading history of a pool now reads: "THIS POOL HAS NOT COMMENCED TRADING AND DOES NOT HAVE ANY PERFORMANCE HISTORY." (Rule 4.25(c)(1)(ii)).[110] Similarly, the legend relating to the lack of experience of the CPO or trading manager and its trading principals now reads: "NEITHER THIS POOL OPERATOR (TRADING MANAGER, if applicable) NOR ANY OF ITS TRADING PRINCIPALS HAS PREVIOUSLY OPERATED ANY OTHER POOLS OR TRADED ANY OTHER ACCOUNTS." (Rule 4.25(c)(2)(ii)). Similar legends are required, where applicable, with respect to major CTAs and investee pools.

[100] The Commission's disclosure rules previously did not specifically address the order of required performance disclosures.

[101] Proposed Rule 4.25(a)(2) also required that the offered pool's rate of return be stated in monthly increments.

[102] As discussed above, Rule 4.25(b) provides that if the offered pool has traded commodity interests for at least three years, during which time at least 75% of its assets were contributed by persons unaffiliated with its CPO, trading manager, CTAs or any of their principals, only the offered pool's past performance must be disclosed.

[103] As discussed above, Rules 4.25(a)(3) and (a)(4) provide guidance for determining whether pools or accounts may be included in the same composite.

[104] As discussed in Section V.C.3. *infra*, pro forma adjustments to performance data are required for certain purposes and such adjustments are not affected by the restrictions upon placement of supplemental information.

[105] Rules 4.24(v) for CPOs and 4.34(n) for CTAs (both captioned "Supplemental information"), are discussed more fully below in Section VI.

[106] Former Rules 4.21(a)(4) and (a)(5) for CPOs and 4.31(a)(3) for CTAs required lengthier legends. For example, former Rule 4.21(4)(i)(B) specified a statement that the Commission requires disclosure of the performance of the offered pool and of other pools operated by the CPO and its principals and that neither the CPO nor its principals have any prior performance history. *See* 59 FR 25351, 25361 for a more complete discussion of the former requirements.

[107] 59 FR 25351, 25361.

[108] The Commission is retaining in Rules 4.25(c) and 4.35(b) the explanation that if any of the persons for whom a prescribed legend must be displayed is a sole proprietorship, reference to its trading principals need not be included.

[109] Those criteria, as adopted, are: (1) The pool has traded commodity interests for at least three years; and (2) during the three-year (or greater) period, at least seventy-five percent of the pool's assets were contributed by persons unaffiliated with the CPO, the trading manager (if applicable), the CTA or any of their principals.

[110] The legend required by former Rule 4.21(a)(4)(c) read as follows:

THE COMMODITY FUTURES TRADING COMMISSION REQUIRES A COMMODITY POOL OPERATOR TO DISCLOSE TO PROSPECTIVE POOL PARTICIPANTS THE ACTUAL PERFORMANCE RECORD OF THE POOL FOR WHICH THE OPERATOR IS SOLICITING PARTICIPANTS. YOU SHOULD NOTE THAT THIS POOL HAS NOT BEGUN TRADING AND DOES NOT HAVE ANY PERFORMANCE HISTORY.

(Rules 4.25(c)(3)(ii) and (c)(4)(ii), respectively). The revised rules similarly require a CTA Disclosure Document to disclose, if applicable, the lack of experience of the CTA and its principals. If the CTA has no prior experience, the following legend is to be included: "THIS TRADING ADVISOR PREVIOUSLY HAS NOT DIRECTED ANY ACCOUNTS." (Rule 4.35(b)(1)). The following legend is to be used for trading principals: "NONE OF THE TRADING PRINCIPALS OF THIS TRADING ADVISOR HAS PREVIOUSLY DIRECTED ANY ACCOUNTS." (Rule 4.35(b)(2)). If neither the CTA nor any of its principals has prior trading experience, rather than displaying two separate cautionary legends concerning the CTA and the CTA's principals, the following single sentence is to be included: "NEITHER THIS TRADING ADVISOR NOR ITS TRADING PRINCIPALS HAVE PREVIOUSLY DIRECTED ANY ACCOUNTS." (Rule 4.35(b)(3)).

b. Legends Relating to Predictive Value of Past Performance: Rules 4.25(a)(9) for CPOs and 4.35(a)(8) for CTAs[111]

To indicate the general lack of predictive value of past performance information, proposed Rules 4.25(a)(10) for CPOs and 4.34(a)(7) for CTAs would have required that any past performance information, whether required or voluntarily provided, be preceded by the statement that "PAST PERFORMANCE IS NOT PREDICTIVE OF FUTURE PERFORMANCE," prominently displayed.[112] Thus, if a registrant presents both required and voluntarily provided performance information in its Disclosure Document, the specified disclaimer must precede each such performance presentation.

One commenter strongly opposed the proposal as a "potentially misleading" departure from the language of NFA Compliance Rule 2-29, which prohibits reference to past trading profits without mentioning that past results "are not necessarily indicative of future results."[113] Other commenters stated, similarly, that "not necessarily indicative" is more accurate and balanced than "not predictive."

Although the Commission does not agree that the proposed legend was either potentially misleading or less accurate than NFA's existing performance disclaimer, it has determined to revise the proposed text of this legend in the interest of establishing a single, uniform standard. Consequently, the Commission has revised the text of the proposed legend to conform it to the language of NFA Compliance Rule 2-29, that is, "Past performance is not necessarily indicative of future results."[114] However, the Commission may revisit this issue in the context of its further consideration of past performance and risk disclosure issues. The Commission believes that pools are likely to be sold based on past performance claims and therefore, a *formatted* disclosure requirement assures consistency and auditability. The Commission remains convinced that past performance is not generally predictive of future rates of return.

7. Summary Tables

a. Performance Disclosure Requirements

The following table summarizes the past performance requirements set forth in Rules 4.25 and 4.35.

SUMMARY OF REQUIRED PERFORMANCE DISCLOSURES—CPO DISCLOSURE DOCUMENTS

Category	Requirement
Offered pools with 3 years history & 75% or more of assets from non-affiliates of CPO, trading mgr., CTAs or principals.	—Performance of offered pool for five most recent calendar years and year-to-date ("YTD") (or if shorter, for life of pool); with monthly rates of return ("RORs") presented in bar graph or table. Rules 4.25(b); 4.25(a)(5); 4.25(a)(2).
Offered pools that do not meet three-year history and asset contribution standards.	—Performance of offered pool for life of pool first, with monthly RORs in table or bar chart. Prescribed statement if pool has no operating history. Rules 4.25(c)(1); 4.25(a)(2). —Performance of CPO's and trading manager's other pools and accounts for five most recent calendar years and YTD, with annual RORs. Performance for pools of the same class as the offered pool must be presented more prominently than that of other pools. Rule 4.25(c)(2)(i). —If CPO or trading manager has less than three-year history in trading pools with 75% outside contributions, performance of CPO's trading principals, with annual RORs. *Prescribed statement* if no prior trading history of CPO/trading manager or trading principals. Rules 4.25(c)(2)(i); 4.25(c)(2)(ii). —Performance of major CTAs and investee pools. Prescribed statement if no prior history. Rules 4.25(c)(3), 4.25(c)(4). —Narrative description of non-major CTAs' and/or investee pools' past performance, trading, investment activities, strategies, and experience. Rule 4.25(c)(5).
All	—Required performance is to be given for most recent five calendar years and YTD (or, if shorter, for life of account). Rule 4.35(a)(5). —Performance of offered trading program presented first, with monthly rates of return presented in bar graph or table. CTA must make performance available in multi-column format of former Rule 4.21(a)(5) upon request. Rule 4.35(a)(2). —Performance of each other account directed by CTA and by each of CTA's trading principals, with annual RORs. Rule 4.35(b). —Performance of accounts traded pursuant to same trading program may be presented in composite unless misleading. Rule 4.35(a)(3). —*Prescribed statement* if no prior trading history of CTA or trading principals. Rule 4.35(b).

[111] The Commission's former disclosure rules did not contain any such legends with respect to past performance *generally*. Rule 4.41(b) specifies a disclaimer required to precede the presentation of simulated or hypothetical performance results, and NFA Compliance Rule 2-29(b)(5) requires language similar to that in proposed Rules 4.25(a)(10) and 4.34(a)(7).

[112] As the Commission noted in its proposal, numerous studies have shown the general lack of predictive value of past performance. 60 FR 25351, 25361 at n.42.

[113] NFA Compliance Rule 2-29, which concerns communications with the public and use of promotional materials by NFA members, prohibits a member or associate from using promotional material which "includes any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results." (NFA Compliance Rule 2-29(b)(5)).

[114] The Commission is adopting proposed Rules 4.25(a)(10) and 4.34(a)(7) as Rules 4.25(a)(9) and 4.35(a)(8), respectively.

b. Sample Capsule Performance Presentations

The following are examples of "capsule" performance presentation under Rules 4.25 and 4.35.

Capsule Performance Examples Under Rule 4.25 Capsule Performance of the Offered Pool

[XYZ Partners, L.P. is a privately offered, single-advisor pool that does not have a guarantee feature. Past performance is shown for the most recent five calendar years and year-to-date (monthly rates of return for the most recent calendar year and year-to-date). For purposes of this example, it is assumed that thirty percent of the assets were provided by X, the CPO, and that the performance of other pools operated by X is therefore required to be presented. Of the other pools operated by X, Pool A, which is of the same class as the offered pool is presented first (and separately). Pools B, C and D are of different classes than that of the offered pool, and since Pools B and C belong to the same class, the performance of B and C is presented in a composite.]

Percentage rate of return (computed on a compounded monthly basis)	Month					
	Year-to-date	1994	1993	1992	1991	1990
January	1.12	2.43	3.50	2.56	1.54	0.69
February	1.34	3.11	(2.30)	1.96	(0.89)	(0.82)
March	0.96	(0.23)	1.60	3.72	1.15	0.55
April	1.45	1.16	1.22	4.66	0.97	1.06
May	———	1.54	(3.62)	2.75	1.21	0.90
June	———	0.32	1.32	(16.87)	0.51	1.12
July	———	1.28	1.15	(9.87)	0.11	1.01
August	———	1.12	1.85	(7.03)	(0.14)	0.93
September	———	2.09	0.87	6.61	0.56	0.99
October	———	1.34	2.10	4.23	0.23	1.01
November	———	1.57	0.90	3.97	1.11	1.19
December	———	1.04	0.825	3.81	0.32	1.14
Year	6.32	18.66	8.48	(3.60)	7.80	12.11

Offered pool
Name of Pool: XYZ Partners, L.P.
Type of Pool: Privately offered
Inception of Trading: January 1, 1989
Aggregate Subscriptions: $1,673,000
Current Net Asset Value: $1,925,000
Worst Monthly Percentage Draw-down:* 7–92/16.54%
Worst Peak-to-Valley Draw-down: 6 to 9–92/30.52%
*"Draw-down" means losses experienced by the pool over a specified period.

Capsule Performance of Other Pools Operated by the Offered Pool'S CPO

Name of pool	Type of pool	Inception of trading	Aggregate subscription ($ x 1,000)	Current total NAV ($ x 1,000)	Worst monthly percent draw-down	Worst peak-to valley draw-down	Percentage rate of return (computed on a compounded monthly basis)					
							1990	1991	1992	1993	1994	Year-to-date
Other pools operated by X, different class from offered pool:												
A	2	8/86	617	730	(11.73) 7/93	(19.61%) 4–8/91	11.17	6.2	3.4	10.6	6.8	4.82
Other pools operated by X, same class as offered pool:												
B; C	2, 3	8/93; 10/89	9,101	20,701	(1.09) 12/93*	(1.09%) 10–12/93*	6.8	8.8	9.6	11.2	12.6	0.51
D	1, 2	1/90	631	279	(16.01) 8/92	(40.81%) 5–8/92	(2.3)	4.3	6.2	(8.2)	13.9	(17.26%)

Key to type of pool
1—Principal-protected pool
2—Privately offered pool
3—Multi-advisor pool
*Worst draw-down for any of the pools included in the composite.
**In the case of composite presentation, combined rate of return figures are weighted on the basis of the net asset values of the pools included in the composite.

c. Sample Bar Chart/Graph of Monthly Rates of Return

The following is an example of monthly rates of return for a five-year period presented in the form of a bar chart.

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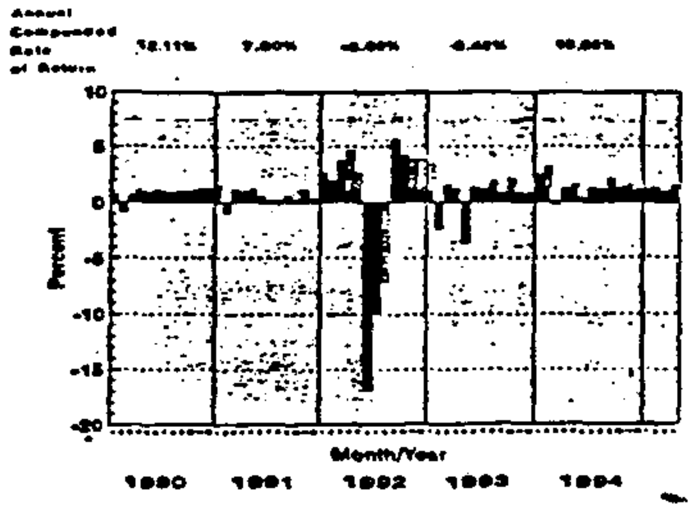
XYZ Partners, L.P. Past Performance



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C. Non-Required Performance Disclosures

1. Voluntary and Supplemental Performance Disclosures: Rules 4.24(v) for CPOs and 4.34(n) for CTAs[115]

Proposed Rules 4.24(v) and 4.33(n) would have required that information (including performance information) other than that required by Commission rules, the antifraud provisions of the Act,[116] or federal or state securities laws and regulations "appear following the related required disclosures." In addition, the proposed rules provided that such information could not be misleading in content or presentation nor inconsistent with required disclosures. The purpose of these rules was to ensure that the principal focus of the Disclosure Document would remain upon the required information because of its generally high degree of materiality.

As emphasized in the Proposing Release, voluntary performance disclosures can readily be constructed to create misleading effects by, for example, focusing attention upon positive performance while omitting negative results. If the performance of two pools (other than the offered pool) operated by a CPO were voluntarily provided, it could be misleading to show the favorable performance of Pool 1 but not the negative performance of Pool 2 or to show the performance of Pool 1 in capsule format and that of Pool 2 in full format. It could also be misleading to show the performance of a pool in capsule format for year one and in full format for year two or to show the pool's performance for 1991 and not 1992. Clearly, care must be taken to assure that supplementally provided performance disclosures are not presented in a manner that creates the potential to mislead.[117]

Commenters claimed that in view of the requirement to disclose all material information,[118] the determination that information is not required by Commission rules, the Act or other laws necessarily involves a determination that the information is not material and that designating it as "voluntary" reinforces that determination. A number of commenters stressed the difficulty of determining in many cases what information is required to be disclosed and what is merely advisable, and believed that, in consequence, mandating that non-required information follow required disclosures could create confusion. Further, some commenters incorrectly read proposed Rules 4.24(v) and 4.33(n) to require placing all non-required information at the end of the document (instead of following the related required disclosures). One commenter suggested that placement of non-required information adjacent to the required information to which it relates may be clearer to the reader.

One commenter urged that CPOs and CTAs be permitted to present performance disclosure beyond the required five-year period, provided material changes are disclosed, while another commenter urged that CPOs and CTAs be required to present either five years' performance or the full trading history of the pool or trading program, in order to prevent "cherry picking."

As adopted, Rules 4.24(v) and 4.34(n) provide significantly more guidance regarding the placement of supplementally provided information. Rules 4.24(v) and 4.34(n), as adopted, also expand the category of required information to include information required by "any applicable laws of non-United States jurisdictions." In addition, applicable federal and state requirements are no longer restricted to securities laws and regulations. The comments received and the Commission's action with respect to the application of proposed Rules 4.24(v) and 4.33(n) to supplementally provided non-performance information are discussed below in Section VI. With respect to supplemental past performance, however, the Commission believes that requiring such data to follow required past performance disclosure is appropriate.

The Commission will permit presentation of additional past performance information beyond the required five calendar years and year-to-date, provided that any such supplemental information is calculated in compliance with the requirements of

[115] Rules 4.24(v) and 4.34(n) regulate placement of *all* supplementally supplied information. Application of these rules to non-performance disclosures is discussed below at paragraph C of Section VI. The Commission's former disclosure rules did not *specifically* address the placement of voluntary performance disclosures.

[116] *See* Sections 4b and 4o of the Act, 7 U.S.C. 6b and 6o (1994). Section 4b of the Act prohibits fraud in connection with the making of any contract of sale of any commodity for future delivery. Section 4o of the Act prohibits CPOs, CTAs and their associated persons from employing any device, scheme, or artifice to defraud a pool participant, prospective pool participant or client and from engaging in any transaction, practice or course of business which operates as a fraud or deceit upon such participant or client. In addition, under section 4o(2) of the Act CPOs, CTAs and their associated persons are precluded from representing or implying that they have been sponsored, recommended or approved by the United States or by any agency or officer thereof.

[117] 58 FR 25351, 25361.

[118] Former Rules 4.21(h) and 4.31(g), renumbered as Rules 4.24(w) and 4.34(o).

Rules 4.25 or 4.35, as applicable, and is presented following all required performance disclosures. Such additional performance information must not be misleading. For example, if additional performance information beyond the required five years is presented but the entire history of the pool or program is not covered, the additional performance results shown must be representative of the results that would have been shown if the entire history were presented. Thus, "cherry picking" of performance data to highlight positive performance is a misleading practice precluded under existing antifraud standards. Generally, inclusion of voluntarily provided performance data should be made on a result-neutral basis that results in inclusion of all similar data.[119] The Commission also notes that the practice of advertising a pool by touting the excellent past performance record of a particular CTA to attract prospective participants and shortly thereafter reallocating pool assets to another CTA, a practice commonly referred to as "bait-and-switch," is misleading and that use of performance data in this manner would violate relevant antifraud provisions.

Any proprietary performance must be presented in accordance with Rule 4.25(a)(8) for CPOs and Rule 4.35(a)(7) for CTAs, as discussed below. Hypothetical, extracted, simulated and pro forma[120] performance information is also now required by Rules 4.4(v) and 4.34(n) to be presented separately after all other information.[121]

2. Proprietary Trading Results: Rules 4.25(a)(8) for CPOs and 4.35(a)(7) for CTAs[122]

Proposed Rules 4.25(a)(9) and 4.34(a)(6) would have permitted CPOs and CTAs, respectively, to disclose proprietary trading results under appropriate restrictions. Proposed Rule 4.25(a)(9) would have provided that the performance of pools and accounts in which the CPO, trading manager, CTA or other person providing services to the pool owns or controls fifty percent or more of the beneficial interest may not be included in pool Disclosure Documents unless prominently labeled as proprietary and set forth separately following all required performance and non-performance disclosures. Proposed Rule 4.34(a)(6) set forth similar restrictions for CTA Disclosure Documents with respect to accounts in which the CTA or any of its principals or any person providing services to the account owns or controls fifty percent or more of the beneficial interests.

While a number of commenters agreed with the intent of the Commission's proposal, *i.e.*, to prevent disguising of proprietary trading by including an insignificant amount of money from outside participants, other commenters claimed that the proposal would have the undesirable effect of discouraging CPOs from investing in their own pools. One commenter stressed that proprietary trading is often the only way a pool can begin trading before raising outside capital. Commenters suggested raising the threshold for ownership or control by the pool operator, advisor, principals or other service providers from fifty to between sixty and eighty percent. Commenters also asked the Commission to clarify that the interests in the pool of the CPO, the CTA, their principals and other service providers are not required to be added together when applying the fifty percent test in proposed Rule 4.25(a)(9) unless such persons are affiliated. One commenter urged that the definition of proprietary performance should be broadened to include both accounts for which the CPO, trading manager, CTA or respective principals receive no direct fees as well as pools in which any affiliate or family member of the CPO, trading manager or CTA owns or controls fifty percent or more of the beneficial interest. Several commenters suggested that if proprietary accounts are traded in a manner similar to pool and customer accounts, the rules should permit CPOs and CTAs to include the performance in a composite with customer accounts, provided *pro forma* adjustments are made for fees and other differences.

The Commission is adopting Rule 4.25(a)(9) (renumbered as Rule 4.25(a)(8)) and Rule 4.34(a)(6) (renumbered as Rule 4.35(a)(7)) substantially as proposed, permitting presentation of proprietary performance information, subject to restrictions intended to assure that the disclosure of such information is not misleading. Further, the Commission has determined to adopt the comment that accounts in which an affiliate or family member of the CPO, trading manager or CTA owns or controls fifty percent of more of the beneficial interest should be characterized as proprietary and has revised the rules accordingly. As adopted, the text of these rules has been reorganized for clarity and cross-references to the respective rule provisions governing placement of supplemental information have been included. The word "required" has been omitted to clarify the requirement that proprietary trading results (together with any hypothetical, extracted, pro forma[123] or simulated results) follow all of the other disclosures in a Disclosure Document.

Although proprietary performance results in CPO and CTA Disclosure Documents have a significant potential to mislead, given the often material differences in the conditions under which proprietary trading results as opposed to non-proprietary results are obtained, the Commission recognizes that proprietary trading results may be the only performance results available to some new traders to present to customers as evidence of trading experience.[124] The requirement that proprietary trading results be presented after all required and non-required disclosures, rather than just the required performance disclosures, reflects the relatively low utility of such data to prospective customers and the relatively high potential for confusion of proprietary and customer trading results. Given the significant potential

[119] Thus, for example, and as the Commission explained in the Proposing Release, in the case of a pool meeting the criteria of Rule 4.25(b), where only the past performance of the offered pool is required, the past performance of two CTAs each allocated an equal portion of the pool's assets generally should either be included for both CTAs or omitted entirely. Similarly, where only the past performance of the offered pool is required, generally the past performance of the CPO's other pools should be shown in total or omitted. *Id.*

[120] As discussed in section 3, *infra*, pro forma adjustments to performance data are required for certain purposes and such adjustments are not affected by the restrictions upon placement of supplemental information.

[121] If a Disclosure Document contains two or more of these types of performance information, the registrant may choose the order of presentation between or among them at the end of the document.

[122] The Commission's former disclosure rules did not specifically address the placement of proprietary trading results.

[123] *See* discussion in Section 3, *infra*, concerning required pro forma adjustments.

[124] As the Commission explained in its proposal, use of proprietary trading results in soliciting customer accounts is a practice which has long been of concern to the Commission. CPOs and CTAs may trade proprietary funds for a variety of purposes, including to test a new trading strategy before implementing it for customer funds or to establish a track record prior to trading customer funds. However, proprietary accounts may be traded in a different manner, for example, more aggressively, using higher leverage and assuming greater risk than customer accounts. Also, proprietary accounts are usually not subject to the same fees as customer accounts. Naturally, no management or incentive fee would apply where a CTA traded its own account, and clearing fees may be waived or reduced if the account is cleared by an affiliate. In addition, where proprietary and customer assets are combined for purposes of performance presentation, the total amount of assets under management is inflated and conceals the actual amount of customer funds being traded. For these reasons, proprietary trading results may, in many cases, be of little relevance to a prospective pool participant or CTA client and actually misleading in others. 60 FR 25331, 25340.

to mislead inherent in proprietary trading results, the Commission believes that if such data are permitted to be included in the Disclosure Document, they should be placed after all required information in order to *minimize* the likelihood that such results will be accorded undue weight.

The Commission noted in the Proposing Release that staff have previously advised registrants that any proprietary trading results presented in a Disclosure Document must be clearly labeled as such and presented in a separate table.[125] Staff have also required that if fees, expenses, commissions, margin-to-equity ratios, or any other item pertaining to the proprietary trading is materially different from that relevant to the pool or trading program offered to participants or clients the registrant must "*pro forma*" such items to correspond to those in the pool or program being offered.[126] The Commission will continue to require registrants to make such pro-forma adjustments to proprietary trading results.

With respect to whether the interests of the CPO, the CTA, their principals and other service providers would be required to be aggregated for purposes of applying the fifty-percent test, the Commission generally agrees that the interests of unaffiliated parties need not be aggregated. However, a CPO would be considered to be affiliated with the CPO's principal, affiliates or family members, for example, and a CTA with its principals, affiliates or family members for this purpose.

3. Pro Forma, Hypothetical and Extracted Performance Results[127]

In the Proposing Release, the Commission discussed the potential for inappropriate use of certain types of performance data, specifically, hypothetical, pro forma and extracted results.[128] Hypothetical results are based on hindsight and can be readily manipulated. Pro forma results can reflect the same type of hindsight selection as hypothetical results and are thus also subject to abuse. Similarly, although extracted results are taken from actual results, they are subject to manipulation through, for example, emphasis upon results of an isolated *portion* of an *overall* trading strategy. Under the proposed rules, hypothetical, pro forma and extracted results would be treated like other disclosures voluntarily provided (proposed Rules 4.24(v) and 4.33(n)) and would be subject to the Commission's general antifraud provisions and such restrictions as may be imposed under the rules of a registered futures association. Further, of course, Rule 4.41 requires that any presentation of simulated or hypothetical trading results must be accompanied by a prescribed cautionary statement describing the limited value of such results.[129] As discussed *infra*, the Commission is amending Rule 4.41 to provide that such presentations must be accompanied either by the statement set forth therein or a statement provided for this purpose by a registered futures association.

In some circumstances, the Commission requires registrants to make pro forma adjustments to disclosed information, e.g., to adjust performance presentations to the same fee structure as that of the pool or program being offered. Such pro forma adjustments are not within the scope of the restrictions of Rules 4.24(v) and 4.34(n). As noted in the Proposing Release, NFA has recently adopted Compliance Rule 2–29(c) which, together with an accompanying interpretive notice, requires that promotional materials containing hypothetical results include a prominently displayed prescribed disclaimer, comparable actual performance results displayed at least as prominently as hypothetical results, and a description of the material assumptions used, and that no statement be made placing undue emphasis on the hypothetical results.[130]

The restrictions in NFA Compliance Rule 2–29(c) do not apply to promotional materials directed exclusively to "qualified eligible participants" as defined in Commission Rule 4.7(a)(1)(ii). However, Rule 4.41 requires that such a statement be provided without regard to the status of the offeree and will thus require that either the statement specified in Rule 4.41 or the statement specified in NFA Compliance Rule 2–29(c), if approved by the Commission, be provided whenever simulated or hypothetical trading results are presented.

Commenters generally agreed that hypothetical, pro forma, extracted (and simulated) results should not be prohibited, but should be subject to strict regulatory oversight and controls. The Commission was also urged to delegate to NFA and industry groups any rulemaking regarding use of pro forma, hypothetical and simulated results.

Based upon its review of the comments received and of NFA Compliance Rule 2–29(c) and the accompanying interpretive release, the Commission has determined to retain the same general approach to pro forma, hypothetical and extracted results as indicated in the Proposing Release, pending further review of this area. Although such results would not be precluded from inclusion in the Disclosure Document, Rule 4.24(v)(2)(iii) requires that such results, if included, must appear as the last disclosure in the document following all required and non-required disclosures. Further, such disclosures would be required to be accompanied by the cautionary language of Rule 4.41 or of NFA Compliance Rule 2–29(c), if approved by the Commission, with respect to the limited usefulness of hypothetical results, where applicable. To avoid duplication of cautionary statements as to the limitations of pro forma, hypothetical and extracted results, the Commission is adopting an amendment to Rule 4.41 to permit use of an NFA disclaimer in lieu of the disclaimer in Rule 4.41.

Like other supplemental disclosures, disclosure of pro forma, hypothetical and extracted results must comply with Rule 4.24(v) for CPOs and Rule 4.34(n) for CTAs. Moreover, such disclosures

[125] 59 FR 25351, 25360.

[126] *Id.* See discussion in Section 2, *infra*, concerning required pro forma adjustments.

[127] Hypothetical results are results calculated based upon the application of a given program to historical market prices and purport to present results that could have been obtained in trading a particular program during the specified historical period. Pro forma results present trading results with adjustments to reflect certain factors, such as a particular fee schedule or degree of leverage, to permit easier comparison with other types of results. Extracted performance results isolate a single component of a trading strategy for presentation to customers. The Commission's former disclosure rules did not specifically address the placement of such performance results.

[128] 59 FR 25351, 25360.

[129] The statement required by Rule 4.41(b)(1) reads as follows:

"Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under-or-over compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown."

[130] 59 FR 25351, 25360. The draft Interpretive Notice accompanying NFA's proposed amendments to Compliance Rule 2–29 would permit pro forma performance histories solely for the purpose of adjusting performance presentations to the same fee structure as that of the pool or program offered. No pro forma results which reflect a hindsight analysis, such as to show results a multi-advisor pool could have achieved using a different allocation of assets among CTAs, would be permitted. Extracted results would only be permitted to be presented based on the percentage of net asset value actually committed to the particular component extracted.

must comply with applicable NFA restrictions and they are subject to the antifraud provisions of the Act and Commission rules.

VI. Non-Performance Disclosures: Section-by-Section Analysis

A. Introduction

As proposed and as adopted, non-performance disclosure requirements are now set forth in Rules 4.24 for CPOs and 4.34 for CTAs.[131]

Preliminarily, the Commission notes that it did not receive any comments on certain of its proposed non-performance disclosure requirements and is adopting those requirements as proposed. Specifically, these are the CPO requirements found in the following paragraphs of Rule 4.24: (n) (specified performance); (p) (transferability and redemption); (q) (liability of pool participants); (r) (distribution of profits and taxation); (t) (ownership in pool);[132] (u) (reporting to participants); and (w) (material information). For CTAs, corresponding requirements are found in the following paragraphs of Rule 4.34: (h) (description of trading program); (i) (fees); (m) (specified performance disclosures); and (o) (material information).

1. Disclosures Concerning a Pool's CTAs

As proposed, several provisions of Rule 4.24 would have based the level of required non-performance disclosures with respect to a pool's CTAs (and their principals) on such CTAs' respective percentage allocations of the pool's aggregate initial futures margin and premiums for commodity option contracts.[133] Several commenters recommended that these disclosure requirements (as well as the major CTA and multi-advisor pool definitions) be based upon the percentage of the pool's assets allocated to each CTA. As discussed above, the definition of major commodity trading advisor, as adopted in Rule 4.10(i), no longer is based upon the percentage of initial margin and premiums but, instead, considers the CTA's allocated portion of the pool's funds available for futures and option transactions pursuant to agreement between the pool's CPO or trading manager, on behalf of the pool, and the CTA. Wherever Rule 4.24, as proposed, keyed disclosure requirements regarding a pool's CTAs to allocation size, the rule as adopted uses the major CTA definition adopted in Rule 4.10(i).

2. Disclosures Concerning Investee Pools[134]

Unlike the former rules, the new disclosure framework (as proposed and as adopted) specifically addresses disclosures concerning investee pools. As with performance disclosure requirements, non-performance disclosure requirements relating to investee pools are also being tailored to take into account the relative importance of the investee pool to the offered pool, as measured by the amount of assets allocated or intended to be allocated to the investee pool. Thus, no disclosures would have been required for investee pools allocated or intended to be allocated less than ten percent of the assets of the offered pool. With respect to each investee pool allocated at least ten percent of the assets of the offered pool, the CPO would have been required to disclose the name of the operator and the operator's principals[135] and any conflicts of interest on the part of the investee pool's operator in respect of the offered pool.[136]

With respect to investee pools allocated twenty-five percent or more of the assets of the offered pool,[137] the CPO would have been required to disclose the business background of, material litigation against, and any ownership in the offered pool on the part of the investee pool's operator and the operator's principals. (Rules 4.24 (f), (*l*) and (t)). In addition, the proposed rules requiring disclosure of the use of proceeds (Rule 4.24(h)), risk factors (Rule 4.24(g)), fees and expenses (Rule 4.24(i)), and redemption restrictions (Rule 4.24(p)) would have required information relative to the offered pool's investments, including participation in investee pools. As the Commission explained in the Proposing Release, these provisions are appropriate because investments in investee pools may entail both the risks inherent in the investee pool's own investments and liquidity risks due to restrictions upon redemption of the investment in the investee pool; fees and expenses may accrue at each level of a multi-tier structure; and investments in investee pools with redemption periods different from those of the pool offered or with minimum "lock-in" provisions[138] may affect the ability of the top tier pool promptly to honor redemption requests from its participants.[139]

The Commission sought comment concerning the proposed treatment of investee pools. In particular, commenters were invited to address any special public policy or disclosure considerations presented by tiered investment structures by means of which a commodity pool can, in effect, appropriate the value of a second fund's management by investing all or a portion of its funds in the second fund. No commenter specifically addressed this issue. The Commission also requested comment concerning whether any additional protections, other than disclosure of applicable fees, are appropriate in light of the "layering" of fees that typically occurs at each level of a fund of funds structure. No comments specifically responded to this request.[140]

The Commission has determined to key non-performance disclosures with respect to a pool's investee pools to the new definition of major investee pool adopted as Rule 4.10(d)(5). Thus, for purposes of Rules 4.24 (f), (*l*) and (t) as adopted, disclosure is required with respect to investee pools allocated ten

[131] As proposed, Rule 4.34 was numbered 4.32.

[132] Because proposed Rule 4.24(t) required disclosure with respect to major CTAs, it was indirectly addressed by the commenters who suggested changes to the major CTA definition.

[133] These were proposed Rules 4.24 (e)(2) (names), (f) (business backgrounds), (j) (conflicts of interest), (*l*) (litigation) and (t) (ownership in pool).

[134] As discussed above in Section IV, "investee pool" is now defined in Rule 4.10(d)(4). Former Rule 4.21 did not specifically address disclosures relative to these trading vehicles.

[135] *See* proposed Rule 4.24(e).

[136] *See* proposed Rule 4.24(j).

[137] As proposed in Rule 4.10(*l*), such investee pools would be "major" investee pools. Rule 4.10(d)(5) contains the definition, as adopted, of the term major investee pool, discussed above at paragraph B. of Section IV.

[138] *Certain pools lock in initial investments for a specified period before allowing any redemptions. Because there are no Commission rules requiring that an opportunity for redemption of pool interests be afforded in very short timeframes as for investment companies, disclosure of volatility risks as required by new Rule 4.24(g) has added importance.*

[139] 59 FR 25351, 25363.

[140] A number of commenters, however, claimed that the proposed revisions failed to adequately address the compliance problems faced by funds-of-funds. Some stated that obtaining required information from investee funds on a timely basis is often difficult or impossible for a variety of reasons, *e.g.*, because securities investee fund managers may consider the names of investee funds and managers to be proprietary; Rule 4.12(b) investee funds and securities trading partnerships report on a quarterly basis; partnerships that predominantly trade securities do not provide the same level of expense reporting as do pools; and if an investee pool is not soliciting participants when the investee pool prepares its Disclosure Document, the information from the investee pool may be unavailable or stale. Other commenters suggested that specific information regarding investee pools is unhelpful and may be misleading where the CPO frequently drops and adds investee pools. As a general matter, the Commission does not believe that fund-of-funds structures should be permitted to impair or diminish the duty of pool operators to provide timely material information to prospective and current pool participants. Consequently, the pool operator should ascertain the availability of such information prior to using pool funds for such investments. However, the Commission intends that the staff will continue to grant relief from reporting timeframes in fund-of-funds contexts as warranted by the circumstances presented.

percent or more of the offered pool's net assets, rather than the proposed twenty-five percent standard of the proposed major investee pool definition. Rule 4.24(j) (conflicts of interest involving the pool) effectively retains the ten percent threshold of the proposal.

B. Required Non-Performance Disclosures

1. Prescribed Non-Performance Statements, Table of Contents and Forepart Information: Rules 4.24 (a) through (d) for CPOs and 4.34 (a) through (d) for CTAs

Proposed Rules 4.24 (a) through (d) for CPOs and 4.33 (a) through (d) for CTAs would have specified the content and order of certain core information required to be placed at the front of Disclosure Documents. In particular, proposed Rules 4.24 (a) and (b) would have required a cautionary statement to be placed on the cover page of a pool Disclosure Document, followed by a risk disclosure statement. Rule 4.24(c) would have required a table of contents to follow the risk disclosure statement, and Rule 4.24(d) would have required specified descriptive information regarding the offered pool and the CPO to follow the table of contents in the forepart of the Disclosure Document. Proposed Rules 4.33 (a), (b) and (c) would have required the cautionary statement, risk disclosure statement and table of contents to be sequenced in the same manner in CTA Disclosure Documents as in pool documents. Proposed Rule 4.33(d) would have required inclusion of descriptive information regarding the CTA in the forepart.[141]

Two commenters favored standardizing the order of disclosures, asserting that it would promote consistency, clarity and comparability within the industry, both for potential investors and for regulators. Of the five commenters who opposed regulation of the placement of information, two suggested that the Commission's review process is capable of effectuating more prominent disclosure of underemphasized or "buried" information and one claimed that a summary cross-reference to the body of the document should provide sufficient clarity.

The Commission believes that investors are well served by requiring that certain items of particular significance be placed at the front of the Disclosure Document. With minor exceptions as noted below, it is adopting Rules 4.24(a) through (d) for CPO documents and Rules 4.33(a) through (d) for CTA documents (Rule 4.33 is renumbered 4.34) as proposed. The Commission notes that federal and state securities laws may also address the order and format of certain disclosures. These rules are not intended to supersede such requirements.

Placement of all required disclosures other than those specified in Rules 4.24(a) through (d) and 4.34(a) through (d) is left to the discretion of the registrant. Placement of information other than required disclosures is addressed by Rules 4.24(v) and 4.34(n), which are intended to maintain the prominence of required disclosures while giving discretion to the registrant with respect to placement of other matters, *e.g.*, supplementally provided performance information.[142] Thus, registrants will retain substantial discretion in arranging information in the Document. However, the required table of contents should facilitate review notwithstanding differences in placement of some items.

a. Cautionary Statement

Rules 4.24(a) and 4.34(a), which contain the requirements of former Rules 4.21(a)(18) and 4.31(a)(9), respectively, specify that a Cautionary Statement, *i.e.*, a statement that the Commission has not passed upon the merits of the investment or the adequacy of the Disclosure Document, appear on the cover page of the Document. Apart from comments generally urging that specific required statements and legends be minimized, no comments were received on the text of the proposed Cautionary Statement. The Commission is adopting Rules 4.24(a) and 4.33(a) as proposed (except that Rule 4.33(a) is renumbered 4.34(a)).[143]

b. Risk Disclosure Statement

The Risk Disclosure Statement specified in Rules 4.24(b) and 4.34(b) is required to be "prominently displayed" immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission or any applicable federal or state securities laws and regulations or by any applicable laws of non-United States jurisdictions.[144] As proposed, the revised Risk Disclosure Statement included page references to textual descriptions of fees and expenses, principal risk factors and the break-even point. Inadvertently omitted from the Proposing Release was the requirement for a legend (if applicable) to warn of potential liability in excess of the amount of a pool participant's investment. As explained in the Proposing Release, the proposed revisions to the prescribed Risk Disclosure Statements were also intended to address the potential for duplicative disclosure created by prior revisions of Rules 1.55[145] and 30.6(a)[146] by eliminating the need to provide two prescribed Risk Disclosure Statements, one for domestic futures trading and one for foreign futures trading.[147] Thus, the proposed revised statements addressed the risks of foreign as well as domestic transactions and revision of Rule 30.6(b) was proposed to cross-reference the Part 4 Risk Disclosure Statements. In addition, the proposal would have replaced the terms "domestic" and "foreign," previously used to refer to contract markets or exchanges in foreign jurisdictions, with the terms "United States" and "non-United States," in order to avoid confusion in the context of offerings in non-United States jurisdictions to non-United States participants for whom the term "foreign" does not mean "non-United States."

Some commenters encouraged minimizing required verbatim cautionary statements and legends. Two commenters suggested that the Commission prescribe one risk statement for inclusion in both CPO and CTA documents, incorporating all of the issues the Commission believes are necessary for investor protection, in order to increase the effectiveness of such disclosure. Another commenter asked whether the Risk Disclosure Statement would be more effective if set forth in the text of the Disclosure Document.

[141] In connection with developing its proposed revisions to the disclosure rules, the Commission also considered whether a particular order for all required information should be mandated in order to "standardize" the entire format of Disclosure Documents. However, the Commission determined to propose, and now to adopt, only the limited sequence requirements contained in Rules 4.24 (a) through (d) and 4.34 (a) through (d).

[142] Rules 4.24(v) and 4.34(n) are discussed in detail in Section C of this Section VI.

[143] The requirement in Rules 4.24(a) and 4.34(a) that the Cautionary Statement be "prominently" displayed means that, as with the former rules, capital letters and boldface type are required. *See* Rule 4.1(b).

[144] The Risk Disclosure Statement must be printed in capital letters and in boldface type. Rule 4.1(b).

[145] 59 FR 25351, 25363. Rule 1.55 sets forth the basic risk disclosure requirement applicable to FCMs and IBs opening accounts for domestic futures and option contracts.

[146] Part 30 generally governs transactions in foreign futures and option contracts. Rule 30.6(a) requires an FCM or IB to deliver a risk disclosure statement (pursuant to Rule 1.55(b)) prior to the opening of a foreign futures or options account.

[147] 59 FR 25351, 25363.

The Commission is adopting Rules 4.24(b) and 4.34(b)[148] as proposed with the following exceptions. As adopted, Rules 4.24(b)(1) and 4.34(b)(1) recognize that foreign jurisdictions may require specific information on the cover page by adding the language "or by any applicable laws of non-United States jurisdictions." As adopted, Rule 4.24(b) incorporates the requirement of former Rule 4.21(a)(17)(ii) to include in the Risk Disclosure Statement additional language if the pool participant's liability can exceed the purchase price of his interest in the pool. Further, Rule 4.34(b) as adopted omits reference to a break-even point. In addition, Rule 1.55 is being amended, as proposed, to provide that pools need not be treated as customers for purposes of delivery of the Risk Disclosure Statement required thereunder.

The Commission believes that the different risks and characteristics of pools as compared to direct trading through a managed account, perhaps most notably the difference between participating in a limited liability trading vehicle as opposed to an individually-managed account, warrant different risk disclosure statements. Accordingly, the Commission is not prescribing a single, common statement for both CPO and CTA Disclosure Documents. Further, the Commission believes that the information contained in the Risk Disclosure Statement is critical in order to inform potential investors as to many of the generic risks inherent in commodity interest trading, and that the importance of this information is appropriately highlighted by placing the Risk Disclosure Statement at the beginning of the document.

c. Table of Contents[149]

Rules 4.24(c) and 4.34(c) specify that the Disclosure Document must include a table of contents immediately following the Risk Disclosure Statement. The table of contents must show, by subject matter, the location of disclosures in the Disclosure Document. One commenter stated that a table of contents should be optional for smaller documents. Several commenters favored requiring a table of contents but requested latitude in its placement, e.g., to permit it to appear on the back cover page. The Commission believes that placement of the table of contents at the beginning, rather than the end of (or elsewhere in) the Disclosure Document will be most helpful to investors, given the format of most pool documents, and that the benefits of a table of contents outweigh any burdens attendant to its preparation. The Commission thus is adopting as proposed the requirement that a table of contents be included in all Disclosure Documents immediately following the Risk Disclosure Statement.

d. Information To Be Included in Forepart[150]

Proposed Rules 4.24(d) and 4.33(d) would have required that specified basic information appear immediately following the table of contents, in the forepart of the Disclosure Document. With respect to CPO documents, this information would have included the following: The name, business address, business phone number and form of organization of the offered pool and of the CPO (and if the pool's address is a post office box or is outside the United States, the location of the books and records); a statement whether the offered pool is privately offered under the Securities Act, a multi-advisor pool or a limited risk pool;[151] the closing date of the pool offering (or a statement that the offering is continuous); the date the Disclosure Document will first be used; and the break-even point of the pool.[152] The forepart of a CTA document would have been required to contain the business address, business phone number and form of organization of the CTA (and if the address is a post office box or is outside the United States, the location of the books and records) as well as the date the Disclosure Document will first be used.

The Commission is adopting Rules 4.24(d) and 4.33(d) as proposed, with the following exceptions. Instead of requiring a "statement whether the pool is" privately offered, a multi-advisor pool or a limited risk (principal-protected) pool, Rule 4.24(d)(3) requires disclosure only in the event that one or more of such descriptions applies to the offered pool. In addition, instead of the date the Disclosure Document will actually be used, the forepart must indicate the date the CPO or CTA first intends to use it.[153] Cross-references have been conformed and corrected. Finally, proposed Rule 4.33(d) is adopted as 4.34(d).

e. Persons To Be Identified

Proposed Rule 4.24(e) would have required disclosure of names of the CPO's principals, the trading manager (if any) and its principals, each investee pool allocated at least ten percent of the assets of the offered pool, each CTA allocated at least ten percent of the pools initial margin and option premiums, the person who will make trading decisions for the offered pool, and, if known, the FCM to be used by the offered pool. Proposed Rule 4.33(e) would have required a CTA to name each of its principals, as well as any FCM or IB the CTA's client will be required to use.

Rule 4.24(e), as adopted, eliminates the initial margin and premiums standard for CTA disclosure and requires instead that only CTAs (and investee pools) that are "major" must be named. Rule 4.24(e) also requires identification of any IB the offered pool will use, and otherwise is adopted as proposed. Rule 4.33(e) is adopted as proposed except that it is renumbered 4.34(e).

2. Business Background: Rules 4.24(f) for CPOs and 4.34(f) for CTAs

As proposed, Rule 4.24(f) would have required disclosure in a pool document of the business backgrounds of the CPO, any trading manager of the pool, major CTAs, and the operators of major investee pools. The only principals of the foregoing for whom disclosure of business backgrounds would have been required are those "who participate in making trading or operational decisions * * * or who supervise those so engaged." Proposed Rule 4.33(f) would have required a CTA document to provide the business background of the CTA and the principals thereof participating in making trading or operational decisions.

Former Rule 4.21(a)(2) required business backgrounds for the CPO, the CTA and *all* of their respective principals, and, similarly, former Rule 4.31(a)(2) called for the backgrounds of the CTA and all of its principals. The

[148] Rule 4.34(b) was proposed as Rule 4.33(b).

[149] Neither former Rule 4.21 for CPOs nor former Rule 4.31 for CTAs required a table of contents. However, most Disclosure Documents reviewed by the Division contain such a table. Further, Form S-1, the form most frequently used to register pool offerings with the SEC, requires "a reasonably detailed table of contents showing the subject matter of the various sections or subdivisions of the prospectus and the page number on which each section or subdivision begins." *See* Item 502(g) of Regulation S-K, 17 CFR 229.502(g) (1994), incorporated by reference into Item 2 of Form S-1, 17 CFR 239.11 (1994). The Commission believes that a table of contents should contribute to making the disclosure document "reader-friendly" and readily reviewable.

[150] Neither former Rule 4.21 nor 4.31 required specified information to be placed in the forepart of the Disclosure Document.

[151] As discussed at Section IV above, new Rule 4.10(d)(3) replaces the proposed term "limited risk pool" with the term "principal-protected pool" (while continuing to define it, as proposed, as pool designed to limit the loss of the initial investment of its participants).

[152] The term "break-even point" is discussed in Section IV above.

[153] Proposed Rules 4.24(d)(4) and 4.33(d)(2) had required "[t]he date when the Disclosure Document will first be used."

proposed revisions were designed to reduce the number of principals subject to business background disclosure and, in the context of trading advisors and operators of investee pools, restricted business background disclosure to major CTAs and the operators of major investee pools.

Commenters generally supported the proposed reduction of business background disclosure. Six suggested further limiting disclosure with respect to principals by deleting the words "or operational" and effectively employing the definition of "trading principal" in Rule 4.10(e)(2).[154]

The Commission is adopting Rules 4.24(f) and 4.33(f) as proposed, except that the provision with respect to principals who participate in making trading or operational decisions for the pool or supervise persons so engaged is revised to make clear that officers and directors are included among the principals whose business background is required, as only shareholders and other passive investors who would constitute principals were intended to be excluded. Proposed Rule 4.33(f) is adopted as Rule 4.34(f). The requirement to disclose business backgrounds for principals who participate in making operational decisions for a pool operator or advisor is retained because such persons can have as significant an effect on the performance of the pool operator or advisor as those who make its trading decisions. For example, the persons who supervise sales solicitations, manage the pool's back office and perform compliance functions may be wholly uninvolved in the pool's trading yet integral to the pool's success or failure. Accordingly, the Commission believes that the business backgrounds of such persons should be disclosed to prospective participants or clients.[155] As noted above, the Commission intends that the principals who participate in making trading or operational decisions for the pool or who supervise persons so engaged would include all principals other than purely passive investors or owners.

3. Principal Risk Factors: Rules 4.24(g) for CPOs and 4.34(g) for CTAs[156]

As noted above, Rules 4.24(b) and 4.34(b) require the inclusion, at the beginning of the Disclosure Document, of a standardized Risk Disclosure Statement that generically describes the risks of the investment. Proposed Rules 4.24(g) and 4.33(g) would have required that the prescribed generic risk disclosures be supplemented by a particularized discussion of the "principal risk factors" specific to the pool or trading program being offered, including, without limitation, risks due to volatility, leverage and counterparty creditworthiness. As the Commission explained in the Proposing Release, this requirement was designed to elicit a "plain English" discussion of the risks of the offered investment, with particular attention to the risks created by over-the-counter transactions.[157] For example, as noted in the Proposing Release, the discussion of principal risk factors should address the volatility of an offered pool investment as compared to investments in other types of trading vehicles and other risks relevant to the trading program to be followed, such as risks resulting from concentration of investments in particular commodities or from trading foreign contracts that are subject to currency rate fluctuations. Other risks cited included risks inherent in transactions in off-exchange instruments and risks arising from the lack of relevant experience of the CPO or CTA.[158] The Commission noted that in establishing an express requirement for disclosure of principal risk factors, it was essentially codifying disclosure requirements previously required under the obligation to disclose all material information or under other provisions of the former rules. This provision also accords with existing SEC requirements for publicly offered funds.[159]

The Commission requested comment as to whether additional guidance should be given in the rules as to the types of risk factors that should be discussed and as to any specific factors that should be identified in this context. The commenters did not suggest any additional specific risk factors. One commenter supported the proposed requirement for a particularized discussion of the risks beyond the standardized required risk disclosure. Another urged that the rules not list specific required risk factors, since risks vary by pool or program, and such a requirement would mean that risks that are important in certain contexts but not in others would be required to be disclosed in the same manner in all contexts. Another commenter stated that discussion of counterparty creditworthiness is not warranted for a pool that restricts its trading to exchange-traded instruments. One commenter proposed that the level of risk factor disclosure with respect to an investee pool be determined by the percentage of assets allocated to such investee pool.

The Commission is adopting Rules 4.24(g) and 4.33(g) as proposed (renumbering proposed Rule 4.33(g) as 4.34(g)) with certain modifications designed to provide more specific guidance as to the types of disclosures called for in the discussion of principal risks. The principal risk factor discussion must now include, without limitation, risks relating to volatility, leverage, liquidity and counterparty creditworthiness, as applicable to the types of trading programs to be followed, trading structures to be employed and investment activity expected to be engaged in by the offered pool. Similarly, under Rule 4.34(g), the focus is on the trading program and the types of transactions and investment activity expected to be engaged in pursuant to the trading program. As noted, the specific types of risks cited in the rules (volatility, leverage, liquidity and counterparty creditworthiness) are illustrative, not exclusive, are likely to be significant across a wide range of trading programs and investments and thus are logical starting points for a discussion of principal risk factors. The final rule includes specific reference to

[154] Under the rule amendments as proposed and as adopted, the "trading principal" concept is not used in connection with non-performance disclosure requirements. *See* Rule 4.25(c) for CPOs and Rule 4.35(b) for CTAs.

[155] The Commission emphasizes that while disclosure of business backgrounds of principals is being limited to officers, directors and other operational or trading principals, the names of all principals of the CPO, trading manager, major CTAs, and operators of major investee pools continue to be required to be disclosed in the Disclosure Document. *See* Rules 4.24(e) for CPOs and 4.34(e) for CTAs.

[156] Former Rules 4.21 and 4.31 did not contain any specific requirements applicable to the particular risks of the pool or trading program.

[157] 60 FR 25351, 25364. These risks may differ materially from those entailed in exchange-traded futures and option transactions, which generally are backed by clearing organization guarantees, daily marking-to-market and settlement, and segregation and minimum capital requirements applicable to intermediaries. Transactions entered directly between two counterparties generally do not benefit from such protections and expose the parties to the risk of counterparty default.

[158] 60 FR 25351, 25364.

[159] Public securities offerings are required by Item 503(c) of Regulation S–K (17 CFR 229.503(c) (1994)) to include immediately following the cover page of the prospectus (or following the summary, if one is included) "a discussion of the principal factors that make the offering speculative or one of high risk." Possible risk factors included in Item 503(c) include absence of an operating history, absence of profitable operations in recent periods, financial position, nature of the registrant's business and absence of a previous market for the offered securities. SEC Release Number 33–6900, which provides guidance with respect to disclosure requirements for limited partnership offerings and roll-up transactions, requires that the cover page of a limited partnership prospectus indicate the most significant risk factors "highlighted through the use of a concise list of bullet-type statements." (17 CFR 231.6900 (1994)).

"liquidity" as a risk factor, in recognition that the risk of illiquidity is one that arises in a wide range of instruments and that liquidity issues may often be linked to the other identified risk factors.

Rule 4.24(g) as adopted provides three contexts in which such risks should be considered, the trading programs to be followed, the trading structures to be employed and the investment activity expected to be engaged in by the offered pool. Risk factors specific to each context should be discussed. For example, this discussion should indicate any material historical or expected volatility of the trading program and any other special characteristics of the trading program, such as concentration in a particular commodity, lack of trading history, or negative performance history associated with the trading program. The trading structures or vehicles to be employed may also present significant risks. For example, multi-CTA and multi-investee-fund structures generally involve more complex fee structures than other pools and their profit potential may be adversely affected as a result of the potential for the pool to maintain offsetting positions due to the separate trading of various CTAs and investee funds. The specific types of investment activity in which the pool is expected to engage must also be examined to identify principal risk factors. For example, highly leveraged off-exchange transactions such as some types of swaps, may present risks of rapid price movements, illiquidity, lack of transparency and the potential for counterparty default which may not be material in the context of domestic exchange-traded futures contracts. Given the wide range of potential pool investments, the CPO must determine on a case-by-case basis what risk factors must be addressed in light of the contemplated trading and investment activity of the pool.

A CPO must make a determination whether the risks affecting each investee pool (or investee fund), when considered in the context of the investor pool's participation in such investee pool (or fund), constitute principal risk factors of the investor pool. In determining whether counterparty creditworthiness is a principal risk factor in the context of a given pool offering or trading program, factors such as the use of instruments other than those that are traded on United States contract markets must be considered.[160]

4. Investment Program and Use of Proceeds: Rule 4.24(h) for CPOs[161]

Proposed Rule 4.24(h) would have consolidated under the caption "Use of Proceeds" the provisions of former Rule 4.21(a)(1)(viii), which required a description of the types of commodity interests the pool is expected to trade and any restrictions on such trading, with those of former Rule 4.21(a)(9), which required disclosure of the manner in which the pool would fulfill its margin requirements and the form in which non-margin funds would be held. As a result, taken together, former Rules 4.21(a)(1)(viii) and (a)(9) called for disclosure of both the commodity interest trading expected to be engaged in by the pool and all other types of trading, investments, custodial arrangements and other uses of the funds of the pool. Proposed Rule 4.24(h) thus would have unified previously separate related disclosures to create a single, cogent discussion of all of the contemplated uses of pool funds. In addition to integrating disclosures previously required under separate rule provisions, Proposed Rule 4.24(h) was designed to reflect the increasingly diverse nature of non-futures investments made by pools, for example, interests in other commodity pools, commercial paper and foreign securities.

Several commenters recommended that use of proceeds disclosure requirements minimize (or eliminate) information regarding "normal" investment uses and concentrate on (or be limited to) "unusual" uses of assets or uses that present special risks to the investor. Several commenters argued that expanded use of proceeds disclosures have unnecessarily lengthened Disclosure Documents, resulting in disproportionate emphasis on standard or mundane investments and obscuring the pool's primary business objectives. Some commenters urged that the use of pool assets in securities trading that is independent of rather than incidental to a pool's commodity interest trading should not require disclosure. With respect to participation in investee pools or funds, one commenter suggested that only a general statement that the pool would invest in investee pools or funds should be sufficient. Another commenter suggested that the requirement for use of proceeds disclosure should be based upon the percent of assets allocated to the investee pool and that if the investment involved less than ten percent of the offered pool's assets, disclosure should not be required. Two commenters criticized the requirement to disclose whether (and in what form) assets are held in segregation.

Based upon its review of the comments received and of the overall content of the proposed and final rules, the Commission has determined to modify proposed Rule 4.24(h) in order to provide greater clarity and specificity as to the disclosures called for. In essence, proposed Rule 4.24(h) was designed to elicit a description of the types of interests in which the proceeds of the offering would be invested and of the trading programs to be followed. To better reflect the overall intent and scope of this provision, it has been retitled "Investment Program and Use of Proceeds" and the text has been restructured and refined to provide more specific guidance as to the minimum disclosures called for. As revised, Rule 4.24(h) calls for four main types of information: information about the types of commodity interests and other interests which the pool will trade; a description of the trading and investment programs and policies that will be followed by the offered pool; a summary description of the pool's commodity trading advisors and investee pools or funds; and information concerning the manner in which the pool will fulfill its margin requirements, the approximate percentage of the pool's assets that will be held in segregation and related matters. With respect to each topic, explanatory text has been added to clarify the types of information to be provided. For example, information concerning the "types of commodity interests or other interests the commodity pool operator intends that the pool will hold or trade" is to include the approximate percentage of the pool's assets that will be used to trade commodity interests, securities and other types of interests. The provision also calls for the different types of interests in which the pool will trade to be categorized so as to provide a meaningful explanation of the contemplated trading and investment portfolio. Thus, the rule provides for categorization by the type of commodity or market sector, type of security, whether traded or listed on a regulated exchange market, maturity ranges, and investment rating, as applicable. Further, the regulatory status of such

[160] As shown by the recent events involving the collapse of Barings, PLC, under certain circumstances exchange-traded instruments may be subject to some of the same risks as over-the-counter transactions.

[161] Because of the differences between CPOs and CTAs, the Commission did not propose nor is it now adopting any general "use of proceeds" disclosure requirement for CTAs. However, both new Rules 4.24(h)(2) for CPOs and Rule 4.34(b) for CTAs require a description of the trading program that will be used for the pool or managed account client.

interests, *i.e.*, the extent to which they are subject to state or federal regulation, foreign regulation or supervision by a self-regulatory organization, is called for.

Second, Rule 4.24(h)(2) requires a description of the trading and investment program and policies to be followed by the offered pool. This description must include an explanation of the methodologies and data used to select CTAs, investee pools and types of investment activity to which pool assets will be committed. The objective is to provide an explanation of the basic trading and investment approach to be followed by the pool, including, if applicable, an explanation of the systems used to select the pool's advisors and the types of investment activity in which the pool will engage.[162]

A new subparagraph, designated as Rule 4.24(h)(3), calls for a narrative description of the major commodity trading advisors and investee funds to which the pool will commit funds. This discussion is required to include percentage allocations of pool assets to major CTAs and investee pools and funds, a description of the trading programs to be followed by such advisors, and for each such advisor and investee fund, the types of interests traded and material information as to the advisor's historical experience trading such program, including material information as to volatility, leverage and rates of return and the length of time during which the advisor has traded such program. Similarly, for the pool's investee pools or funds, the description should extend to the nature and operation of such investee pools and funds, including for each investee pool or fund the types of interests traded, material information as to volatility, leverage and rates of return for such investee pool or fund and the period of its operation.

Finally, Rule 4.24(h)(4), like the proposed "Use of proceeds" section, calls for information as to the manner in which the pool will fulfill its margin requirements and the approximate percentage of the pool's assets that will be held in segregation pursuant to the Act and the Commission's regulations, the nature of anticipated non-cash margin deposits and to whom income generated by margin assets will be paid.

5. Fees and Expenses; "Break-Even" Analysis for CPOs: Rules 4.24(i) for CPOs and 4.34(i) for CTAs[163]

Proposed Rule 4.24(i) was intended to provide in a single location a complete discussion of costs incurred by a commodity pool for all purposes. The proposed rule combined the requirements of former Rule 4.21(a)(7), which called for a description of the expenses that the CPO knew or should have known had been incurred in the preceding year or would be incurred in the current year (*e.g.*, fees for management, trading advice, brokerage commissions, legal advice, accounting and organizational services), with those of former Rule 4.21(a)(14), which required disclosure of fees and commissions paid in connection with solicitations for the pool.[164] In addition, it called for a description of certain fees and expenses that were not specifically enumerated in the former rules but that nonetheless constitute material information about which a prospective investor should be informed. These include clearance fees and fees paid to national exchanges and self-regulatory organizations, incentive fees (including any disproportionate share of profits allocated to the CPO, *i.e.*, a right of the CPO to receive a greater than pro-rata share of the pool's profits), and fees and expenses incurred as a result of investments in investee pools and other investment vehicles or in connection with funding the guarantee of a principal-protected pool. The proposed rule also required an explanation of the calculation of the pool's "break-even point."

With respect to CTAs, proposed Rule 4.33(i) differed from former Rule 4.31(a)(4) only in requiring that if a fee is determined by reference to a base amount such as net assets or net profits, the manner in which such base amount will be calculated must be explained, where former Rule 4.31(a)(4) simply required that such base amount be defined.[165]

The Commission received numerous comments in response to its request for comment as to whether a description of fees and expenses should continue to be required or whether the break-even analysis is sufficient to accurately describe the costs of participation in a pool. These comments included the following: That a break-even analysis is sufficient unless in the CPO's judgment more information is required to make the break-even analysis more understandable; that investors benefit from receiving a separate, more comprehensive description of applicable fees than is contained in a break-even discussion; that for a pool in operation for more than one year the prior year's actual expenses should suffice with no requirement for estimated expenses; that estimated expenses be required to be disclosed in a manner similar to that required under SEC rules applicable to mutual funds; and that a description of fees and expenses that are paid by the CPO or the CTA out of their own assets on behalf of the pool should not be required. Some commenters asserted that calculation of a break-even point would be difficult or impossible for pools with no maximum amount of capital that can be raised, for pools invested in other collective investment vehicles, and for multi-advisor pools with high CTA turnover and reallocation. One commenter suggested a convention (such as 2% of average net asset value) for approximating the profit shares to be paid in a multi-advisor fund with non-netted incentive fees.

Several commenters argued that estimating incentive and other fees would be difficult or impossible for CPOs of existing pools as well as operators of new pools. One commenter, however, stated that since the CPO establishes and understands the fee structure (and is allowed to make and to state any necessary assumptions) it is incorrect to argue that a break-even analysis cannot be provided because fees cannot be estimated.

The Commission is adopting Rules 4.24(i) and 4.33(i) as proposed (renumbering proposed Rule 4.33(i) as 4.34(i)). For pool Disclosure Documents both the break-even analysis and the narrative fee and expense description are required because the Commission believes that each serves a valuable purpose. A description of each separate fee and expense may not convey a clear understanding of the actual portion of each pool participation absorbed by the aggregate fees and expenses of the pool. To foster a better understanding of the nature of those costs and their impact upon an investment in the pool, the revised rules require that the narrative description of fees and expenses, which is designed to explain the basis for each such expenditure, be accompanied by a

[162] The requirement in proposed Rule 4.24(h)(1) to disclose "any restrictions or limitations on such interests or trading required by the pool's organizational documents or otherwise" (originally part of former Rule 4.21(a)(1)(viii)) was revised to refer to "any *material* restrictions or limitations * * *"

[163] The Commission's former disclosure rules did not require a break-even analysis.

[164] By way of clarification, as proposed and as adopted, Rule 4.24(i) also requires that disclosure of fees paid in connection with solicitations for the pool must include trailing commissions as well as any type of benefit that may accrue to persons engaged in such solicitations.

[165] The same change was also incorporated in proposed CPO Rule 4.24(i).

tabular presentation of fees and expenses from all sources, setting forth how the break-even point for the pool is calculated ("break-even analysis"). Where specific components of the break-even analysis are not available or are not subject to precise determination, good faith estimates should be made, based on reasonable assumptions properly disclosed. As noted above, the "break-even point" for the pool is required by Rule 4.24(d)(5) and 4.10(j) to be set forth as a separate item in the forepart of the Disclosure Document, immediately following the table of contents, and must be expressed both as a dollar amount and as a percentage of the minimum unit of initial investment. The break-even analysis provides an explanation, in tabular form, of how the break-even point is calculated, taking into account all fees, expenses and commissions applicable to the pool. Rule 4.10(j) requires that the break-even point be prepared in accordance with rules promulgated by a registered futures association pursuant to section 17(j) of the Act. As noted above, NFA has adopted (and the Commission has approved) an Interpretive Notice to accompany NFA Compliance Rule 2–13, setting forth how a break-even point must be calculated and the format in which such calculation must be disclosed.

The Commission is clarifying that the break-even point must represent the trading profit the pool must realize in the first year of an investor's participation in order for the investor to recoup his initial investment, and Rule 4.10(j) as adopted so states. Revision of the break-even point is required for ongoing pool offerings whenever the Disclosure Document is amended or updated. Of course, if the actual break-even point becomes materially different from that which appears in the Disclosure Document, amendment is required.

As proposed and as adopted, Rules 4.24(i) and 4.34(i) require disclosure of fees and expenses expected to be incurred in the current fiscal year, including estimated figures if actual amounts cannot be determined. The Commission believes that reliance solely upon the prior year's actual fees and expenses may be misleading, especially if the CPO has reason to anticipate changes in investment strategies or advisors or market conditions. With respect to fees and expenses borne entirely by the CPO or the CTA, disclosure should not be necessary unless the compensation paid by the pool or account to the CPO or CTA is increased as a result. Of course, disclosure is required if such fees and expenses are subsequently charged to the pool or account.

Where a fee or expense item is variable or otherwise difficult to determine (*e.g.*, in the case of a multi-advisor pool rapidly substituting and re-allocating among numerous advisors), the narrative discussion required by Rule 4.24(i) must indicate a range based upon the CPO's advisor selection criteria, investment objectives and other business practices. For purposes of the break-even analysis, however, a good faith estimate should be used, as discussed above, and the assumptions for such estimate disclosed. This situation illustrates the benefit of requiring both the break-even analysis and the narrative discussion.

The Commission believes that the revised fee and expense disclosure requirements better codify disclosures required under the former rules, that the break-even analysis makes such disclosures more understandable, and that the revised requirements will better assist readers of Disclosure Documents in understanding the nature and effect upon investment returns of costs incidental to the offering and operation of the pool or trading program.

6. Conflicts of Interest: Rules 4.24(j) for CPOs and 4.34(j) for CTAs; Related Party Transactions: Rule 4.24(k) for CPOs[166]

a. Conflicts of Interest—CPOs

Proposed Rule 4.24(j) called for a full description of any actual or potential conflicts on the part of: (a) The pool's CPO, trading manager (if any), CTAs allocated at least ten percent of the pool's initial margin and premiums, the operators of investee pools allocated at least ten percent of pool assets; (b) any principal of the foregoing; and (c) any person providing services to the pool or soliciting participants for the pool. Proposed Rule 4.24(j) specifically referred to arrangements whereby a person benefits from the pool's use of a particular FCM or IB (specifically including payment for order flow and soft dollar arrangements)[167] or from the investment of pool assets in investee pools or other investments. Former Rule 4.21(a)(3) required disclosure of conflicts involving the following persons or their principals: The CPO, the CTA, any FCM that will execute the pool's trades, and any IB through which the pool's trades will be introduced. The former rule specified that such description should include any arrangement whereby the CPO or the CTA might benefit directly or indirectly from maintenance of the pool's account with the FCM or introduction of the account by the IB. The proposed rule would have retained the requirement to disclose conflicts of interest on the part of the CPO and its principals but, subject to the requirement that all material information be disclosed, generally would have eliminated such disclosure with respect to CTAs allocated less than ten percent of the pool's futures margins and option premiums. Further, rather than limiting the disclosure of conflicts of interest to specified categories of registrants, such as FCMs and IBs, specifically identified in the former rule, the proposed rule would have encompassed conflicts of interest on the part of any person providing services to, or soliciting participants for, the pool. As noted in the Proposing Release, the purposes of conflict of interest disclosure are not confined to conflicts involving a Commission registrant.[168] Unregulated parties such as a CPO affiliate acting as counterparty to over-the-counter transactions with the pool may be equally relevant for such purposes. Finally, unlike former Rule 4.21(a)(3), proposed Rule 4.24(j) would have specifically referenced payment for order flow and soft-dollar arrangements as types of disclosable arrangements by which a person may benefit from maintenance of the pool's account with an FCM or the introduction of the pool's account by an IB. As with the former rule, disclosure of all material conflicts would continue to be required, whether

[166] Former Rules 4.21(a)(3) for CPOs and 4.31(a)(5) for CTAs addressed conflicts of interest. The Commission's former disclosure rules did not contain any specific requirements with respect to related party transactions.

[167] Payment for order flow is a practice whereby FCMs and IBs compensate CPOs (and CTAs) for directing customers to them. Soft dollar arrangements consist of arrangements whereby customer or pool funds are used to pay for research or other services that benefit the CPO (or CTA). Both practices have concerned regulators because, among other things, they are often inadequately disclosed. *See Market 2000, An Examination of Current Equity Market Developments: Study V, Best Execution* (Division of Market Regulation, SEC, January 1994). The SEC recently adopted Rule 11Ac1–3 and amendments to Rule 10b–10 (17 CFR 240.10b–10 (1994)) under the Securities Exchange Act of 1934 15 U.S.C. 78a *et seq.* to require enhanced disclosure on customer confirmations and account statements (and upon opening of new accounts) with respect to payment for order flow practices. Release No. 34–34902, 59 FR 55006 (November 2, 1994). At the same time, revisions to Rule 11Ac1–3 and further amendments to Rule 10b–10 were proposed. Release No. 34–34903, 59 FR 55014 (November 2, 1994). The effective date of Rule 11Ac1–3 and the amendments to Rule 10b–10 has been postponed to October 2, 1995 (Release No. 34–35473, 60 FR 14366, March 17, 1995).

[168] 59 FR 25351, 25355.

or not specifically called for under proposed Rule 4.24(j).[169]

Several commenters supported the expansion of the range of required conflicts disclosure to include persons not registered with the Commission. However, several commenters noted that conflict of interest disclosures have expanded beyond reasonable measure and recommended restricting disclosure to "actual" as opposed to "potential" conflicts. Others urged that only those conflicts that the CPO reasonably believes might be considered material should be required. One commenter suggested that only conflicts likely to have a direct material adverse effect on the pool, its performance or its relationships with its FCMs should be required.

The Commission is adopting Rule 4.24(j) generally as proposed. However, the Commission has added to the final rule new § 4.24(j)(2) which requires description of "(a)ny other material conflict of interest involving the pool," to make clear that material conflicts involving non-major CTAs and the operators of non-major investee pools must be disclosed. Under the general materiality standard, disclosure of conflicts of interest on the part of CTAs and CPOs of investee pools below the ten percent thresholds is required if, in light of all relevant circumstances, including, for example, the nature and severity of the conflict, such disclosure would be material to prospective pool participants. Thus, the additional subparagraph will reinforce the dictates of the general materiality standard stated in Rule 4.24(w) in this area.

With respect to the comments concerning the desirability of limiting conflict of interest disclosures, for example, by requiring the disclosure only of "actual" as opposed to "potential" conflicts of interest or material conflicts, the Commission does not believe that a clear bright line distinction of this nature can meaningfully be drawn on a prospective basis. A situation that may ripen into a conflict of interest, although it has not done so as of the date of the Disclosure Document, nonetheless may be as material as an actual conflict that currently exists. However, the Commission does believe that conflict of interest disclosure should be guided by a rule of reason and that only those conflicts that are reasonably likely to be material must be disclosed. The Commission stresses, however, that materiality in this context should not necessarily be determined on a strictly quantitative basis, e.g., in terms of the expected quantitative impact on a pool's rate of return, but rather, on the basis of what a prospective investor would consider to be material.

b. Conflicts of Interest—CTAs

Proposed Rule 4.33(j) differed from former Rule 4.31(a)(5) in that the proposed rule would have added the words "(a) full description of" any actual or potential conflict. Also, the following paragraph, which was proposed as part of the conflicts of interest provision for CPO Disclosure Documents in proposed Rule 4.24(j), was inadvertently omitted from Rule 4.33(j) in the Proposing Release, and it has been included in the rule as adopted:[170]

> (2) Included in the description of such conflict shall be any arrangement whereby the trading advisor or any principal thereof may benefit, directly or indirectly, from the maintenance of the client's commodity interest account with a futures commission merchant or the introduction of that account through an introducing broker (such as payment for order flow or soft dollar arrangements).

No comments were received specifically addressing proposed Rule 4.33(j). The Commission is adopting Rule 4.33(j) as proposed (renumbering it as 4.34(j)), with the addition of the foregoing paragraph, including the reference to payment for order flow and soft dollar arrangements.

c. Related Party Transactions

Proposed Rule 4.24(k) would have required that the CPO describe and discuss the costs to the pool of any material transactions or arrangements between the pool and any person affiliated with a person providing services to the pool for which there is no publicly disseminated price. Although the rules previously contained no corresponding provision, the Commission believes that this type of disclosure is already mandated in many cases under the general requirement that material information be disclosed. However, given the increasing use of over-the-counter transactions in which pools contract with their CPO or an affiliate of the CPO as counterparty to the transaction, the Commission believes that an express requirement for such disclosure is warranted.

Two commenters claimed that computing costs of related party transactions is difficult. One asked the Commission to consider requiring disclosure of the benefit to the related entity and the potential detriment to the pool. Another commenter stated that it will be very difficult, if not impossible, for a sponsor to quantify the spreads charged on forward trades between its pools and counterparties affiliated with the sponsor and urged that no greater cost detail be required than "cannot be quantified but will constitute a significant cost to the pool." One commenter urged that if Rule 4.24(k) applies to investee pools, no disclosure should be required with respect to pools allocated less than ten percent of pool assets; an intermediate level of disclosure should be required for pools allocated at least ten but less than twenty-five percent; and full disclosure should be required for pools allocated more than twenty-five percent.

The Commission is adopting Rule 4.24(k) as proposed (with a word order change for clarity).[171] In situations in which a transaction is undertaken with an affiliate for which there is no publicly disseminated price, the Commission recognizes that quantification of the "cost" thereof to the pool may be difficult. In such contexts, the Commission believes that, as suggested by a commenter, an explanation of the benefit to the related party and the potential detriment to the pool may be sufficient. In other cases, a good faith estimate or a qualitative description of the potential negative impact on the pool may be sufficient. The fact that such transactions are entered into on a noncompetitive basis should also be highlighted. With respect to investee pools, the Commission does not believe that the three-level disclosure suggested by one of the commenters is warranted because Rule 4.24(k) applies to transactions or arrangements that directly involve, and that are material to, the offered pool.[172] Thus, in applying Rule 4.24(k) to investee pool transactions, pool operators may consider the extent of the pool's allocation of funds to an investee pool in assessing the materiality of a related party transaction.

7. Litigation: Rules 4.24(l) for CPOs and 4.34(k) for CTAs

As proposed, Rule 4.24(l) would have required disclosure of any material administrative, civil or criminal action within the preceding five years against the pool's CPO, trading manager (if any), major CTAs and operators of major

[169] Former Rule 4.21(h) and new Rule 4.24(w).

[170] Except for the language in parentheses, the paragraph is identical to the last paragraph of former Rule 4.31(a)(5)(i). The parenthetical language conforms to proposed Rule 4.24(j) for CPOs.

[171] See 56 F.R. 25351, 25365 n.57 for a discussion of the litigation involving Stotler Funds, Inc., as an illustration of the purpose of this requirement.

[172] Moreover, as adopted, the revised rules do not retain the proposed three-level disclosure framework for past performance disclosures.

investee pools, any principal of the foregoing, and the pool's FCMs and IBs (if any). Disclosure of actions that were concluded by adjudication on the merits in favor of the listed persons would not have been required. Proposed Rule 4.33(k) would have required similar disclosure with respect to the CTA and with respect to the FCM and IB required to be used by the CTA's client.

Former Rule 4.21(a)(13) required disclosure of any action against a pool's CPO, CTA, FCM, IB or any of their principals within five years preceding the Document date without regard to the outcome. Former Rule 4.31(a)(7) required similar disclosure with respect to the CTA, any FCM or IB the client is required to use, and any principal of those persons. If there had been no actions against any of the listed persons, the former rules required a statement to that effect.

In addition to eliminating the requirement to disclose actions resolved on the merits in favor of one of the identified persons, the proposed rules would have substantially reduced required litigation disclosures concerning FCMs and IBs. First, the basic determinant of whether FCM or IB litigation would be material would be the extent of potential impact of the proceeding upon the FCM or IB, unless the proceeding were brought by the Commission or another regulatory or self-regulatory organization. The proceeding would be disclosable only if it would be required to be disclosed in the notes to the FCM's or IB's financial statements prepared pursuant to generally accepted accounting principles.[173] Disclosure of actions brought by the Commission and other regulatory agencies was also proposed to be streamlined. Commission actions would have been deemed material except for concluded actions which did not result in civil monetary penalties exceeding $50,000 and did not involve allegations of fraud or willful misconduct or which was adjudicated on the merits in favor of the specified person. Actions brought by other federal or state regulatory agencies or domestic or foreign self-regulatory organizations would have been required to be disclosed either if they were required to be disclosed in the notes to financial statements as discussed above or if they involved allegations of fraud or willful misconduct. Proposed Rule 4.24(*l*) also would expressly have required disclosure of litigation against a pool's trading manager, if any, and its principals, a requirement previously encompassed within the former requirement for disclosure of litigation against CTAs.

Proposed Rules 4.24(*l*) and 4.33(k) thus represented a reduction of required litigation disclosure, particularly with respect to FCMs and IBs. The scope of previously required litigation disclosures as to CTAs would have been limited under proposed Rule 4.24(*l*) to major, as opposed to all, CTAs for the pool, and only litigation against operators of major investee pools would be included.[174] Litigation involving FCM and IB principals was not included in the proposed rule.

Commenters generally supported the proposed changes but suggested certain further revisions. One commenter urged that *all* Commission and other regulatory matters concluded favorably with respect to the respondent (whether or not involving allegations of fraud or willful conduct) should be considered *not* material. Several commenters contended that litigation against FCMs is immaterial because such litigation generally does not jeopardize customer funds and virtually all FCMs have been subject to litigated customer claims. One commenter stated that only litigation required to be disclosed in the FCM's financial statements (and not the regulatory matters required by Rule 4.24(*l*)(2) (ii) and (iii)) is material and should be required in CPO and CTA Documents. Other commenters contended that CPOs and CTAs must rely upon the FCM to furnish its litigation history and are unable to verify independently the information that is provided. Consequently, commenters recommended, variously, that litigation disclosures be limited to those actions against an FCM that the FCM reasonably believes are likely to have a material adverse effect on the FCM's ability to provide brokerage services to the pool or managed account program or upon the investor's decision to place his funds with that FCM, or actions *actually* disclosed in an FCM's or IB's financial statements. Another commenter asserted that the impact of the litigation disclosure requirement upon funds-of-funds is unclear.

The Commission is adopting Rules 4.24(*l*) and 4.33(k) as proposed (renumbering proposed Rule 4.33(k) as 4.34(k)) with the exception that the rule is clarified to make explicit that actions involving an FCM or IB brought by a non-United States regulatory agency and involving allegations of fraud or willful misconduct will be considered material. The requirement to disclose actions that would be required to be disclosed in an FCM's or IB's financial statements is being retained. Since FCMs carry funds of the pool or managed account, their financial status and reliability are matters of material importance to prospective investors.

Except for events occurring subsequent to the issuance of the latest certified financial statements, litigation required to be disclosed would already have been disclosed in the FCM's or IB's latest certified financial statements. Generally, the CPO or CTA will be able to rely, under a reasonable diligence standard, upon these pre-existing disclosures as to matters covered by such statements. A CPO should exercise reasonable diligence in determining which subsequent actions are required to be so disclosed. Generally, absent facts placing the CPO or CTA on notice of special circumstances, the CPO or CTA should be able to rely upon representations by the FCM or IB as to what litigation is required to be disclosed in the firm's financial statements.

Actions brought by the Commission are treated differently from those brought by other regulatory agencies due to the presumptively greater relevance of such actions to the investment decision being made. All actions brought by the Commission are considered material other than concluded actions that did not result in civil monetary penalties exceeding $50,000 and did not involve allegations of fraud or other willful misconduct or which were adjudicated on the merits in favor of the specified person. Actions brought by any other federal or state agency, by a non-United States regulatory agency or by a self-regulatory organization, whether domestic or foreign, are material if they involve allegations of fraud or other willful misconduct. In all cases, subject to the general materiality standard, concluded actions resulting in an adjudication on the merits in favor of such persons would not be required to be disclosed.

As in the case of other provisions of the final rules, Rule 4.24(*l*) provides parallel treatment of litigation against CTAs for the pool and the operators of

[173] Proposed Rules 4.24(*l*)(2)(i) and 4.33(k)(2)(i). Under generally accepted accounting principles, certain information regarding litigation must be disclosed if the potential of a financial loss from the litigation is either probable (*i.e.*, likely to occur) or reasonably possible (more than remote but less than likely). *See* ACCOUNTING FOR CONTINGENCIES, Statement of Financial Accounting Standard No. 5, (Financial Accounting Standards Board, 1975) relating to disclosure of contingencies, including litigation.

[174] *See* Rules 4.10(i) and (d)(5), which define the terms "major commodity trading advisor" and "major investee pool." Of course, as noted above with respect to conflicts of interest on the part of FCM and IB principals, the requirement to disclose all material information may require disclosure of litigation involving persons not expressly designated in the rules.

investee pools. Subject to the general materiality standard of Rule 4.24(w),[175] disclosure of litigation against non-major CTAs and investee pool operators would not be required by Rule 4.24(*l*). Litigation against the FCM and IB for investee funds, absent special circumstances, would not be required to be disclosed.

8. Principal-Protected Pools: Rule 4.24(o) for CPOs[176]

Proposed Rule 4.24(*o*) would have set forth minimum disclosures relevant to so-called "guaranteed pools," which the Proposing Release termed "limited risk pools." Generally, Proposed Rule 4.24(*o*) would have codified Commission Advisory 86–1[177] by requiring the CPO of a "limited risk pool" to describe the nature of the limitation on risk intended to be provided, the manner in which the limitation would be achieved, including the cost of providing it, the conditions to be satisfied in order for participants to receive the benefits of the risk limitation and the circumstances in which the risk limitation would become operative.[178] Proposed Rule 4.24(*o*) would also have required the CPO to include in the break-even analysis required by Rule 4.24(i)(6) disclosure of the cost of establishing and maintaining the risk limitation, expressed as a percentage of the price of a unit of participation in the pool.

The Commission noted in the Proposing Release the proliferation of so-called "guaranteed pools," which are designed to assure participants the return of their initial investment, generally by committing a substantial portion of the assets of the pool to interest-bearing instruments or comparable investments in order to fund the guarantee feature. As noted, such "guarantee" structures generally impose costs which limit the potential for return on futures transactions and other types of investment returns, are often subject to significant restrictions, for example, that the participant maintain his investment in the fund for a specified period of years in order to realize on the guarantee, and are subject to the risk of nonfulfillment due to various causes. Consequently, in the past, representations in pool Disclosure Documents concerning various types of guarantee structures have been carefully scrutinized and guidance has been provided by advisory concerning material disclosures that should be made to prospective investors in pools with "guarantee" structures.[179] Proposed Rule 4.24(*o*) was designed to codify these specific minimum disclosures concerning "guarantee" structures.

The principal comment offered on this provision of the proposed rules was that the term "limited risk pool" proposed to be used in Rule 4.24(*o*) was potentially confusing in that most commodity pools are limited partnerships in which the risk to investors is to some degree limited no matter what other measures are taken. A variety of substitute terms were proposed, including "capital protected pools" and "principal return guaranteed pools." Other than the comments on the proposed "limited risk pool" term, the Commission did not receive any specific comments on proposed Rule 4.24(*o*).

The Commission has determined to substitute the term "principal-protected pool" for "limited risk pool," and otherwise to adopt Rule 4.24(*o*) as proposed. As discussed above, "principal-protected pool" is defined in Rule 4.10(d)(3) to mean "a pool (commonly referred to as a "guaranteed pool") that is designed to limit the loss of the initial investment of its participants." The Commission agrees that use of the "limited risk" terminology of the proposal could be confusing to investors and that "principal-protected" better distinguishes pools supported by a guarantee feature from those that are not.

As adopted, Rule 4.24(*o*) requires that the CPO describe the nature of the contemplated principal protection feature, disclosing the manner by which protection of principal will be achieved, sources of funding for the protection feature, conditions that must be satisfied for participants to receive the benefits of the protection feature, and when the protection feature becomes operative. The rule also specifies that the costs of purchasing and carrying assets necessary to fund the principal protection feature be included in the break-even analysis required by Rule 4.24(i)(6), expressed as a percentage of the price of a unit of participation. Rule 4.24(*o*) is intended to supersede the specific disclosures set forth in Advisory 86–1. However, Advisory 86–1 may continue to be helpful in constructing disclosures under 4.24(*o*), as well as providing insight into the purposes of this provision. Further, CPOs are reminded of the admonition in Advisory 86–1 that "(a)ny statements that suggest that the risks of futures trading are decreased by reason of this structure have a high potential to mislead or deceive and could result in serious violations of the Commission's regulations and anti-fraud provisions."

C. Supplemental and Voluntary Disclosures: Rules 4.24(v) for CPOs and 4.34(n) for CTAs[180]

A frequent complaint concerning commodity pool Disclosure Documents is that in many cases the disclosure process fails to achieve its intended purpose due to the high volume of information, much of which is beyond the scope of Commission requirements, included in the Disclosure Document. To address this concern, the Commission proposed a format for Disclosure Documents under which disclosures that are "volunteered" would be required to be placed after all relevant required disclosures. Specifically, proposed Rules 4.24(v) and 4.33(n) would have required all information, other than that required by the Commission,[181] the antifraud provisions of the Act, and any federal or state securities laws and regulations, to be placed "following the related required disclosures, unless otherwise specified in this rule." Additionally, such information could not have been misleading in content or presentation or inconsistent with required disclosures, and it would be subject to the anti-fraud provisions of the Act[182] and the regulations thereunder, and to rules regarding the use of promotional material promulgated by a registered futures association pursuant to section 17(j) of the Act. Essentially, Proposed

[175] Former Rule 4.21(h).

[176] Former Rule 4.21 did not specifically address disclosures relative to principal-protected pools.

This section also discusses Rule 4.10(d)(3), which defines the term "principal-protected pool." *See*, also Rule 4.24(i)(6), which requires disclosures of costs arising from the guarantee of a principal-protected pool.

[177] [1986–1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,035 (April 25, 1986).

[178] Rule 4.24(p), which deals with transferability and redemption, requires a description of restrictions on redemption associated with the pool's investments. The Commission intends that this discussion include a description of any restrictions on transferability and redemption due to use of pool funds to support a guarantee or principal protection feature and of any restrictions upon vesting of such guarantee or principal protection feature.

[179] *See, e.g.*, Advisory 86–1 [1986–1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,035 (April 25, 1986), cited previously.

[180] The Commission's former disclosure rules did not specifically address supplemental and voluntary disclosures.

[181] Commission-required disclosures include information required by former Rules 4.21(h) [renumbered as Rule 4.24(w) for CPOs]] and 4.31(g) [renumbered as Rule 4.34(o) for CTAs]]. As noted above, these rules require CPOs and CTAs to disclose all material information to existing and prospective pool participants and clients even if the information is not specifically required by Commission rules.

[182] *See* sections 4b and 4o of the Act.

Rules 4.24(v) and 4.33(n) were designed to assure that core disclosures required under Commission and other rules and statutes are given due prominence and that focus upon these matters is not displaced by the often voluminous material gratuitously included in the Disclosure Document.

The comments received by the Commission indicated significant confusion regarding the meaning and operation of proposed Rules 4.24(v) and 4.33(n). Commenters asserted that it was unclear where various types of voluntary information would be required (or permitted) to be placed. They noted the potential for scattering of related items in different portions of a Disclosure Document, when clarity would be fostered by placing non-required information adjacent to the required information to which it relates. Also, commenters claimed that, in essence, by designating information as "voluntary," registrants would be declaring that such information was not material or important, when in fact such information may be necessary to explain or clarify required disclosures. Commenters also noted that it is often difficult to determine what information is mandated by law or regulation and what is merely advisable to include.

The Commission has adopted Rules 4.24(v) and 4.33(n) (renumbered as 4.34(n)) with the following modifications. The word "voluntary" has been replaced in the rule heading with "supplemental," and the rules as adopted distinguish among supplemental performance disclosures (which must be placed after the last required performance disclosure), supplemental information with respect to required non-performance disclosures (which may be placed after or within the text of the corresponding required disclosures), and supplemental information which relates neither to the performance nor the non-performance disclosures required by Commission rules, federal or state laws and regulations, self-regulatory agency regulations or laws of non-United States jurisdictions (which must be placed after the last required disclosure).

As proposed, Rules 4.24(v) and 4.33(n) referred to disclosures required, *inter alia*, by federal or state securities laws or regulations. The modifier "securities" has been deleted from the final rules to take account of the potential applicability of other bodies of law. Further, as adopted, the required disclosures from which supplemental information is distinguished by Rules 4.24(v) and 4.34(n) include information required by applicable laws of a non-United States jurisdiction. Rules 4.24(v) and 4.34(n) as adopted, treat supplemental performance and non-performance information differently due to the extensive specific requirements of Commission rules with respect to performance data and the high susceptibility of performance data to use in a misleading manner. Thus, the entire required performance presentation must precede any supplemental performance data.[183] However, required volatility disclosure, for example, supplemental disclosure to indicate high monthly volatility for a CTA whose performance is otherwise required to be provided only on an annual basis, is expressly permitted to be included with the related performance disclosure. Supplemental non-performance information that relates to a disclosure required by Commission rules may be included in the text of or immediately following the related required disclosure, provided that the required disclosure is not thereby obscured or made less prominent. Other supplemental information must follow the last required disclosure, except that proprietary, hypothetical, extracted, pro forma (except as previously discussed)[184] or simulated trading results, because of their inherent lack of reliability and high potential to mislead, must be placed at the end of the Disclosure Document following all other information.[185]

VII. Other Changes

A. Deletion of Negative Disclosures

The Commission proposed to eliminate certain statements which the former rules had required registrants to include if there was no affirmative response to a particular disclosure requirement (*e.g.*, a statement that no material actions had been brought against the CPO in the preceding five years). Although many commenters generally approved of the Commission's efforts to eliminate excessive and burdensome required statements, none of the comments received specifically addressed these proposed changes.

As adopted, the revised disclosure rules thus no longer require CPOs or CTAs to make the following types of statements, as applicable: That there are no actual or potential conflicts of interest regarding any aspect of the pool or trading program on the part of certain persons;[186] that certain persons do not own any beneficial interest in the pool;[187] that there is no minimum or maximum amount of contributions or maximum amount of time pool funds will be held prior to trading;[188] that there are no restrictions on transfer or redemptions of participations;[189] that no material actions have been brought within the past five years against certain persons;[190] and that certain persons will not trade for their own accounts.[191] There remain requirements for affirmative, positive related disclosures on these subjects, as applicable.

B. Use, Amendment and Filing of Disclosure Documents: Rules 4.26 for CPOs and 4.36 for CTAs

As proposed, Rules 4.26 and 4.35, which govern the use, amendment and filing of Disclosure Documents, would have retained, substantially unchanged, the requirements of the former rules, with one exception.[192] The Commission proposed to extend the length of time that a Disclosure Document could have been used following the date thereof from six to nine months. As the Commission noted in the Proposing Release, this would conform the updating requirements of pool Disclosure Documents to those of section 10(a)(3) of the Securities Act for public securities offerings.[193] Thus,

[183] The Commission does not consider footnotes and explanatory text, if any, directly related to a required performance presentation to be supplemental performance disclosures and thus they should be included with the required performance.

[184] *See* discussion in Section V.C.3., *supra*, concerning required pro forma adjustments.

[185] *See* Rules 4.25(a)(8) for CPOs and 4.35(a)(7) for CTAs. The Commission is not specifying the order of presentation as among proprietary, hypothetical, extracted, pro forma or simulated trading results.

[186] *See* former Rules 4.21(a)(3)(ii) and 4.31(a)(5)(iii).

[187] *See* former Rule 4.21(a)(6)(ii).

[188] *See* former Rules 4.21(a)(8)(i)(B), 4.21(a)(8)(ii)(B) and 4.21(a)(8)(iii)(B).

[189] *See* former Rule 4.21(a)(10)(ii)(C)(7).

[190] *See* former Rules 4.21(a)(12)(ii) and 4.31(a)(7)(ii).

[191] *See* former Rules 4.21(a)(15)(iii) and 4.31(a)(6)(iii).

[192] Proposed Rule 4.26 would have combined the requirements of former Rules 4.21 (b), (e), (f) and (g), which, respectively, required correction of material inaccuracies or omissions in a Disclosure Document, specified how current the performance and non-performance information must be and how long a Disclosure Document could be used, required attachment of the current Account Statement and Annual Report, and specified the filing requirements for CPO Disclosure Documents. Proposed Rule 4.35 would have combined the requirements of former Rules 4.31 (b), (e) and (f), which, respectively, required correction of material inaccuracies or omissions in a Disclosure Document, specified how current the performance and non-performance information must be and how long a Disclosure Document could be used, and specified the filing requirements for CTA Disclosure Documents.

[193] 59 FR 25351, 25367. Section 10(a)(3) of the Securities Act (15 U.S.C. 77j(a)(3)) requires that when a securities prospectus is used more than nine months after the effective date of the registration statement, information contained therein may not be as of a date more than sixteen

Continued

these rules would have continued to address the currentness of a Disclosure Document and the information therein, corrections, filing and, in the case of CPOs, attachment of the most recent Account Statement and Annual Report to pool Disclosure Documents.

Two commenters questioned whether it was appropriate to adopt a nine-month standard from Securities Act Section 10(a)(3), and recommended instead an annual updating schedule. One commenter objected to maintaining the former rules' requirement to deliver a current Account Statement with the Disclosure Document, contending that in a medium- to long-term investment, monthly account statements are not material and that the requirements to attach the most recent Account Statement to thousands of prospectuses distributed to various branch offices presents substantial compliance problems.[104]

Rules 4.26 and 4.35 are being adopted generally as proposed, with Rule 4.35 renumbered as 4.36. With respect to the comments favoring a one-year updating cycle for Disclosure Documents, the Commission notes that since performance information need only be current as of a date three months prior to the Disclosure Document date, extending the updating requirement to nine months means that the performance information in the Disclosure Document may be as much as a year old. The Commission believes that further extending the updating cycle to twelve months is unwarranted, and that the purpose of the proposed revisions to permit updating on a nine-month cycle, *i.e.*, harmonization with the SEC update cycle, is achieved by adoption of the update provisions as proposed.

The Commission notes that Disclosure Document amendments are not subject to the twenty-one day prefiling requirement, but may be used simultaneously with their filing with the Commission, *i.e.*, not more than twenty-one days after the date on which the CPO or CTA first knows or has reason to know that the Disclosure Document is materially inaccurate or incomplete. In response to a commenter's request for clarification, the Commission also is confirming that an offering memorandum distributed pursuant to Rule 4.12(b) must be updated in the same manner as a Disclosure Document.

In response to the comment concerning the difficulty of, and lack of benefit from, including the current Account Statement with the Disclosure Document, the Commission notes that the information contained in the Account Statement provides a prospective participant with relevant current information, particularly with respect to the pool's performance, that is not available in the Disclosure Document. The requirement to provide the most recent monthly Account Statement is a means of assuring that prospective investors receive recent data concerning the pool's performance. This requirement, coupled with the duty to provide material information to prospective investors, should assure that prospective investors receive timely information concerning the pool's performance as necessary to balance the potentially stale performance data in the Disclosure Document. If it would be misleading not to disclose performance information for the period subsequent to that reflected in the Disclosure Document but prior to the Account Statement, the CPO may be required to provide additional information. In light of the new nine-month update cycle, pool operators should exercise special caution in assuring that sufficient additional information is provided to investors concerning performance volatility occurring subsequent to the period covered in the Disclosure Document. The Commission does not agree with the view expressed by the commenter that monthly data are not material to prospective pool participants. The importance of such current data will in fact be heightened under these rules, given the extension of the update cycle to nine months rather than six months.

The *Commission* believes that the purpose of the requirement to attach the most recent Account Statement may, however, be accomplished by other methods and has provided in the final rules an alternative procedure to attachment of the Account Statement to the *Disclosure* Document. Under the alternative procedure, in lieu of attaching the most recent monthly Account Statement to the Disclosure Document, the pool operator would provide performance information for the pool (which may be, but is not required to be, set forth in the form of a monthly Account Statement) current as of a date not more than sixty days prior to the date on which the Disclosure Document is provided to the prospective participant and covering the period since the most recent performance data contained in the Disclosure Document. Of course, any material changes in the pool's performance would require supplementation of the Disclosure Document.

In response to another commenter's request for clarification, the Commission is confirming that a CPO need not (1) file the most current Account Statement for a pool unless it is being used as an amendment to the pool's Disclosure Document; (2) include the most current Account Statement and Annual Report with a Disclosure Document amendment prior to filing such amendment with the Commission; or (3) physically attach the most current Account Statement and Annual Report to a Disclosure Document amendment prior to distributing the amendment to investors—inclusion in the same package is sufficient. When an amendment is distributed to existing pool participants, the CPO need not include the latest Annual Report and Account Statement (provided the existing participants have been receiving such reports on a timely basis). If a Disclosure Document amendment is distributed to previously solicited *prospective* investors, however, the most recent Annual Report and Account Statement must be included.

C. Disclosure Document Delivery Requirements

As proposed, Rules 4.21 and 4.31 would have retained, respectively, only paragraphs (a) and (d) of former Rules 4.21 and 4.31. In each case, paragraph (a) was the requirement for delivery of a Disclosure Document at or before the time of solicitation, and paragraph (d) was the requirement that a signed acknowledgment of receipt of the Disclosure Document be obtained. The requirements specified in former Rules 4.21(a) and (d) and former Rules 4.31(a) and (d) were left intact in the proposed revisions, except that CPOs would have been permitted to use summary offering materials in certain circumstances.

1. Notice of Intended Offering and Term Sheet

Proposed Rule 4.21(a) would have permitted CPOs to provide prospective participants who are accredited

months prior to such use if the information is known and can be furnished without unreasonable effort or expense.

[104] Another commenter sought guidance (or a safe harbor) with respect to the level of investee pool changes or reallocations which trigger the need to update performance information and/or the Disclosure Document for a *fund-of-funds* (suggesting a quarterly performance update). *But see* Rule 4.8, which provides specified relief from the pre-filing requirement for CPOs who operate pools of the nature specified therein. Further, as discussed above, whether a given investee pool allocation or reallocation is material depends upon the particular factual circumstances of the pool, including the overall frequency and significance of such changes. Thus, for example, in a dynamically allocated multi-advisor pool with multiple monthly CTA changes, the likelihood of a given CTA change being material is less than in a pool with fewer advisors and less frequent reallocations.

investors as defined in Rule 501 of Regulation D under the Securities Act[195] with a notice of intended offering and term sheet prior to delivery of the Disclosure Document, subject to rules promulgated by a registered futures association pursuant to Section 17(j) of the Act. This provision was intended to facilitate the offering of pools that qualify for relief from registration under the Securities Act as private offerings.

One commenter called the proposed change a worthwhile advance. Most commenters on the proposed provision urged that its coverage be expanded. Two commenters suggested that a CPO should be able to deliver a term sheet to a person who is not an accredited investor, so long as a Disclosure Document was delivered, ultimately or within a "reasonable time." Several commenters urged that CTAs be permitted to use term sheets and notices of intended offerings to solicit accredited investors. Another commenter stated that the proposed amendment to Rule 4.21 would provide no additional relief beyond that already provided by Rule 4.8 and sought both clarification whether a Disclosure Document must still be provided to the recipient of a term sheet and inclusion in the rule itself of the requirement (if any) that the term sheet be filed.

The Commission has determined to adopt Rule 4.21 as proposed. The Commission believes that extending the use of term sheets to non-accredited investors is not appropriate at this time and that such investors should receive the full protection of the disclosure rules to make an informed decision about participating in a pool. The Commission is also declining to permit CTAs to employ a procedure comparable to the use of a notice of intended offering and term sheet. The purpose of allowing the use of this type of short-form solicitation in the case of a pool offering is to permit a simple statement of basic terms to be provided in lieu of an often lengthy pool Disclosure Document. The relative brevity and simplicity of CTA Disclosure Documents do not at this time appear to warrant establishment of a comparable procedure. The Commission confirms that a Disclosure Document must be provided to the recipient of a term sheet and that the term sheet is not required to be filed.

2. Acknowledgment of Disclosure Document

The Commission also sought comment on whether the requirement that CPOs and CTAs must receive from a prospective investor a signed and dated acknowledgment continues to be necessary. Three commenters proposed that, in the case of pools, the requirement be permitted to be satisfied if an acknowledgment is included in the subscription documents, with one such commenter suggesting that such an acknowledgment need not include the date of the Disclosure Document in order to permit use of the subscription documents throughout the offering, asserting that a blank left for the Disclosure Document date would likely be overlooked. The Commission confirms that an acknowledgment may be included in the subscription documents for a pool, provided that the text of the acknowledgment is prominently captioned and distinguished from the subscription agreement and that there is a separate line for the acknowledgment signature and date thereof. The Commission notes that the required provision of a date imposes a minimal burden, if any at all, protects the interests of both the CPO and the participant and is a critical component of the pool's audit trail.

D. Conforming Changes

The Proposing Release contained a number of changes to conform cross-references in the text of various Commission rules to the new section numbering within part 4, which changes are being adopted. The rules so affected are Rules 4.12, 4.21, 4.23, 4.32 (renumbered as 4.33), 30.6 and 150.3. One commenter pointed out that cross references in Rule 4.7 to former Rules 4.21 and 4.31 required amendment to conform with the reorganization and separate designation of certain provisions of former Rules 4.21 and 4.31. The Commission has revised Rule 4.7 accordingly, and has also revised Ru!^-4.8 to conform cross-references to the revised rule numbers.

VIII. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601–611 (1988), requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The rule amendments discussed herein will affect registered CPOs and CTAs. The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its rules on such entities in accordance with the RFA.[196] The Commission previously has determined that registered CPOs are not small entities for the purpose of the RFA.[197] With respect to CTAs, the Commission has stated that it would evaluate within the context of a particular rule proposal whether all or some affected CTAs would be considered to be small entities and, if so, the economic impact on them of any rule.[198]

The revised rules reduce rather than increase the requirements of former Rule 4.21 for CPOs and the requirements of former Rule 4.31 for CTAs. The revised rules significantly decrease the amount of past performance and other information required to be disclosed by CPOs and CTAs, and Disclosure Documents may be used for nine months rather than six months. The Commission has adopted in the final revised rules further reductions in disclosure requirements from the proposed revisions (*e.g.*, permitting CTAs to use the new capsule format for presenting the past performance of the offered pool).

In certifying pursuant to section 3(a) of the RFA that the proposed revisions to the part 4 CPO and CTA disclosure rules would not have a significant economic impact on a substantial number of small entities, the Commission invited comments from any CPO or CTA who believed that the proposed revisions, if adopted, would have a significant economic impact on their activities. No such comments were received on the proposed revisions.

Accordingly, pursuant to Rule 3(a) of the RFA (5 U.S.C. 605(b)), the Chairman, on behalf of the Commission, certifies that the action taken herein will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1980, ("PRA") 44 U.S.C. 3501 *et seq.*, imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. In compliance with the PRA, the Commission has submitted these proposed rule amendments and the associated information collection requirements to the Office of Management and Budget. The burden associated with this entire collection, including these rules, is as follows:

Average burden hours per response.	124.85

[195] 17 CFR 230.501 (1994).

[196] 47 FR 18618–18621 (April 30, 1982).

[197] 47 FR 18618–18620.

[198] 47 FR 18618–18620.

Number of respondents	2,924
Frequency of response	On occasion

The burden associated with these specific rules, is as follows:

Average burden hours per response.	8.05
Number of respondents	1,162
Frequency of response	On occasion

Copies of the information collection submission to OMB are available from Joe F. Mink, CFTC Clearance officer, 2033 K Street, NW, Washington, DC 20581, (202) 254–9735.

List of Subjects

17 CFR Part 1

Consumer protection, Risk disclosure statements.

17 CFR Part 4

Brokers, Commodity futures, Commodity pool operators and commodity trading advisors.

17 CFR Part 30

Commodity futures, Consumer protection, Foreign futures and foreign options transactions.

17 CFR Part 150

Commodity futures, Limits on positions.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act, and in particular, sections 2(a)(1), 4b, 4c, 4l, 4m, 4n, 4o, and 8a, 7 U.S.C. 2, 6b, 6c, 6l, 6m, 6n, 6o, and 12a, the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for Part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23 and 24.

2. Section 1.55 is amended by adding paragraph (a)(1)(iii) to read as follows:

§ 1.55 Distribution of "Risk Disclosure Statement" by futures commission merchants and introducing brokers.

(a)(1) * * *

(iii) Solely for purposes of this section, a pool operated by a commodity pool operator registered under the Commodity Exchange Act or exempt from such registration need not be treated as a customer.

* * * * *

PART 4—COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

Subpart A—General Provisions, Definitions and Exemptions

3. The authority citation for part 4 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 4, 6b, 6c, 6l, 6m, 6n, 6o, 12a and 23.

§ 4.7 [Amended]

4. In § 4.7, paragraph (a)(2)(i)(A) is amended by removing the reference "§ 4.21" and by adding the reference "§§ 4.21, 4.24, 4.25 and 4.26" in its place.

§ 4.7 [Amended]

5. In § 4.7, paragraph (a)(4) is amended by removing the reference "§§ 4.21, 4.22 or 4.23" and by adding the reference "§§ 4.21, 4.22, 4.23, 4.24, 4.25 or 4.26" in its place.

§ 4.7 [Amended]

6. In § 4.7, paragraph (b)(2)(i)(A) is amended by removing the reference "§ 4.31" and by adding the reference "§§ 4.31, 4.34, 4.35 and 4.36" in its place.

§ 4.7 [Amended]

7. In § 4.7, paragraph (b)(4) is amended by removing the reference "§§ 4.31 or 4.32" and by adding the reference "§§ 4.31, 4.33, 4.34, 4.35 or 4.36" in its place.

§ 4.8 [Amended]

8. In § 4.8, the section heading is amended by removing the reference to "rules 4.21" and by adding the reference "rule 4.26" in its place.

§ 4.8 [Amended]

9. In § 4.8, paragraphs (a) and (b) are amended by removing the reference "paragraph (g) of § 4.21" and by adding the reference "paragraph (d) of § 4.26" in its place.

10. Section 4.10 is amended by designating paragraph (d) as paragraph (d)(1), by adding new paragraphs (d)(2), (d)(3), (d)(4), (d)(5), (h), (i), (j), (k) and (l), and by revising paragraph (e) to read as follows:

§ 4.10 Definitions.

* * * * *

(d)(1) *Pool* means any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests.

(2) *Multi-advisor pool* means a pool in which:

(i) No commodity trading advisor is allocated or intended to be allocated more than twenty-five percent of the pool's funds available for commodity interest trading; and

(ii) No investee pool is allocated or intended to be allocated more than twenty-five percent of the pool's net asset value.

(3) *Principal-protected pool* means a pool (commonly referred to as a "guaranteed pool") that is designed to limit the loss of the initial investment of its participants.

(4) *Investee pool* means any pool in which another pool or account participates or invests, *e.g.*, as a limited partner thereof.

(5) *Major investee pool* means, with respect to a pool, any investee pool that is allocated or intended to be allocated at least ten percent of the net asset value of the pool.

(e)(1) *Principal*, when referring to a person that is a principal of a particular entity, means:

(i) Any person including, but not limited to, a sole proprietor, general partner, officer or director, or person occupying a similar status or performing similar functions, having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the activities of the entity;

(ii) Any holder or any beneficial owner of ten percent or more of the outstanding shares of any class of stock of the entity; and

(iii) Any person who has contributed ten percent or more of the capital of the entity.

(2) "Trading principal" means:

(i) With respect to a commodity pool operator, a principal who participates in making trading decisions for a pool, or who supervises, or has authority to allocate pool assets to, persons so engaged; and

(ii) with respect to a commodity trading advisor, a principal who participates in making trading decisions for the account of a client or who supervises or selects persons so engaged.

* * * * *

(h) *Trading manager* means, with respect to a pool, any person, other than the commodity pool operator of the pool, having sole or partial authority to allocate pool assets to commodity trading advisors or investee pools.

(i) *Major commodity trading advisor* means, with respect to a pool, any commodity trading advisor that is allocated or is intended to be allocated at least ten percent of the pool's funds available for commodity interest trading. For this purpose, the percentage allocation shall be the amount of funds allocated to the trading advisor by agreement with the commodity pool operator (or trading manager) on behalf of the pool, expressed as a percentage of the lesser of the aggregate value of the assets allocated to the pool's trading advisors or the net assets of the pool at the time of allocation.

(j) *Break-even point:*

(1) Means the trading profit that a pool must realize in the first year of a participant's investment to equal all fees and expenses such that such participant will recoup its initial investment, as calculated pursuant to rules promulgated by a registered futures association pursuant to section 17(j) of the Act; and

(2) Must be expressed both as a dollar amount and as a percentage of the minimum unit of initial investment and assume redemption of the initial investment at the end of the first year of investment.

(k) *Draw-down* means losses experienced by a pool or account over a specified period.

(*l*) *Worst peak-to-valley draw-down* means the greatest cumulative percentage decline in month-end net asset value due to losses sustained by a pool, account or trading program during any period in which the initial month-end net asset value is not equaled or exceeded by a subsequent month-end net asset value. Such decline must be expressed as a percentage of the initial month-end net asset value, together with an indication of the months and year(s) of such decline from the initial month-end net asset value to the lowest month-end net asset value of such decline.[1] For purposes of §§ 4.25 and 4.35, a peak-to-valley draw-down which began prior to the beginning of the most recent five calendar years is deemed to have occurred during such five-calendar-year period.

11. Section 4.12 is amended by revising paragraphs (b)(2)(i) and (b)(5)(i) to read as follows:

§ 4.12 Exemption from provisions of part 4.

* * * * *

(b) * * *

(2) * * *

(i) In the case of § 4.21, that the Commission accept in lieu and in satisfaction of the Disclosure Document specified by that section an offering memorandum for the pool which does not contain the information required by §§ 4.24(a), 4.24(b), and 4.24(n): *Provided, however*, that the offering memorandum:

(A) Is prepared pursuant to the requirements of the Securities Act of 1933, as amended, or the exemption from said Act pursuant to which the pool is being offered and sold;

(B) Contains the information required by §§ 4.24(c) through (m) and (o) through (u); and

(C) Complies with the requirements of §§ 4.24(v) and (w).

* * * * *

(5)(i) If a claim of exemption has been made under § 4.12(b)(2)(i), the commodity pool operator must make a statement to that effect on the cover page of each offering memorandum, or amendment thereto, that it is required to file with the Commission pursuant to § 4.26.

* * * * *

Subpart B—Commodity Pool Operators

12. Section 4.21 is revised to read as follows:

§ 4.21 Required delivery of pool Disclosure Document.

(a) No commodity pool operator registered or required to be registered under the Act may, directly or indirectly, solicit, accept or receive funds, securities or other property from a prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the commodity pool operator delivers or causes to be delivered to the prospective participant a Disclosure Document for the pool containing the information set forth in § 4.24: *Provided, however*, that where the prospective participant is an accredited investor, as defined in 17 CFR 230.501(a), a notice of intended offering and statement of the terms of the intended offering may be provided prior to delivery of a Disclosure Document, subject to compliance with rules promulgated by a registered futures association pursuant to section 17(j) of the Act.

(b) The commodity pool operator may not accept or receive funds, securities or other property from a prospective participant unless the pool operator first receives from the prospective participant an acknowledgment signed and dated by the prospective participant stating that the prospective participant received a Disclosure Document for the pool.

13. Section 4.23 is amended by revising paragraph (a)(3) to read as follows:

§ 4.23 Recordkeeping.

* * * * *

(a) * * *

(3) The acknowledgement specified by § 4.21(b) for each participant in the pool.

* * * * *

14. Sections 4.24, 4.25 and 4.26 are added to read as follows:

§ 4.24 General disclosures required.

Except as otherwise provided herein, a Disclosure Document must include the following information.

(a) *Cautionary Statement.* The following Cautionary Statement must be prominently displayed on the cover page of the Disclosure Document.

THE COMMODITY FUTURES TRADING COMMISSION HAS NOT PASSED UPON THE MERITS OF PARTICIPATING IN THIS POOL NOR HAS THE COMMISSION PASSED ON THE ADEQUACY OR ACCURACY OF THIS DISCLOSURE DOCUMENT.

(b) *Risk Disclosure Statement.* (1) The following Risk Disclosure Statement must be prominently displayed immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission, by any applicable federal or state securities laws and regulations or by any applicable laws of non-United States jurisdictions.

RISK DISCLOSURE STATEMENT

YOU SHOULD CAREFULLY CONSIDER WHETHER YOUR FINANCIAL CONDITION PERMITS YOU TO PARTICIPATE IN A COMMODITY POOL. IN SO DOING, YOU SHOULD BE AWARE THAT FUTURES AND OPTIONS TRADING CAN QUICKLY LEAD TO LARGE LOSSES AS WELL AS GAINS. SUCH TRADING LOSSES CAN SHARPLY REDUCE THE NET ASSET VALUE OF THE POOL AND CONSEQUENTLY THE VALUE OF YOUR INTEREST IN THE POOL. IN ADDITION, RESTRICTIONS ON REDEMPTIONS MAY AFFECT YOUR ABILITY TO WITHDRAW YOUR PARTICIPATION IN THE POOL.

FURTHER, COMMODITY POOLS MAY BE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT, AND ADVISORY AND BROKERAGE FEES. IT MAY BE NECESSARY FOR THOSE POOLS THAT ARE SUBJECT TO THESE CHARGES TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETION OR EXHAUSTION OF THEIR ASSETS. THIS DISCLOSURE DOCUMENT CONTAINS A COMPLETE DESCRIPTION OF EACH EXPENSE TO BE CHARGED THIS POOL AT PAGE (insert page number) AND A STATEMENT OF THE PERCENTAGE RETURN NECESSARY TO BREAK EVEN, THAT IS, TO RECOVER THE AMOUNT OF YOUR INITIAL INVESTMENT, AT PAGE (insert page number).

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND OTHER FACTORS NECESSARY TO EVALUATE

[1] For example, a worst peak-to-valley draw-down of "4 to 8–92/25%" means that the peak-to-valley draw-down lasted from April to August of 1992 and resulted in a twenty-five percent cumulative draw-down.

YOUR PARTICIPATION IN THIS COMMODITY POOL. THEREFORE, BEFORE YOU DECIDE TO PARTICIPATE IN THIS COMMODITY POOL, YOU SHOULD CAREFULLY STUDY THIS DISCLOSURE DOCUMENT, INCLUDING A DESCRIPTION OF THE PRINCIPAL RISK FACTORS OF THIS INVESTMENT, AT PAGE (insert page number).

(2) If the pool may trade foreign futures or options contracts, the Risk Disclosure Statement must further state:

YOU SHOULD ALSO BE AWARE THAT THIS COMMODITY POOL MAY TRADE FOREIGN FUTURES OR OPTIONS CONTRACTS. TRANSACTIONS ON MARKETS LOCATED OUTSIDE THE UNITED STATES, INCLUDING MARKETS FORMALLY LINKED TO A UNITED STATES MARKET, MAY BE SUBJECT TO REGULATIONS WHICH OFFER DIFFERENT OR DIMINISHED PROTECTION TO THE POOL AND ITS PARTICIPANTS. FURTHER, UNITED STATES REGULATORY AUTHORITIES MAY BE UNABLE TO COMPEL THE ENFORCEMENT OF THE RULES OF REGULATORY AUTHORITIES OR MARKETS IN NON-UNITED STATES JURISDICTIONS WHERE TRANSACTIONS FOR THE POOL MAY BE EFFECTED.

(3) If the potential liability of a participant in the pool is greater than the amount of the participant's contribution for the purchase of an interest in the pool and the profits earned thereon, whether distributed or not, the commodity pool operator must make the following additional statement in the Risk Disclosure Statement, to be prominently disclosed as the last paragraph thereof:

ALSO, BEFORE YOU DECIDE TO PARTICIPATE IN THIS POOL, YOU SHOULD NOTE THAT YOUR POTENTIAL LIABILITY AS A PARTICIPANT IN THIS POOL FOR TRADING LOSSES AND OTHER EXPENSES OF THE POOL IS NOT LIMITED TO THE AMOUNT OF YOUR CONTRIBUTION FOR THE PURCHASE OF AN INTEREST IN THE POOL AND ANY PROFITS EARNED THEREON. A COMPLETE DESCRIPTION OF THE LIABILITY OF A PARTICIPANT IN THIS POOL IS EXPLAINED MORE FULLY IN THIS DISCLOSURE DOCUMENT.

(c) *Table of contents.* A table of contents showing, by subject matter, the location of the disclosures made in the Disclosure Document must appear immediately following the Risk Disclosure Statement.

(d) *Information required in the forepart of the Disclosure Document.* (1) The name, address of the main business office, main business telephone number and form of organization of the pool. If the mailing address of the main business office is a post office box number or is not within the United States, its territories or possessions, the pool operator must state where the pool's books and records will be kept and made available for inspection;

(2) The name, address of the main business office, main business telephone number and form of organization of the commodity pool operator. If the mailing address of the main business office is a post office box number or is not within the United States, its territories or possessions, the pool operator must state where its books and records will be kept and made available for inspection;

(3) As applicable, a *statement* that the pool is:

(i) Privately offered pursuant to section 4(2) of the Securities Act of 1933, as amended (15 U.S.C. 77d(2)), or pursuant to Regulation D thereunder (17 CFR 230.501 *et seq.*);

(ii) A multi-advisor pool as defined in § 4.10(d)(2);

(iii) A principal-protected pool as defined in § 4.10(d)(3); or

(iv) Continuously offered. If the pool is not continuously offered, the closing date of the offering must be disclosed.

(4) The date when the commodity pool operator first intends to use the Disclosure Document; and

(5) The break-even point per unit of initial investment, as specified in § 4.10(j).

(e) *Persons to be identified.* The names of the following persons:

(1) Each principal of the pool operator;

(2) The pool's trading manager, if any, and each principal thereof;

(3) Each major investee pool, the operator of such investee pool, and each principal of the operator thereof;

(4) Each major commodity trading advisor and each principal thereof;

(5) Which of the foregoing persons will make trading decisions for the pool; and

(6) If known, the futures commission merchant through which the pool will execute its trades, and, if applicable, the introducing broker through which the pool will introduce its trades to the futures commission merchant.

(f) *Business background.* (1) The business background, for the five years preceding the date of the Disclosure Document, of:

(i) The commodity pool operator;

(ii) The pool's trading manager, if any;

(iii) Each major commodity trading advisor;

(iv) The operator of each major investee pool; and

(v) Each principal of the foregoing persons who participates in making trading or operational decisions for the pool or who supervises persons so engaged, including, without limitation, the officers and directors of such persons.

(2) The pool operator must include in the description of the business background of each person identified in § 4.24(f)(1) the name and main business of that person's employers, business associations or business ventures and the nature of the duties performed by such person for such employers or in connection with such business associations or business ventures. The location in the Disclosure Document of any required past performance disclosure for such person must be indicated.

(g) *Principal risk factors.* A discussion of the principal risk factors of participation in the offered pool. This discussion must include, without limitation, risks relating to volatility, leverage, liquidity, and counterparty creditworthiness, as applicable to the types of trading programs to be followed, trading structures to be employed and investment activity expected to be engaged in by the offered pool.

(h) *Investment program and use of proceeds.* The pool operator must disclose the following:

(1) The types of commodity interests and other interests which the pool will trade, including:

(i) The approximate percentage of the pool's assets that will be used to trade commodity interests, securities and other types of interests, categorized by type of commodity or market sector, type of security (debt, equity, preferred equity), whether traded or listed on a regulated exchange market, maturity ranges and investment rating, as applicable;

(ii) The extent to which such interests are subject to state or federal regulation, regulation by a non-United States jurisdiction or rules of a self-regulatory organization; (iii)(A) The custodian or other entity (*e.g.*, bank or broker-dealer) which will hold such interests; and

(B) If such interests will be held or if pool assets will be invested in a non-United States jurisdiction, the jurisdiction in which such interests or assets will be held or invested.

(2) A description of the trading and investment programs and policies that will be followed by the offered pool, and any material restrictions or limitations on trading required by the pool's organizational documents or otherwise. This description must include, if applicable, an explanation of the systems used to select commodity trading advisors, investee pools and types of investment activity to which pool assets will be committed;

(3)(i) A summary description of the pool's major commodity trading advisors, including their respective percentage allocations of pool assets, a description of the nature and operation of the trading programs such advisors will follow, including the types of interests traded pursuant to such programs, and each advisor's historical experience trading such program including material information as to volatility, leverage and rates of return and the length of time during which the advisor has traded such program;

(iii) A summary description of the pool's major investee pools or funds, including their respective percentage allocations of pool assets and a description of the nature and operation of such investee pools and funds, including for each investee pool or fund the types of interests traded, material information as to volatility, leverage and rates of return for such investee pool or fund and the period of its operation; and

(4)(i) The manner in which the pool will fulfill its margin requirements and the approximate percentage of the pool's assets that will be held in segregation pursuant to the Act and the Commission's regulations thereunder;

(ii) If the pool will fulfill its margin requirements with other than cash deposits, the nature of such deposits; and

(iii) If assets deposited by the pool as margin generate income, to whom that income will be paid.

(i) *Fees and expenses.* (1) The Disclosure Document must include a complete description of each fee, commission and other expense which the commodity pool operator knows or should know has been incurred by the pool for its preceding fiscal year and is expected to be incurred by the pool in its current fiscal year, including fees or other expenses incurred in connection with the pool's participation in investee pools and funds.

(2) This description must include, without limitation:

(i) Management fees;

(ii) Brokerage fees and commissions, including interest income paid to futures commission merchants;

(iii) Fees and commissions paid in connection with trading advice provided to the pool;

(iv) Fees and expenses incurred within investments in investee pools, investee funds and other collective investment vehicles, which fees and expenses must be disclosed separately for each investment tier;

(v) Incentive fees;

(vi) Any allocation to the commodity pool operator, or any agreement or understanding which provides the commodity pool operator with the right to receive a distribution, where such allocation or distribution is greater than a pro rata share of the pool's profits based on the percentage of capital contributions made by the commodity pool operator;

(vii) Commissions or other benefits, including trailing commissions paid or that may be paid or accrue, directly or indirectly, to any person in connection with the solicitation of participations in the pool;

(viii) Professional and general administrative fees and expenses, including legal and accounting fees and office supplies expenses;

(ix) Organizational and offering expenses;

(x) Clearance fees and fees paid to national exchanges and self-regulatory organizations;

(xi) For principal-protected pools, any direct or indirect costs to the pool associated with providing the protection feature, as referred to in paragraph (o)(3) of this section; and

(xii) Any other direct or indirect cost.

(3) Where any fee, commission or other expense is determined by reference to a base amount including, but not limited to, "net assets," "allocation of assets," "gross profits," "net profits," or "net gains," the pool operator must explain how such base amount will be calculated, in a manner consistent with calculation of the break-even point.

(4) Where any fee, commission or other expense is based on an increase in the value of the pool, the pool operator must specify how the increase is calculated, the period of time during which the increase is calculated, the fee, commission or other expense to be charged at the end of that period and the value of the pool at which payment of the fee, commission or other expense commences.

(5) Where any fee, commission or other expense of the pool has been paid or is to be paid by a person other than the pool, the pool operator must disclose the nature and amount thereof and the person who paid or who is expected to pay it.

(6) The pool operator must provide, in a tabular format, an analysis setting forth how the break-even point for the pool was calculated. The analysis must include all fees, commissions and other expenses of the pool, as set forth in § 4.24(i)(2).

(j) *Conflicts of interest.* (1) A full description of any actual or potential conflicts of interest regarding any aspect of the pool on the part of:

(i) The commodity pool operator;

(ii) The pool's trading manager, if any;

(iii) Any major commodity trading advisor;

(iv) The commodity pool operator of any major investee pool;

(v) Any principal of the persons described in paragraphs (k)(1) (i), (ii), (iii) and (iv) of this section; and

(vi) Any other person providing services to the pool or soliciting participants for the pool.

(2) Any other material conflict involving the pool.

(3) Included in the description of such conflicts must be any arrangement whereby a person may benefit, directly or indirectly, from the maintenance of the pool's account with the futures commission merchant or from the introduction of the pool's account to a futures commission merchant by an introducing broker (such as payment for order flow or soft dollar arrangements) or from an investment of pool assets in investee pools or funds or other investments.

(k) *Related party transactions.* A full description, including a discussion of the costs thereof to the pool, of any material transactions or arrangements for which there is no publicly disseminated price between the pool and any person affiliated with a person providing services to the pool.

(l) *Litigation.* (1) Subject to the provisions of § 4.24(l)(2), any material administrative, civil or criminal action, whether pending or concluded, within five years preceding the date of the Document, against any of the following persons; *Provided, however,* that a concluded action that resulted in an adjudication on the merits in favor of such person need not be disclosed:

(i) The commodity pool operator, the pool's trading manager, if any, the pool's major commodity trading advisors, and the operators of the pool's major investee pools;

(ii) Any principal of the foregoing; and

(iii) The pool's futures commission merchants and introducing brokers, if any.

(2) With respect to a futures commission merchant or an introducing broker, an action will be considered material if:

(i) The action would be required to be disclosed in the notes to the futures commission merchant's or introducing broker's financial statements prepared pursuant to generally accepted accounting principles;

(ii) The action was brought by the Commission; *Provided, however,* that a concluded action that did not result in civil monetary penalties exceeding $50,000 need not be disclosed unless it involved allegations of fraud or other willful misconduct; or

(iii) The action was brought by any other federal or state regulatory agency, a non-United States regulatory agency or a self-regulatory organization and involved allegations of fraud or other willful misconduct.

(m) *Trading for own account.* If the commodity pool operator, the pool's trading manager, any of the pool's commodity trading advisors or any principal thereof trades or intends to trade commodity interests for its own account, the pool operator must disclose whether participants will be permitted to inspect the records of such person's trades and any written policies related to such trading.

(n) *Performance disclosures.* Past performance must be disclosed as set forth in § 4.25.

(o) *Principal-protected pools.* If the pool is a principal-protected pool as defined in § 4.10(d)(3), the commodity pool operator must:

(1) Describe the nature of the principal protection feature intended to be provided, the manner by which such protection will be achieved, including sources of funding, and what conditions must be satisfied for participants to receive the benefits of such protection;

(2) Specify when the protection feature becomes operative; and

(3) Disclose, in the break-even analysis required by § 4.24(i)(6), the costs of purchasing and carrying the assets to fund the principal protection feature or other limitation on risk, expressed as a percentage of the price of a unit of participation.

(p) *Transferability and redemption.* (1) A complete description of any restrictions upon the transferability of a participant's interest in the pool; and

(2) A complete description of the frequency, timing and manner in which a participant may redeem interests in the pool. Such description must specify:

(i) How the redemption value of a participant's interest will be calculated;

(ii) The conditions under which a participant may redeem its interest, including the cost associated therewith, the terms of any notification required and the time between the request for redemption and payment;

(iii) Any restrictions on the redemption of a participant's interest, including any restrictions associated with the pool's investments; and

(iv) Any liquidity risks relative to the pool's redemption capabilities.

(q) *Liability of pool participants.* The extent to which a participant may be held liable for obligations of the pool in excess of the funds contributed by the participant for the purchase of an interest in the pool.

(r) *Distribution of profits and taxation.* (1) The pool's policies with respect to the payment of distributions from profits or capital and the frequency of such payments;

(2) The federal income tax effects of such payments for a participant, including a discussion of the federal income tax laws applicable to the form of organization of the pool and to such payments therefrom; and

(3) If a pool is specifically structured to accomplish certain federal income tax objectives, the commodity pool operator must explain those objectives, the manner in which they will be achieved and any risks relative thereto.

(s) *Inception of trading and other information.* (1) The minimum aggregate subscriptions that will be necessary for the pool to commence trading commodity interests;

(2) The minimum and maximum aggregate subscriptions that may be contributed to the pool;

(3) The maximum period of time the pool will hold funds prior to the commencement of trading commodity interests;

(4) The disposition of funds received if the pool does not receive the necessary amount to commence trading, including the period of time within which the disposition will be made; and

(5) Where the pool operator will deposit funds received prior to the commencement of trading by the pool, and a statement specifying to whom any income from such deposits will be paid.

(t) *Ownership in pool.* The extent of any ownership or beneficial interest in the pool held by the following:

(1) The commodity pool operator;

(2) The pool's trading manager, if any;

(3) The pool's major commodity trading advisors;

(4) The operators of the pool's major investee pools; and

(5) Any principal of the foregoing.

(u) *Reporting to pool participants.* A statement that the commodity pool operator is required to provide all participants with monthly or quarterly (whichever applies) statements of account and with an annual report containing financial statements certified by an independent public accountant.

(v) *Supplemental information.* If any information, other than that required by Commission rules, the antifraud provisions of the Act, other federal or state laws or regulations, rules of a self-regulatory agency or laws of a non-United States jurisdiction, is provided, such information:

(1) May not be misleading in content or presentation or inconsistent with required disclosures;

(2) Is subject to the antifraud provisions of the Act and Commission rules and to rules regarding the use of promotional material promulgated by a registered futures association pursuant to section 17(j) of the Act; and

(3) Must be placed as follows, unless otherwise specified by Commission rules:

(i) Supplemental performance information (not including proprietary trading results as defined in § 4.25(a)(8), or hypothetical, extracted, pro forma or simulated trading results) must be placed after all specifically required performance information; *Provided, however,* that required volatility disclosure may be included with the related required performance disclosure;

(ii) Supplemental non-performance information relating to a required disclosure may be included with the related required disclosure; and

(iii) Other supplemental information may be included after all required disclosures; *Provided, however,* that any proprietary trading results as defined in § 4.25(a)(8), and any hypothetical, extracted, pro forma or simulated trading results included in the Disclosure Document must appear as the last disclosure therein following all required and non-required disclosures.

(w) *Material information.* Nothing set forth in §§ 4.21, 4.24, 4.25 or § 4.26 shall relieve a commodity pool operator from any obligation under the Act or the regulations thereunder, including the obligation to disclose all material information to existing or prospective pool participants even if the information is not specifically required by such sections.

§ 4.25 Performance disclosures.

(a) *General principles*—(1) *Capsule performance information*—(i) *For pools.* Unless otherwise specified, disclosure of the past performance of a pool must include the following information. Amounts shown must be net of any fees, expenses or allocations to the commodity pool operator.

(A) The name of the pool;

(B) A statement as to whether the pool is:

(*1*) Privately offered pursuant to section 4(2) of the Securities Act of 1933, as amended (15 U.S.C. 77d(2)), or pursuant to Regulation D thereunder (17 CFR 230.501 et seq.);

(*2*) A multi-advisor pool as defined in § 4.10(d)(2); and

(*3*) A principal-protected pool as defined in § 4.10(d)(3);

(C) The date of inception of trading;

(D) The aggregate gross capital subscriptions to the pool;

(E) The pool's current net asset value;

(F) The largest monthly draw-down during the most recent five calendar years and year-to-date, expressed as a percentage of the pool's net asset value and indicating the month and year of the draw-down (the capsule must include a definition of "draw-down" that is consistent with § 4.10(k));

(G) The worst peak-to-valley draw-down during the most recent five calendar years and year-to-date, expressed as a percentage of the pool's net asset value and indicating the months and year of the draw-down; and

(H) Subject to § 4.25(a)(2) for the offered pool, the annual and year-to-date rate of return for the pool for the most recent five calendar years and year-to-date, computed on a compounded monthly basis;

(ii) *For accounts.* Disclosure of the past performance of an account required under this § 4.25 must include the following capsule performance information:

(A) The name of the commodity trading advisor or other person trading the account and the name of the trading program;

(B) The date on which the commodity trading advisor or other person trading the account began trading client accounts and the date when client funds began being traded pursuant to the trading program;

(C) The number of accounts directed by the commodity trading advisor or other person trading the account pursuant to the trading program specified, as of the date of the Disclosure Document;

(D)(*1*) The total assets under the management of the commodity trading advisor or other person trading the account, as of the date of the Disclosure Document; and

(*2*) The total assets traded pursuant to the trading program specified, as of the date of the Disclosure Document;

(E) The largest monthly draw-down for the trading program specified during the most recent five calendar years and year-to-date expressed as a percentage of client funds, and indicating the month and year of the draw-down;

(F) The worst peak-to-valley draw-down for the trading program specified during the most recent five calendar years and year-to-date, expressed as a percentage of net asset value and indicating the months and year of the draw-down; and

(G) The annual and year-to-date rate-of-return for the program specified, computed on a compounded monthly basis.

(2) *Additional requirements with respect to the offered pool.* (i) The performance of the offered pool must be identified as such and separately presented first;

(ii) The rate of return of the offered pool must be presented on a monthly basis for the period specified in § 4.25(a)(5), either in a numerical table or in a bar graph;

(iii) A bar graph used to present monthly rates of return for the offered pool:

(A) Must show percentage rate of return on the vertical axis and one-month increments on the horizontal axis;

(B) Must be scaled in such a way as to clearly show month-to-month differences in rates of return; and

(C) Must separately display numerical percentage annual rates of return for the period covered by the bar graph; and

(iv) The pool operator must make available upon request to prospective and existing participants all supporting data necessary to calculate monthly rates of return for the offered pool as specified in § 4.25(a)(7), for the period specified in § 4.25(a)(5).

(3) *Additional requirements with respect to pools other than the offered pool.* With respect to pools other than the offered pool for which past performance is required to be presented under this section:

(i) Performance data for pools of the same class as the offered pool must be presented following the performance of the offered pool, on a pool-by-pool basis.

(ii) Pools of a different class than the offered pool must be presented less prominently and, unless such presentation would be misleading, may be presented in composite form: *Provided, however,* that:

(A) The Disclosure Document must disclose how the composite was developed;

(B) Pools of different classes or pools with materially different rates of return may not be presented in the same composite.

(iii) For the purpose of § 4.25(a)(3)(ii), the following, without limitation, shall be considered pools of different classes: Pools privately offered pursuant to section 4(2) of the Securities Act of 1933, as amended (15 U.S.C. 77d(2)), or pursuant to Regulation D thereunder (17 CFR 230.501 *et seq.*), and public offerings; and principal-protected and non-principal-protected pools. Multi-advisor pools as defined in § 4.10(d)(2) will be presumed to have materially different rates of return from those of non-multi-advisor pools absent evidence sufficient to demonstrate otherwise.

(iv) Material differences among the pools for which past performance is disclosed, including, without limitation, differences in leverage and use of different trading programs, must be described.

(4) *Additional requirements with respect to accounts.* (i) Unless such presentation would be misleading, past performance of accounts required to be presented under this section may be presented in composite form on a program-by-program basis using the format set forth in § 4.25(a)(1)(ii).

(ii) Accounts that differ materially with respect to rates of return may not be presented in the same composite.

(iii) The commodity pool operator must disclose all material differences among accounts included in a composite.

(5) *Time period for required performance.* All required performance information must be presented for the most recent five calendar years and year-to-date or for the life of the pool, account or trading program, if less than five years.

(6) *Trading programs.* If the offered pool will use any of the trading programs for which past performance is required to be presented, the Disclosure Document must so indicate.

(7) *Calculation of, and recordkeeping concerning, performance information.* (i) All performance information presented in a Disclosure Document, including performance information contained in any capsule and performance information not specifically required by Commission rules, must be current as of a date not more than three months preceding the date of the Document, and must be supported by the following amounts, calculated on an accrual basis of accounting in accordance with generally accepted accounting principles, as specified below or by a method otherwise approved by the Commission.

(A) The beginning net asset value for the period, which shall be the same as the previous period's ending net asset value;

(B) All additions, whether voluntary or involuntary, during the period;

(C) All withdrawals and redemptions, whether voluntary or involuntary, during the period;

(D) The net performance for the period, which shall represent the change in the net asset value net of additions, withdrawals, and redemptions;

(E) The ending net asset value for the period, which shall represent the beginning net asset value plus or minus additions, withdrawals, redemptions and net performance;

(F) The rate of return for the period, which shall be calculated by dividing the net performance by the beginning net asset value or by a method otherwise approved by the Commission; and

(G) The number of units outstanding at the end of the period, if applicable.

(ii) All supporting documents necessary to substantiate the computation of such amounts must be maintained in accordance with § 1.31.

(8) *Proprietary trading results.* (i) Proprietary trading results may not be included in a Disclosure Document unless such performance is prominently labeled as proprietary and is set forth separately after all disclosures in accordance with § 4.24(v), together with a discussion of any differences between such performance and the performance of the offered pool, including, but not limited to, differences in costs, leverage and trading methodology.

(ii) For the purposes of § 4.24(v) and this § 4.25(a), proprietary trading results means the performance of any pool or account in which fifty percent or more of the beneficial interest is owned or controlled by:

(A) The commodity pool operator, trading manager (if any), commodity trading advisor or any principal thereof

(B) An affiliate or family member of the commodity pool operator, trading manager (if any) or commodity trading advisor; or

(C) Any person providing services to the pool.

(9) *Required legend.* Any past performance presentation, whether or not required by Commission rules, must be preceded by the following statement, prominently displayed:

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

(b) *Performance disclosure when the offered pool has at least a three-year operating history.* The commodity pool operator must disclose the performance of the offered pool, in accordance with paragraphs (a)(1)(i) (A) through (H) and (a)(2) of this § 4.25, where:

(1) The offered pool has traded commodity interests for three years or more; and

(2) For at least such three-year period, seventy-five percent or more of the contributions to the pool were made by persons unaffiliated with the commodity pool operator, the trading manager (if any), the pool's commodity trading advisors, or the principals of any of the foregoing.

(c) *Performance disclosure when the offered pool has less than a three-year operating history.*—(1) *Offered pool performance.* (i) The commodity pool operator must disclose the performance of the offered pool, in accordance with paragraphs (a)(1)(i)(A) through (H) and (a)(2) of this § 4.25; or

(ii) If the offered pool has no operating history, the pool operator must prominently display the following statement:

THIS POOL HAS NOT COMMENCED TRADING AND DOES NOT HAVE ANY PERFORMANCE HISTORY.

(2) *Other performance of commodity pool operator.* (i)(A) Except as provided in § 4.25(a)(8), the commodity pool operator must disclose, for the period specified by § 4.25(a)(5), the performance of each other pool operated by the pool operator (and by the trading manager if the offered pool has a trading manager) in accordance with paragraphs (a)(1)(i) (C) through (H) and (a)(3) of this § 4.25, and the performance of each other account traded by the pool operator (and by the trading manager if the offered pool has a trading manager) in accordance with paragraphs (a)(1)(ii) (C) through (G) of this § 4.25. If the trading manager has been delegated complete authority for the offered pool's trading, and the trading manager's performance is not materially different from that of the pool operator, the performance of the other pools operated by and accounts traded by the pool operator is not required to be disclosed.

(B) In addition, if the pool operator, or if applicable, the trading manager, has not operated for at least three years any commodity pool in which seventy-five percent or more of the contributions to the pool were made by persons unaffiliated with the commodity pool operator, the trading manager, the pool's commodity trading advisors or their respective principals, the pool operator must also disclose the performance of each other pool operated by and account traded by the trading principals of the pool operator (and of the trading manager, as applicable) unless such performance does not differ in any material respect from the performance of the offered pool and the pool operator (and trading manager, if any) disclosed in the Disclosure Document.

(ii) If neither the pool operator or trading manager (if any), nor any of its trading principals has operated any other pools or traded any other accounts, the pool operator must prominently display the following statement: NEITHER THIS POOL OPERATOR (TRADING MANAGER, IF APPLICABLE) NOR ANY OF ITS TRADING PRINCIPALS HAS PREVIOUSLY OPERATED ANY OTHER POOLS OR TRADED ANY OTHER ACCOUNTS. If the commodity pool operator or trading manager, if applicable, is a sole proprietorship, reference to its trading principals may be deleted from the prescribed statement.

(3) *Major commodity trading advisor performance.* (i) The commodity pool operator must disclose the performance of any accounts (including pools) directed by a major commodity trading advisor in accordance with paragraphs (a)(1)(ii) (C) through (G) of this § 4.25.

(ii) If a major commodity trading advisor has not previously traded accounts, the pool operator must prominently display the following statement:

(name of the major commodity trading advisor). A COMMODITY TRADING ADVISOR THAT HAS DISCRETIONARY TRADING AUTHORITY OVER (percentage of the pool's funds available for commodity interest trading allocated to that trading advisor) PERCENT OF THE POOL'S FUTURES AND COMMODITY OPTION TRADING HAS NOT PREVIOUSLY DIRECTED ANY ACCOUNTS.

(4) *Major investee pool performance.* (i) The commodity pool operator must disclose the performance of any major investee pool.

(ii) If a major investee pool has not commenced trading, the pool operator must prominently display the following statement:

(name of the major investee pool), AN INVESTEE POOL THAT IS ALLOCATED (percentage of the pool assets allocated to that investee pool) PERCENT OF THE POOL'S ASSETS HAS NOT COMMENCED TRADING.

(5) *Other commodity trading advisor and investee pool performance.* With respect to commodity trading advisors and investee pools for which performance is not required to be disclosed pursuant to this § 4.25(c) (3) and (4), the pool operator must provide a summary description of the performance history of each of such advisors and pools, including:

(i) Monthly return parameters (highs and lows);

(ii) Historical volatility and degree of leverage; and

(iii) Any material differences between the performance of such advisors and pools as compared to that of the offered pool's major trading advisors and major investee pools.

§ 4.26 Use, amendment and filing of Disclosure Document.

(a)(1) Subject to paragraph (c) of this section, all information contained in the Disclosure Document must be current as of the date of the Document; *Provided, however,* that performance information may be current as of a date not more than three months prior to the date of the Document.

(2) No commodity pool operator may use a Disclosure Document dated more

than nine months prior to the date of its use.

(b) The commodity pool operator must attach to the Disclosure Document the most current Account Statement and Annual Report for the pool required to be distributed in accordance with § 4.22: *Provided, however*, that in lieu of the most current Account Statement the commodity pool operator may provide performance information for the pool current as of a date not more than sixty days prior to the date on which the Disclosure Document is distributed and covering the period since the most recent performance information contained in the Disclosure Document.

(c) (1) If the commodity pool operator knows or should know that the Disclosure Document is materially inaccurate or incomplete in any respect, it must correct that defect and must distribute the correction to:

(i) All existing pool participants within 21 calendar days of the date upon which the pool operator first knows or has reason to know of the defect; and

(ii) Each previously solicited prospective pool participant prior to accepting or receiving funds, securities or other property from any such prospective participant. The pool operator may furnish the correction by way of an amended Disclosure Document, a sticker on the Document, or other similar means.

(2) The pool operator may not use the Disclosure Document until such correction has been made.

(d) Except as provided by § 4.8:

(1) The commodity pool operator must file with the Commission two copies of the Disclosure Document for each pool that it operates or that it intends to operate not less than 21 calendar days prior to the date the pool operator first intends to deliver the Document to a prospective participant in the pool; and

(2) The commodity pool operator must file with the Commission two copies of all subsequent amendments to the Disclosure Document for each pool that it operates or that it intends to operate within 21 calendar days of the date upon which the pool operator first knows or has reason to know of the defect requiring the amendment.

Subpart C—Commodity Trading Advisors

15. Section 4.31 is revised to read as follows:

§ 4.31 Required delivery of Disclosure Document to prospective clients.

(a) No commodity trading advisor registered or required to be registered under the Act may solicit a prospective client, or enter into an agreement with a prospective client to direct the client's commodity interest account or to guide the client's commodity interest trading by means of a systematic program that recommends specific transactions, unless the commodity trading advisor, at or before the time it engages in the solicitation or enters into the agreement (whichever is earlier), delivers or causes to be delivered to the prospective client a Disclosure Document for the trading program pursuant to which the trading advisor seeks to direct the client's account or to guide the client's trading, containing the information set forth in §§ 4.34 and 4.35.

(b) The commodity trading advisor may not enter into an agreement with a prospective client to direct the client's commodity interest account or to guide the client's commodity interest trading unless the trading advisor first receives from the prospective client an acknowledgment signed and dated by the prospective client stating that the client received a Disclosure Document for the trading program pursuant to which the trading advisor will direct his account or will guide his trading.

16. Section 4.32 is redesignated Section 4.33, and amended by revising paragraph (a)(2) to read as follows:

§ 4.33 Recordkeeping.

* * * * *

(a) * * *

(2) The acknowledgement specified in § 4.31(b).

* * * * *

§ 4.32 [Reserved]

17. Section 4.32 is added and reserved.

18. Sections 4.34, 4.35 and 4.36 are added to read as follows:

§ 4.34 General disclosures required.

Except as otherwise provided herein, a Disclosure Document must include the following information.

(a) *Cautionary Statement*. The following Cautionary Statement must be prominently displayed on the cover page of the Disclosure Document:

THE COMMODITY FUTURES TRADING COMMISSION HAS NOT PASSED UPON THE MERITS OF PARTICIPATING IN THIS TRADING PROGRAM NOR HAS THE COMMISSION PASSED ON THE ADEQUACY OR ACCURACY OF THIS DISCLOSURE DOCUMENT.

(b) *Risk Disclosure Statement*. (1) The following Risk Disclosure Statement must be prominently displayed immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission, by any applicable federal or state securities laws and regulations or by any applicable laws of non-United States jurisdictions:

RISK DISCLOSURE STATEMENT

THE RISK OF LOSS IN TRADING COMMODITIES CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. IN CONSIDERING WHETHER TO TRADE OR TO AUTHORIZE SOMEONE ELSE TO TRADE FOR YOU, YOU SHOULD BE AWARE OF THE FOLLOWING:

IF YOU PURCHASE A COMMODITY OPTION YOU MAY SUSTAIN A TOTAL LOSS OF THE PREMIUM AND OF ALL TRANSACTION COSTS.

IF YOU PURCHASE OR SELL A COMMODITY FUTURE OR SELL A COMMODITY OPTION YOU MAY SUSTAIN A TOTAL LOSS OF THE INITIAL MARGIN FUNDS AND ANY ADDITIONAL FUNDS THAT YOU DEPOSIT WITH YOUR BROKER TO ESTABLISH OR MAINTAIN YOUR POSITION. IF THE MARKET MOVES AGAINST YOUR POSITION, YOU MAY BE CALLED UPON BY YOUR BROKER TO DEPOSIT A SUBSTANTIAL AMOUNT OF ADDITIONAL MARGIN FUNDS, ON SHORT NOTICE, IN ORDER TO MAINTAIN YOUR POSITION. IF YOU DO NOT PROVIDE THE REQUESTED FUNDS WITHIN THE PRESCRIBED TIME, YOUR POSITION MAY BE LIQUIDATED AT A LOSS, AND YOU WILL BE LIABLE FOR ANY RESULTING DEFICIT IN YOUR ACCOUNT.

UNDER CERTAIN MARKET CONDITIONS, YOU MAY FIND IT DIFFICULT OR IMPOSSIBLE TO LIQUIDATE A POSITION. THIS CAN OCCUR, FOR EXAMPLE, WHEN THE MARKET MAKES A "LIMIT MOVE."

THE PLACEMENT OF CONTINGENT ORDERS BY YOU OR YOUR TRADING ADVISOR, SUCH AS A "STOP-LOSS" OR "STOP-LIMIT" ORDER, WILL NOT NECESSARILY LIMIT YOUR LOSSES TO THE INTENDED AMOUNTS, SINCE MARKET CONDITIONS MAY MAKE IT IMPOSSIBLE TO EXECUTE SUCH ORDERS.

A "SPREAD" POSITION MAY NOT BE LESS RISKY THAN A SIMPLE "LONG" OR "SHORT" POSITION.

THE HIGH DEGREE OF LEVERAGE THAT IS OFTEN OBTAINABLE IN COMMODITY TRADING CAN WORK AGAINST YOU AS WELL AS FOR YOU. THE USE OF LEVERAGE CAN LEAD TO LARGE LOSSES AS WELL AS GAINS.

IN SOME CASES, MANAGED COMMODITY ACCOUNTS ARE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT AND ADVISORY FEES. IT MAY BE NECESSARY FOR THOSE ACCOUNTS THAT ARE SUBJECT TO THESE CHARGES TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETION OR EXHAUSTION OF THEIR ASSETS. THIS DISCLOSURE DOCUMENT CONTAINS, AT PAGE (Insert page number), A COMPLETE DESCRIPTION OF EACH FEE TO BE CHARGED TO YOUR ACCOUNT BY THE COMMODITY TRADING ADVISOR.

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND OTHER

SIGNIFICANT ASPECTS OF THE COMMODITY MARKETS. YOU SHOULD THEREFORE CAREFULLY STUDY THIS DISCLOSURE DOCUMENT AND COMMODITY TRADING BEFORE,YOU TRADE, INCLUDING THE DESCRIPTION OF THE PRINCIPAL RISK FACTORS OF THIS INVESTMENT, AT PAGE (insert page number).

(2) If the commodity trading advisor may trade *foreign* futures or options contracts pursuant to the offered trading program, the Risk Disclosure Statement must further state the following:

YOU SHOULD ALSO BE AWARE THAT THIS COMMODITY TRADING ADVISOR MAY ENGAGE IN TRADING FOREIGN FUTURES OR OPTIONS CONTRACTS. TRANSACTIONS ON MARKETS LOCATED OUTSIDE THE UNITED STATES, INCLUDING MARKETS FORMALLY LINKED TO A UNITED STATES MARKET MAY BE SUBJECT TO REGULATIONS WHICH OFFER DIFFERENT OR DIMINISHED PROTECTION. FURTHER, UNITED STATES REGULATORY AUTHORITIES MAY BE UNABLE TO COMPEL THE ENFORCEMENT OF THE RULES OF REGULATORY AUTHORITIES OR MARKETS IN NON-UNITED STATES JURISDICTIONS WHERE YOUR TRANSACTIONS MAY BE EFFECTED. BEFORE YOU TRADE YOU SHOULD INQUIRE ABOUT ANY RULES RELEVANT TO YOUR PARTICULAR CONTEMPLATED TRANSACTIONS AND ASK THE FIRM WITH WHICH YOU INTEND TO TRADE FOR DETAILS ABOUT THE TYPES OF REDRESS AVAILABLE IN BOTH YOUR LOCAL AND OTHER RELEVANT JURISDICTIONS.

(3) If the commodity trading advisor is not also a registered futures commission merchant, the trading advisor must make the additional following statement in the Risk Disclosure Statement, to be included as the last paragraph thereof:

THIS COMMODITY TRADING ADVISOR IS PROHIBITED BY LAW FROM ACCEPTING FUNDS IN THE TRADING ADVISOR'S NAME FROM A CLIENT FOR TRADING COMMODITY INTERESTS. YOU MUST PLACE ALL FUNDS FOR TRADING IN THIS TRADING PROGRAM DIRECTLY WITH A FUTURES COMMISSION MERCHANT.

(c) *Table of contents.* A table of contents showing, by subject matter, the location of the disclosures made in the Disclosure Document, must appear immediately following the Risk Disclosure Statement.

(d) *Information required in the forepart of the Disclosure Document.* (1) The name, address of the main business office, main business telephone number and form of organization of the commodity trading advisor. If the mailing address of the main business office is a post office box number or is not within the United States, its territories or possessions, the trading advisor must state where its books and records will be kept and made available for inspection; and

(2) The date when the commodity trading advisor first intends to use the Disclosure Document.

(e) *Persons to be identified.* The names of the following persons:

(1) Each principal of the trading advisor;

(2) The futures commission merchant with which the commodity trading advisor will require the client to maintain its account or, if the client is free to choose the futures commission merchant with which it will maintain its account, the trading advisor must make a statement to that effect; and

(3) The introducing broker through which the commodity trading advisor will require the client to introduce its account or, if the client is free to choose the introducing broker through which it will introduce its account, the trading advisor must make a statement to that effect.

(f) *Business background.* (1) The business background, for the five years preceding the date of the Disclosure Document, of:

(i) The commodity trading advisor; and

(ii) Each principal of the trading advisor who participates in making trading or operational decisions for the trading advisor or supervises persons so engaged, including, without limitation, the trading advisor's officers and directors.

(2) The trading advisor must include in the description of the business background of each person identified in § 4.34(f)(1) the name and main business of that person's employers, business associations or business ventures and the nature of the duties performed by such person for such employers or in connection with such business associations or business ventures. The location in the Disclosure Document of any required past performance disclosure for such person must be indicated.

(g) *Principal risk factors.* A discussion of the principal risk factors of this trading program. This discussion must include, without limitation, risks due to volatility, leverage, liquidity, and counterparty creditworthiness, as applicable to the trading program and the types of transactions and investment activity expected to be engaged in pursuant to such program.

(h) *Trading program.* A description of the trading program, which must include the types of commodity interests and other interests the commodity trading advisor intends to trade, with a description of any restrictions or limitations on such trading established by the trading advisor or otherwise.

(i) *Fees.* A complete description of each fee which the commodity trading advisor will charge the client.

(1) Wherever possible, the trading advisor must specify the dollar amount of each such fee.

(2) Where any fee is determined by reference to a base amount including, but not limited to, "net assets," "gross profits," "net profits" or "net gains," the trading advisor must explain how such base amount will be calculated.

(3) Where any fee is based on an increase in the value of the client's commodity interest account, the trading advisor must specify how that increase is calculated, the period of time during which the increase is calculated, the fee to be charged at the end of that period and the value of the account at which payment of the fee commences.

(j) *Conflicts of interest.* (1) A full description of any actual or potential conflicts of interest regarding any aspect of the trading program on the part of:

(i) The commodity trading advisor;

(ii) Any futures commission merchant with which the client will be required to maintain its commodity interest account;

(iii) Any introducing broker through which the client will be required to introduce its account to a futures commission merchant; and

(iv) Any principal of the foregoing.

(2) Any other material conflict involving any aspect of the offered trading program.

(3) Included in the description of any such conflict must be any arrangement whereby the trading advisor or any principal thereof may benefit, directly or indirectly, from the maintenance of the client's commodity interest account with a futures commission merchant or the introduction of such account through an introducing broker (such as payment for order flow or soft dollar arrangements).

(k) *Litigation.* (1) Subject to the provisions of § 4.34(k)(2), any material administrative, civil or criminal action, whether pending or concluded, within five years preceding the date of the Document, against any of the following persons; *Provided, however*, that a concluded action that resulted in an adjudication on the merits in favor of such person need not be disclosed:

(i) The commodity trading advisor and any principal thereof;

(ii) Any futures commission merchant with which the client will be required to maintain its commodity interest account; and

(iii) Any introducing broker through which the client will be required to introduce its account to the futures commission merchant.

(2) With respect to a futures commission merchant or an introducing broker, an action will be considered material if:

(i) The action would be required to be disclosed in the notes to the futures commission merchant's or introducing broker's financial statements prepared pursuant to generally accepted accounting principles;

(ii) The action was brought by the Commission; *Provided, however,* that a concluded action that did not result in civil monetary penalties exceeding $50,000 need not be disclosed unless it involved allegations of fraud or other willful misconduct; or

(iii) The action was brought by any other federal or state regulatory agency, a non-United States regulatory agency or a self-regulatory organization and involved allegations of fraud or other willful misconduct.

(l) *Trading for own account.* If the commodity trading advisor or any principal thereof trades or intends to trade commodity interests for its own account, the trading advisor must disclose whether clients will be permitted to inspect the records of such person's trading and any written policies related to such trading.

(m) *Performance disclosures.* Past performance must be disclosed as set forth in § 4.35.

(n) *Supplemental information.* If any information, other than that required by Commission rules, the antifraud provisions of the Act, other federal or state laws and regulations, any rules of a self-regulatory agency or laws of a non-United States jurisdiction, is provided, such information:

(1) May not be misleading in content or presentation or inconsistent with the required disclosures;

(2) Is subject to the antifraud provisions of the Act and Commission rules, and to rules regarding the use of promotional material promulgated by a registered futures association pursuant to section 17(j) of the Act; and

(3) Must be placed as follows, unless otherwise specified by Commission rules:

(i) Supplemental performance information (not including proprietary trading results as defined in § 4.35(a)(7), or hypothetical, extracted, pro forma or simulated trading results) must be placed after all required performance information;

(ii) Supplemental non-performance information relating to a required disclosure may be included with the related required disclosure; and

(iii) Other supplemental information may be included after all required disclosures: *Provided, however,* That any proprietary trading results as defined in § 4.35(a)(7), and any hypothetical, extracted, pro forma or simulated trading results included in the Disclosure Document must appear as the last disclosure therein following all required and non-required disclosures.

(o) *Material information.* Nothing set forth in §§ 4.31, 4.34, 4.35 or § 4.36 shall relieve a commodity trading advisor from any obligation under the Act or the regulations thereunder, including the obligation to disclose all material information to existing or prospective clients even if the information is not specifically required by such sections.

§ 4.35 Performance disclosures.

(a) *General principles.*—(1) *Capsule performance information.* Unless otherwise specified, disclosure of the past performance of an account or trading program required under this § 4.35 must include the following information:

(i) The name of the commodity trading advisor or other person trading the account and the name of the trading program;

(ii) The date on which the commodity trading advisor or other person trading the account began trading client accounts and the date when client funds began being traded pursuant to the trading program;

(iii) The number of accounts directed by the trading advisor or other person trading the account pursuant to the trading program specified, as of the date of the Disclosure Document;

(iv)(A) The total assets under the management of the trading advisor or other person trading the account, as of the date of the Disclosure Document; and

(B) The total assets traded pursuant to the trading program specified, as of the date of the Disclosure Document;

(v) The largest monthly draw-down for the account or trading program specified during the most recent five calendar year and year-to-date expressed as a percentage of client funds and indicating the month and year of the draw-down (the capsule must include a definition of "draw-down" that is consistent with § 4.10(k));

(vi) The worst peak-to-valley draw-down for the trading program specified during the most recent five calendar year and year-to-date, expressed as a percentage of net asset value and indicating the months and year of the draw-down;

(vii) Subject to § 4.35(a)(2) for the offered trading program, the annual and year-to-date rate-of-return for the program specified for the five most recent calendar years and year-to-date, computed on a compounded monthly basis; *Provided, however,* That performance of the offered trading program must include monthly rates of return for such period; and

(viii) In the case of the offered trading program:

(A) The number of accounts traded pursuant to the offered trading program that were closed during the period specified in § 4.35(a)(5) with positive net performance (profits) as of the date the account was closed; and

(B) The number of accounts traded pursuant to the offered trading program that were closed during the period specified in § 4.35(a)(5) with negative net performance (losses) as of the date the account was closed.

(2) *Additional requirements with respect to the offered trading program.* (i) The performance of the offered trading program must be identified as such and separately presented first;

(ii) The rate of return of the offered trading program must be presented on a monthly basis for the period specified in § 4.35(a)(5), either in a numerical table or in a bar graph;

(iii) A bar graph used to present monthly rates of return for the offered trading program:

(A) Must show percentage rate of return on the vertical axis and one-month increments on the horizontal axis;

(B) Must be scaled in such a way as to clearly show month-to-month differences in rates of return; and

(C) Must separately display numerical percentage annual rates of return for the period covered by the bar graph; and

(iv) The commodity trading advisor must make available to prospective and existing clients upon request a table showing at least quarterly the information required to be calculated pursuant to § 4.35(a)(6).

(3) *Composite presentation.* (i) Unless such presentation would be misleading, the performance of accounts traded pursuant to the same trading program may be presented in composite form on a program-by-program basis, using the format set forth in § 4.35(a)(1).

(ii) Accounts that differ materially with respect to rates of return may not be presented in the same composite.

(iii) The commodity trading advisor must discuss all material differences among the accounts included in a composite.

(4) *Current information.* All performance information presented in the Disclosure Document must be current as of a date not more than three months preceding the date of the Document.

(5) *Time period for required performance.* All required performance information must be presented for the most recent five calendar years and year-to-date or for the life of the trading program or account, if less than five years.

(6) *Calculation of, and recordkeeping concerning, performance information.* (i) All performance information presented in a Disclosure Document, including performance information contained in any capsule and performance information not specifically required by Commission rules, must be current as of a date not more than three months preceding the date of the Document, and must be supported by the following amounts, calculated on an accrual basis of accounting in accordance with generally accepted accounting principles, as specified below or by a method otherwise approved by the Commission.

(A) The beginning net asset value for the period, which shall represent the previous period's ending net asset value;

(B) All additions, whether voluntary or involuntary, during the period;

(C) All withdrawals and redemptions, whether voluntary or involuntary, during the period;

(D) The net performance for the period, which shall represent the change in the net asset value net of additions, withdrawals, redemptions, fees and expenses;

(E) The ending net asset value for the period, which shall represent the beginning net asset value plus or minus additions, withdrawals and redemptions, and net performance; and

(F) The rate of return for the period, computed on a compounded monthly basis, which shall be calculated by dividing the net performance by the beginning net asset value.

(ii) All supporting documents necessary to substantiate the computation of such amounts must be maintained in accordance with § 1.31.

(7) *Proprietary trading results.* (i) Proprietary trading results shall not be included in a Disclosure Document unless such performance is prominently labeled as proprietary and is set forth separately after all disclosures in accordance with § 4.34(n), together with a discussion of any differences between such performance and the performance of the offered trading program, including, but not limited to, differences in costs, leverage and trading.

(ii) For the purposes of § 4.34(n) and this § 4.35(a), proprietary trading results means the performance of any account in which fifty percent or more of the beneficial interest is owned or controlled by:

(A) The commodity trading advisor or any of its principals;

(B) An affiliate or family member of the commodity trading advisor; or

(C) Any person providing services to the account.

(8) *Required legend.* Any past performance presentation, whether or not required by Commission rules, must be preceded with the following statement, prominently displayed:

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

(b) *Performance to be disclosed.* Except as provided in § 4.35(a)(7), the commodity trading advisor must disclose the actual performance of all accounts directed by the commodity trading advisor and by each of its trading principals; *Provided, however,* that if the trading advisor or its trading principals previously have not directed any accounts, the trading advisor must prominently disclose this fact with one of the following statements, as applicable:

(1) THIS TRADING ADVISOR PREVIOUSLY HAS NOT DIRECTED ANY ACCOUNTS; or

(2) NONE OF THE TRADING PRINCIPALS OF THIS TRADING ADVISOR HAS PREVIOUSLY DIRECTED ANY ACCOUNTS; or

(3) NEITHER THIS TRADING ADVISOR NOR ANY OF ITS TRADING PRINCIPALS HAVE PREVIOUSLY DIRECTED ANY ACCOUNTS. If the commodity trading advisor is a sole proprietorship, reference to its trading principals need not be included in the prescribed statement.

§ 4.36 Use, amendment and filing of Disclosure Document.

(a) Subject to paragraph (c) of this section, all information contained in the Disclosure Document must be current as of the date of the Document; *Provided, however,* that performance information must be current as of a date not more than three months preceding the date of the Document.

(b) No commodity trading advisor may use a Disclosure Document dated more than nine months prior to the date of its use.

(c)(1) If the commodity trading advisor knows or should know that the Disclosure Document is materially inaccurate or incomplete in any respect, it must correct that defect and must distribute the correction to:

(i) All existing clients in the trading program within 21 calendar days of the date upon which the trading advisor first knows or has reason to know of the defect; and

(ii) Each previously solicited prospective client for the trading program prior to entering into an agreement to direct or to guide such prospective client's commodity interest account pursuant to the program. The trading advisor may furnish the correction by way of an amended Disclosure Document, a sticker on the Document, or other similar means.

(2) The trading advisor may not use the Disclosure Document until such correction is made.

(d) (1) The trading advisor must file with the Commission two copies of the Disclosure Document for each trading program that it offers or that it intends to offer not less than 21 calendar days prior to the date the trading advisor first intends to deliver the Document to a prospective client in the trading program.

(2) The commodity trading advisor must file with the Commission two copies of all subsequent amendments to the Disclosure Document for each trading program that it offers or that it intends to offer within 21 calendar days of the date upon which the trading advisor first knows or has reason to know of the defect requiring the amendment.

Subpart D—Advertising

19. Section 4.41 is amended by revising paragraph (b)(1) to read as follows:

§ 4.41 Advertising by commodity pool operators, commodity trading advisors, and the principals thereof.

* * * * *

(b) (1) No person may present the performance of any simulated or hypothetical commodity interest account, transaction in a commodity interest or series of transactions in a commodity interest of a commodity pool operator, commodity trading advisor, or any principal thereof, unless such performance is accompanied by one of the following:

(i) The following statement: "Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under- or over-compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown;" or

(ii) A statement prescribed pursuant to rules promulgated by a registered futures association pursuant to section 17(j) of the Act.

* * * * *

PART 30—FOREIGN FUTURES AND FOREIGN OPTIONS TRANSACTIONS

20. The authority citation for part 30 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 4, 6, 6c, and 12a.

21. Section 30.6 is amended by revising paragraphs (b)(1) and (b)(2) to read as follows:

§ 30.6 Disclosure.

* * * * *

(b) *Commodity pool operators and commodity trading advisors.* (1) No commodity pool operator registered or required to be registered under this part, or exempt from registration pursuant to § 30.5 of this part, may, directly or indirectly, solicit, accept or receive funds, securities or other property from a prospective participant in a foreign pool that it operates or that it intends to operate or, in the case of a commodity trading advisor, no commodity trading advisor registered or required to be registered under this part, or exempt from registration pursuant to § 30.5 of this part, may solicit or enter into an agreement with a prospective client to direct or to guide the client's foreign commodity interest trading by means of a systematic program that recommends specific transactions, unless the commodity pool operator or commodity trading advisor, at or before the time it engages in such activities, first provides each prospective participant or client with the Risk Disclosure Statement set forth in § 4.24(b) in the case of a commodity pool operator or § 4.34(b) in the case of a commodity trading advisor.

(2) The disclosure statement required to be provided in paragraph (b)(1) of this section may be given as a separate document or, if part of the Disclosure Document required to be furnished customers or potential customers pursuant to § 4.21 or § 4.31 of this chapter, must be prominently disclosed immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission or any applicable federal or state securities laws and regulations.

* * * * *

PART 150—LIMITS ON POSITIONS

22. The authority citation for part 150 continues to read as follows:

Authority: 7 U.S.C. 6a, 6c and 12a(5)(1988).

23. Section 150.3 is amended by revising paragraph (a)(4)(i)(D) to read as follows:

§ 150.3 Exemptions.

(a) * * *

(4) * * *

(i) * * *

(D) Solicit funds for such trading by separate Disclosure Documents that meet the standards of § 4.24 or § 4.34 of this chapter, as applicable, where such Disclosure Documents are required under part 4 of this chapter.

* * * * *

Issued in Washington, DC, on July 14, 1995, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 95-17871 Filed 7-24-95; 8:45 am]

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TAC 7/17

NFA NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

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SECRETARIAT

July 13, 1999

Ms. Jean A. Webb
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Resubmission of Petition for Rulemaking to Amend CFTC Regulations 4.13 and 4.14

Dear Ms. Webb:

By letter dated June 5, 1998, National Futures Association ("NFA") petitioned the Commission under CFTC Regulation 13.2 to amend CFTC Regulations 4.13 and 4.14. NFA hereby withdraws that petition and resubmits the petition as set forth herein.

NFA petitions the Commission to amend Regulation 4.13 to exempt managers of collective investment vehicles from commodity pool operator ("CPO") registration if they operate only vehicles that do a *de minimis* amount of futures transactions. NFA also petitions the Commission to amend CFTC Regulation 4.14 to provide a similar exemption from commodity trading advisor ("CTA") registration for persons who provide their trading advice solely to these vehicles and to collective investment vehicles described in CFTC Regulation 4.5. This proposal provides significant regulatory benefits to the Commission because it allows both the Commission and NFA to focus their resources on those entities that are marketed to the public as vehicles for futures trading. The proposal is also consistent with the recent recommendations of the President's Working Group concerning hedge funds.

The information required by CFTC Regulation 13.2 follows.

I. TEXT OF PROPOSED AMENDMENTS

PART 4 — COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

§ 4.13 Exemption from registration as a commodity pool operator

(a) A person is not required to register under the Act as a commodity pool operator if:

* * *

(3)(i) It operates only commodity pools that use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1); *Provided, however,* That in addition, with respect to positions in commodity futures and commodity option contracts which do not come within the meaning and intent of § 1.3(z)(1), the aggregate initial margin and premiums required to establish such positions for any pool does not exceed one percent of the liquidation value of that pool's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into and such trading is solely incidental to its other trading activity; And *Provided further,* That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such one percent;

(ii) It has not and does not market participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets;

(iii) It limits the participants in its pools to accredited investors as defined in Securities Exchange Commission Rule 501;

(iv) It discloses in writing to each prospective participant the purpose of and the limitations on the scope of the commodity futures and commodity options trading in which the pool will engage;

(v) It submits to such special calls as the Commission may make to require it to demonstrate compliance with the provisions of this § 4.13(a)(3) including but not limited to information on its pools' financial status and position holdings; and

(vi) It maintains all books and records prepared in connection with its activities as a commodity pool operator for a period of five years from the date of preparation and keeps such books and records readily accessible during the first two years of the five year period. All such books and records shall be open to inspection by any representative of the Commission or the United States Department of Justice.

(b)(1) No person who is exempt from registration as a commodity pool operator under paragraph (a)(1), (a)(2), or (a)(3) of this section and who is not registered as such pursuant to that exemption may, directly or indirectly, solicit, accept or receive funds, securities or other property from any prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the person delivers or causes to be delivered to the prospective participant a written statement that must disclose this fact as follows: "The commodity pool operator of this pool is not required to register, and has not registered, with the Commodity Futures Trading Commission. Therefore, unlike a registered commodity pool operator, this commodity pool operator is not required by the Commission to furnish a Disclosure Document, periodic Account Statements, and an Annual Report to participants in the pool." The person must:

(i) Describe in the statement the exemption pursuant to which it is not registered as a commodity pool operator;

(ii) Provide its name, main business address and main business telephone number on the statement;

(iii) Manually sign the statement as follows: if such person is a corporation, by the chief executive officer, chief financial officer or counterpart thereto; if a partnership, by a general partner; and if a sole proprietorship, by the sole proprietor; and

(iv) By the earlier of seven business days after the date the statement is first delivered to a prospective participant and the date upon which the pool commences trading in commodity interests:

(A) File two copies of the statement with the Commission at the address specified in § 4.2; and

(B) File one copy of the statement with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department).

* * *

(d) If a person exempt from registration under the Act as a commodity pool operator under paragraph (a)(1), (a)(2), or (a)(3) of this section registers as a commodity pool operator, that person must comply with this Part 4 as if such person were not exempt from registration as a commodity pool operator.

§ 4.14 Exemption from registration as a commodity trading advisor

(a) A person is not required to register under the Act as a commodity trading advisor if:

* * *

(9)(i) The person's commodity interest trading advice:

(A) Is directed solely to and for the use of commodity pools that meet the requirements of and are operated by a person exempt from registration under § 4.13(a)(3) or are operated by a person excluded from the definition of commodity pool operator under § 4.5;

(B) Is solely incidental to its business of providing investment advice to such pools in instruments that are either exempt from regulation pursuant to the Commission's regulations or excluded from Commission regulation under the Act; and

(C) Employs only such strategies as are consistent with eligibility status under § 4.13(a)(3).

(ii) The person is not otherwise holding itself out as a commodity trading advisor;

(iii) The person submits to such special calls as the Commission may make to provide information on its position holdings; and

(iv) Prior to the date upon which such person intends to engage in business as a commodity trading advisor, the person files a notice of exemption with the Commission.

(A) The notice must provide the name, main business address, and main business telephone number of the person filing the notice.

(B) The notice must represent that the person qualifies for exemption under this § 4.14(a)(9) and that it will comply with the criteria of this section.

(C) The notice shall be effective upon filing, *Provided, however,* That an exemption claimed hereunder shall cease to be effective upon any change which would render the representations made pursuant to paragraph (a)(9)((iii)(B) of this section inaccurate or the continuation of such representations false or misleading.

(v) In the event a person who has filed a notice of exemption under this § 4.14(a)(9) subsequently becomes registered as a commodity trading advisor, the person must file a supplemental notice of that fact.

(vi) Any notice required to be filed hereunder must be:

(A) In writing;

(B) Signed by a duly authorized representative; and

(C) Filed, along with a copy, with the Commission at the address specified in § 4.2.

(D) A copy also must be filed with the National Futures Association at its headquarters office (ATTN: Director of Compliance, Compliance Department).

II. NATURE OF NFA'S INTEREST

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. Registered CPOs and registered CTAs who manage futures accounts are required to be Members of NFA and are regulated by NFA. Therefore, NFA is interested in ensuring that CPOs and CTAs are regulated in the most efficient and effective manner. NFA believes that the proposed *de minimis* exemption furthers this goal.

III. SUPPORTING ARGUMENTS

NFA's Board of Directors, at the recommendation of the Special Committee for the Review of a Multi-Tiered Regulatory Approach, petitions the Commission to amend its rules to adopt an exemption from CPO registration for managers of collective investment vehicles that do a *de minimis* amount of futures transactions and do not hold themselves out as commodity pools. The exemption would apply to CPOs of hedge funds and other collective investment vehicles that do not commit more than 1% of the liquidation value of their portfolios to initial margin and premiums for commodity futures or options transactions that are not hedging transactions and only if those non-hedge transactions are solely incidental to the vehicle's other trading activity. Furthermore, the investment vehicle must limit participation to accredited investors.

The collective investment vehicles covered by the proposed exemption are not sold to the public as commodity pools, and investors do not invest in them as a means of investing in the futures markets. Since the managers of these vehicles are currently required to be registered, however, they are required to be Members of NFA and are regulated and audited by NFA. By exempting these managers from registration, they would no longer be required to be Members of NFA. This would free up NFA's resources for regulating and auditing firms that are more directly involved in the futures markets.

CFTC Regulation 4.5 excludes investment companies, insurance companies, banks and trust companies, and fiduciaries of ERISA plans from the definition of commodity pool operator. The Special Committee considered whether to take this same approach and recommend that § 4.5 be amended to exclude hedge fund managers from the definition of commodity pool operator. The Special Committee decided, however, to recommend that the Commission take a middle ground and amend § 4.13 to merely exempt these managers from CPO registration.

An exclusion from the definition of commodity pool operator is a complete exemption from all of the provisions of the Act that apply to CPOs, including the anti-fraud provisions. An exemption from registration under § 4.13, on the other hand, does not exempt the CPO from the anti-fraud provisions of the Act. Since the proposed *de minimis* exemption will apply to persons who manage unregulated hedge funds, the Special Committee felt that the anti-fraud protections of the Act should apply.

In drafting the exemption, the Special Committee generally followed the language of § 4.5(c)(2), except that it tried to make the language consistent with the current § 4.13 exemptions by making the requirements self-executing rather than requiring the pool operator to provide representations that it will comply with them. As with the other § 4.13 exemptions, the CPO would also be required to notify participants, the Commission, and NFA that it is an exempt pool; to maintain its books and records for five years and make them available to the Commission and the Department of Justice; and to comply with Part 4 if it decides to register in spite of the exemption. The CPO would not, however, be required to provide participants with FCM brokerage statements since this information would not be particularly helpful to investors. Information on hedge transactions is unenlightening without corresponding information for the transactions being hedged, and other futures transactions will be merely a blip on the radar screen compared to the fund's overall investments. Finally, the exempt pool must submit to special calls from the Commission for financial and position information.

The Board of Directors, at the Special Committee's recommendation, is also petitioning the Commission to amend CFTC Regulaton 4.14 to exempt trading advisors who provide commodity trading advice only to pools subject to the proposed *de minimis* exemption and to § 4.5 entities. The language generally tracks § 4.14(a)(8), which exempts trading advisors for § 4.5 entities. The Special Committee did broaden the "solely incidental" requirement to allow exempt CTAs to provide investment advice for all types of instruments that are not regulated by the CFTC rather than simply to provide investment advice concerning securities. The exemption also requires the exempt CTA to submit to special calls from the Commission for position information.

The proposed exemptions are consistent with the recommendations of the President's Working Group on Financial Markets. In particular, the President's Working Group recommended that hedge funds be required to disclose certain information to the public. The President's Working Group recommended that all CPOs that exceed a particular size be required to file quarterly financial reports instead of annual reports and that the reports filed by CPOs include more meaningful and comprehensive measures of market risk. The proposed exemptions require the exempt CPOs to submit to special calls by the Commission, which would allow the Commission to request the information the President's Working Group recommended disclosing as well as any other information the Commission considers helpful.

NFA respectfully petitions the Commission to amend Regulations 4.13 and 4.14 as described above.

Respectfully submitted,

Daniel J. Roth
General Counsel

ckm/sub/petition re de minimis 0699)

cc: Acting Chairman David D. Spears
Commissioner Barbara Pedersen Holum
Commissioner James E. Newsome
Commissioner Thomas J. Erickson
I. Michael Greenberger, Esq.
Alan L. Seifert, Esq.
Lawrence B. Patent, Esq.
David Van Wagner, Esq.
Riva Spear Adriance, Esq.

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
Facsimile: (202) 418-5521

October 11, 2001

Arthur F. Bell, Jr.
Arthur F. Bell, Jr. & Associates, L.L.C.
Suite 200, 201 International Circle
Hunt Valley, Maryland 21030

Re: Petition for Rulemaking -- CFTC Rule 4.22(c)(2)(ii) and Part 160

Dear Mr. Bell:

This letter acknowledges your letter to John C. Lawton and Jean A. Webb, dated August 17, 2001. Because that letter is also titled a "Petition Under 17 CFR Part 13", it is governed by Rule 13.2, which governs petitions for issuance, amendment, or repeal of a rule.[1]

Your petition suggests that there is a conflict between CFTC Rule 4.22(c)(2)(ii), which requires that operators of capital account commodity pools include in an annual report to each participant the total value of the participant's interest in the pool as of the pool's two preceding fiscal year end dates, and the Commission's recently promulgated rules concerning disclosure by futures firms of nonpublic personal information about their customers. For the reasons set forth below, the Commission disagrees and, accordingly, denies your petition for rulemaking. However, as discussed below, the Commission believes that rulemaking is unnecessary because it agrees with your alternative request for confirmation that capital account balances of pool participants may be presented without identifying participants by name.

A. The Commission's Consumer Privacy Rules

The consumer privacy legislation, as originally adopted (Section 509(3)(B) of Title V of the Gramm-Leach-Bliley Act, hereafter "GLB"), specifically excluded "persons or entities" subject to Commission jurisdiction from the coverage of GLB. This exclusion was eliminated with the enactment of the Commodity Futures Modernization Act of 2000 ("CFMA") on December 21, 2000.[2] Under Section 124 of the CFMA, Congress amended the Commodity Exchange Act ("CEA") to add a new Section 5g to the CEA to include the Commission and certain financial institutions subject to its jurisdiction within the coverage of Title V of GLB. That section of the CFMA makes the Commission a "federal functional regulator" for purposes

[1] 17 C.F.R. §13.2 (2001).

[2] Pub L. No. 106-554, 114 Stat. 2763 (2000), amending 7 U.S.C. §1 et seq.

of Title V and mandates that it promulgate consumer privacy rules for certain entities subject to its jurisdiction. These entities are: (1) futures commission merchants ("FCMs"), (2) commodity trading advisors ("CTAs"), (3) commodity pool operators ("CPOs"), and (4) introducing brokers ("IBs").

On April 27, 2001, the Commission published final rules relating to consumer privacy, which are modeled upon the rules published by the other federal functional regulators,[3] with a compliance date of March 31, 2002.[4] As you know, the Commission's rules prohibit FCMs, CTAs, CPOs, and IBs from disclosing nonpublic personal information about consumers to unaffiliated third parties unless they provide consumers with a mechanism to object to such disclosure, or the disclosure fits within one of the exceptions to the "opt-out" requirement.

B. Rule 4.22(c)(2)(ii)

Rule 4.22(c)(2)(ii) requires CPOs to provide separately, to each participant of a pool, a statement of the participant's interest in the pool. In a capital account pool, a participant's interest equals the value of the participant's capital account. Additionally, CPOs are also required to provide to the Commission and the National Futures Association ("NFA") a summary schedule listing the value of each participant's capital account, the sum of which should equal the net asset value reported on the pool's balance sheet. Rule 4.22(c)(2)(ii) does not require CPOs to identify by name each pool participant on the summary schedule and the Commission and NFA accept coded participant information. Many CPOs prepare the schedule by referring to their participants as "Partner A, B, C," etc. or "Partner 1, 2, 3," etc. CPOs are not required to report to pool participants information about fellow participants' balances.

The Commission requires that the summary schedule of participants' interests be subjected to the same audit procedures as the rest of the pool's financial statements. This means that an auditor will review the summary schedule to ensure that net income or losses of the pool and any special allocations are applied to participants appropriately.

C. Conclusion

The Commission's conclusion is that Rule 4.22(c)(2)(ii) permits various ways for CPOs to report the status of capital accounts, many of which ensure the privacy of participants' interests. Thus, CPOs should be able to comply with Rule 4.22(c)(2)(ii) without violating Commission rules concerning disclosure of customer information under Part 160.

[3] The other federal functional regulators under GLB are: the federal banking agencies (Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision); the National Credit Union Administration; the Securities and Exchange Commission; and the Federal Trade Commission.

[4] 66 Fed. Reg. 21,235 (April 27, 2001). The final rules will be published as 17 C.F.R. Part 160.

If you have any additional questions or concerns, please contact Susan Elliott, an attorney in the Division of Trading and Markets, at (202) 418-5464.

Very truly yours,

Catherine D. Dixon

Catherine D. Dixon
Assistant Secretary of the Commission

cc: Ronald Carletta, Supervisory Auditor, New York Regional Office
Gregory C. Prusik, Vice-President for Compliance and Registration, NFA

20010216

ARTHUR F. BELL, JR. & ASSOCIATES, L.L.C.

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OFC. OF THE SECRETARIAT

Certified Public Accountants

(410) 821-8000

FAX (410) 321-8359

Member:
American Institute of Certified Public Accountants
SEC Practice Section
Maryland Association of Certified Public Accountants

Suite 200
201 International Circle
Hunt Valley, Maryland 21030

August 17, 2001

Mr. John C. Lawton
Acting Director
Division of Trading and Markets
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Ms. Jean A. Webb
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Conflict between CFTC Regulation 4.22(c)(2)(ii) and Section 5g of the Commodity Exchange Act, the Gramm-Leach-Bliley Act of 1999 and CFTC Rule 17 CFR Part 160, *Privacy of Consumer Financial Information*; Petition Under 17 CFR Part 13

Dear Mr. Lawton and Ms. Webb,

Arthur F. Bell, Jr. & Associates, L.L.C. is a Certified Public Accounting firm serving the futures industry for approximately twenty years. The firm has over two hundred clients involved in derivative and equity trading as Commodity Trading Advisors, Commodity Pool Operators, Futures Commission Merchants, Introducing Brokers, Registered Investment Advisers and similar capacities. Members of the firm are involved in numerous industry committees, and Mr. Bell is a member and former Director of the Managed Funds Association (MFA), a member of MFA Government Relations Committee, Futures Industry Association (FIA), National Futures Association (NFA) Special Committee, the CFTC Global Markets Advisory Committee, and various other similar industry groups. The firm's experience and industry involvement are the basis for substantial interest in the relationship among the Gramm-Leach-Bliley Act of 1999 (GLB Act), CFTC's 17 CFR Part 160 and CFTC Regulation 4.22(c)(2)(ii).

The Commodity Futures Modernization Act of 2000 added Section 5g to the Commodity Exchange Act. Section 5g requires the CFTC to prescribe regulations under Title V of the GLB Act. Title V of the GLB Act governs the privacy of consumer's financial information and imposes limits on the disclosure of such information by "institutions" that provide financial products or services to individuals for their personal (i.e., non-business) use. Section 5g requires the CFTC to adopt rules regarding the privacy of nonpublic personal information. As a result, the CFTC adopted 17 CFR Part 160, *Privacy of Consumer Financial Information*. The rule became effective June 21, 2001, with mandatory compliance required by March 31, 2002.

17 CFR Part 160 requires, among other things, that institutions, including commodity pool operators, develop privacy policies with respect to consumer nonpublic information and to provide periodic notices to all customers which describe the institution's polices and procedures with respect to safeguarding and disclosure of such nonpublic personal information. Nonpublic personal information includes "personally identifiable financial information" that is provided by a client or that results from any transaction or service performed for the client (e.g., an investor's capital account balance).

CFTC Regulation 4.22(c) requires that each commodity pool operator registered under the Commodity Exchange Act must distribute an Annual Report to each participant in each pool that it operates. Under Regulation 4.22(c)(2), the Annual Report must contain the net asset value per outstanding participation unit in the pool as of the end of each of the pool's two preceding years (Regulation 4.22(c)(2)(i) which is applicable to unit based pools) or the total value of the participant's interest or share in the pool as of the end of each of the pool's two preceding fiscal years (Regulation 4.22(c)(2)(ii) which is applicable to capital account commodity pools).

The requirements of Regulation 4.22(c)(2) in Annual Reports are typically met in one of two ways, depending on the structure of the commodity pool. Commodity pool operators typically comply with the requirement of Regulation 4.22(c)(2)(i) for unit based pools by presenting, as part of the Annual Report, the net asset value per outstanding participation unit in the pool as of the end of the current year and for each of the pool's two preceding years. Commodity pool operators typically comply with the requirement of Regulation 4.22(c)(2)(ii) for capital account pools by presenting, as part of the Annual Report, a supplemental financial information schedule listing, by partner or member identification number, each participant's capital account balance as of the end of the current and prior two fiscal years.

Conflict Between Regulation 4.22(c)(2)(ii) and GLB Act and CFTC's 17 CFR Part 160

As previously noted, partner or member capital account balances are considered "nonpublic personal financial information" under the GLB Act. Under the GLB Act, the commodity pool operator is not permitted to disclose such financial information. However, disclosure of each partner's or member's capital account balance is required to be included in the Annual Report distributed to all pool participants under CFTC Regulation 4.22(c)(2)(ii). As such, CFTC Regulation 4.22(c)(2)(ii) conflicts with the requirements of the GLB Act and the CFTC's privacy rules. Therefore, commodity pool operators of capital account commodity pools would violate the privacy provisions of the GLB Act and the CFTC's rules by complying with Regulation 4.22(c)(2)(ii).

Proposed Solution to Conflict

We would propose resolving this apparent conflict by eliminating the requirement of CFTC Regulation 4.22(c)(2)(ii) that is applicable to capital account commodity pools. The objectives of this regulation were to provide investors with some degree of confidence that their capital account balances, as reported to them by the commodity pool operator in their monthly statements, reconciled to the financial statements and to their individual capital account balances presented in the supplemental financial information contained in the Annual Report. From a practical standpoint, however, this requirement provides the investors with minimal additional confidence. This is because the auditor's report on the supplemental financial information states only that the individual capital account balances of the investors are materially stated "in relation to the financial statements taken as a whole." As such, the auditor is not expressing an opinion on the accuracy of individual investor capital account balances and any inference to the contrary is erroneous. Secondly, we are not aware of any instances of fraud involving intentional understatement of certain individual capital balances with intentional overstatements of other individual capital account balances. In essence, a "fraud" where all the assets still exist. Rather, frauds typically involve the intentional overstatement of the pool's aggregate assets and net asset value.

As such, given the conflict between Regulation 4.22(c)(2)(ii) and the GLB Act and the CFTC's privacy rules, as well as the minimal degree of additional investor confidence provided by the requirements of Regulation 4.22(c)(2), we recommend the requirements of this regulation be eliminated from Regulation 4.22 and a revised Regulation 4.22(c)(2) be added which would read as follows, "If applicable, the net asset value per outstanding participation unit in the pool as of the end of the current and each of the pool's two preceding fiscal years."

Should the CFTC not agree with our proposed solution, we ask the CFTC to provide the commodity pool operator community with confirmation that, in the CFTC's opinion, simply altering or disguising the partner or member identification numbers from those used for internal accounting or income tax return reporting purposes, provides the commodity pool operator with sufficient relief such that the commodity pool operator would not, in the opinion of the CFTC, be in violation of either the GLB Act or CFTC's 17 CFR Part 160 by presenting, in a supplemental financial information schedule as part of the Annual Report of a capital account pool, the capital account balances of individual partners or members along with altered partner or member identification numbers.

Thank you for considering our comments and proposals. If you have any questions or would like to discuss them with us, please call Arthur F. Bell, Jr. or Bob Zink at (410) 821-8000.

Sincerely,

Arthur F. Bell, Jr. & Associates, L.L.C.

Arthur F. Bell, Jr. & Associates, L.L.C.

Cc: Susan Elliott, Division of Trading and Markets

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
Facsimile: (202) 418-5521

April 3, 1997

Mr. Frank Taucher
Suite 190
8210 East 71st Street
Tulsa, Oklahoma 74133

Re: Petition for Repeal of Commission Rules 4.13(a)(2)(i) and 4.13(a)(2)(ii)

Dear Mr. Taucher:

This is in response to the portion of your letter dated February 26, 1997 in which you petitioned the Commission for repeal of Commission Rules 4.13(a)(2)(i) and 4.13(a)(2)(ii) (hereinafter referred to collectively as Rule 4.13(a)(2)).[1] In your February 26 letter, you also raised issues concerning the per-transaction assessment fee (or "tax," as you describe it) charged by the National Futures Association and the impact of the Supreme Court ruling in the Dunn case.[2] We have referred those issues to the Commission's Division of Trading and Markets, which will respond by separate letter.

Commission Rule 4.13(a)(2) provides that a person is not required to register under the Commodity Exchange Act (CEAct) as a commodity pool operator (CPO) if: (1) the total gross capital contributions which the person receives for units of participation in all of the pools that the person operates or intends to operate do not in the aggregate exceed $200,000; and (ii) none of the pools operated by the person has more than 15 participants at any time.[3]

[1] Commission Rule 13.2 provides that "[a]ny person may file a petition with the Secretary of the Commission for the issuance, amendment, or repeal of a rule of general application." Commission rules referred to herein are found at 17 C.F.R. Ch. I (1996).

[2] William C. Dunn and Delta Consultants, Inc. v. Commodity Futures Trading Commission, et al., 65 U.S.L.W. 4141 (U.S. Feb. 25, 1997).

[3] In computing the number of participants, the following persons may be excluded: the CPO, any commodity trading advisor (CTA) for the pools, and principals of either the CPO or CTA, as well as any (continued...)

Since the rules that you are petitioning to repeal provide for an exemption from registration as a CPO, the effect of their repeal would be to require a greater number of persons to register as a CPO.[4] From the tenor of your letter, it would appear that, rather than the repeal of rules which provide for exemption from CPO registration, you actually seek a repeal of the statutory requirement for CPO registration. Section 4m(1) of the CEAct[5] provides that it is unlawful for a CPO to use the mails or any means or instrumentality of interstate commerce in connection with his or her business as a CPO unless registered as such under the CEAct.

The criteria set forth in Rule 4.13(a)(2) have been unchanged since 1981.[6] They are well understood in the industry, and the Commission has received very few complaints concerning this rule. Rule 4.13(a)(2) was originally adopted in 1979, following a rulemaking proceeding which lasted approximately two years and established the Commission's Part 4 rules. The Commission received comments from CPOs, CTAs, futures commission merchants, pool participants, clients and subscribers of CTAs, and the general public. The Commission's staff also analyzed CPO and CTA registration applications and sent questionnaires to all registered CPOs and CTAs to obtain further information.[7] When the Commission made the first major revisions to Part 4 in 1981 and adopted the standards for Rule 4.13(a)(2) which remain in effect today, it twice extended the comment period on the proposed revisions and received 94 comment letters.[8]

[3] (...continued)
relative, spouse or relative of such spouse living in the same household as another participant.

[4] As of February 28, 1997, there were 1,329 registered CPOs. The Commission receives approximately 100 notices on an annual basis from persons claiming to qualify for exemption from CPO registration under Rule 4.13(a)(2).

[5] 7 U.S.C. §6m(1) (1994).

[6] 46 Fed. Reg. 26004 (May 8, 1981). The registration exemption had previously been applicable to CPOs operating pools where the combined net asset values did not exceed $50,000 as of the beginning of the pools' fiscal years, and the only persons excluded from the computation of the number of participants were the CPO and any CTAs of the pools. 44 Fed. Reg. 1918, 1925 (Jan. 8, 1979).

[7] 44 Fed. Reg. 1918.

[8] 46 Fed. Reg. 26004.

In light of the rulemaking proceedings which preceded the original adoption and subsequent amendment of Rule 4.13(a)(2), and the history of its application, the Commission does not agree with your assertions that "[t]he present levels of $200,000 and 15 participants are arbitrary and capricious" or that the rule has a discriminatory effect. If a CPO operates his or her pool or pools in a manner that does not satisfy the requirements for exemption from registration, all participants and prospective participants will receive the benefits of the protections of the Commission's Part 4 rules, as well as of the registration screening process for the CPO. The Commission's rules permit persons to elect to participate in a pool operated by a registered CPO or to participate in or to organize a small pool that is not operated by a registered CPO.

In light of the foregoing, we find that you have not provided a sufficient basis for repeal or modification of Rule 4.13(a)(2). Accordingly, the Commission has determined to deny your petition to repeal Rule 4.13(a)(2).

For the Commission,

Jean A Webb

Jean A. Webb
Secretary of the Commission

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5430
Facsimile: (202) 418-5536

DIVISION OF
TRADING & MARKETS

April 3, 1997

Mr. Frank Taucher
Suite 190
8210 East 71st Street
Tulsa, Oklahoma 74133

Re: NFA Funding and Dunn Decision

Dear Mr. Taucher:

Your letter dated February 26, 1997 to the Commission's Secretary has been referred to this office for a response to the first two issues you raised concerning: (1) the per-transaction assessment fee (or "tax," as you describe it) charged by the National Futures Association (NFA); and (2) the impact of the Supreme Court ruling in the Dunn case. In your February 26 letter, you also petitioned for repeal of Commission Rules 4.13(a)(2)(i) and 4.13(a)(2)(ii). The petition for rulemaking has been submitted for Commission consideration and a response thereto will be provided separately.

NFA Funding

In your letter, you posed the following questions concerning NFA funding: "Is the per-transaction tax that NFA charges citizens anywhere authorized in the Commodity Exchange Act? If not, from what does NFA derive its authority for this tax?"

By order dated September 22, 1981, the Commission granted registration as a futures association to NFA and approved its initial rules (hereinafter, NFA Registration Order). Among these rules was Bylaw 1301(b), which provided that a portion of NFA's funding would be derived from "round-turn" assessments upon futures and commodity option transactions carried by futures commission merchant (FCM) members of NFA, who would be required to invoice the transactional assessment to their customers.1/

In 1982, during the Commission's second reauthorization process, the Commission presented a proposal to Congress for a per-transaction user fee that would be used to defray a portion of the Commission's budget. Several members of Congress and a

1/ NFA Registration Order at 7.

number of futures industry representatives expressed concern that the imposition of such a user fee would lead to the demise of NFA, since the industry would be unwilling to pay a per-transaction user fee to defray a portion of the Commission's budget and a similar fee to fund NFA.[2] Congress determined not to authorize a per-transaction user fee to fund the Commission in the Futures Trading Practices Act of 1982 (FTPA)[3] and has not done so since that time. When the issue resurfaces periodically, one of the arguments frequently raised against such a fee is that it would interfere with the funding of NFA. The legislative history makes clear that Congress was aware from NFA's inception that a portion of NFA's operating funds would be derived from a per-transaction assessment on member FCMs that would be passed on to customers and has not objected to the per-transaction fee as a funding mechanism for NFA.

In your letter, you also raised the question, "If the tax is lawfully authorized, what is to stop me from declaring myself a Registered Futures Association and taxing all futures contracts in the United States $.15 per transaction in order to raise a potful of money and pay myself an exorbitant salary as NFA pays its executives?"[4]

Under the Commodity Exchange Act (CEAct), there may be multiple registered futures associations. However, a person may not simply declare himself to be a registered futures association. Application must be made to the Commission for registra-

[2] See S. Rep. No. 384, 97th Cong., 2d Sess. 25-26 (1982); *CFTC Reauthorization: Hearings on H.R. 5447 Before the Subcomm. on Conservation, Credit, and Rural Development of the House Comm.on Agriculture*, 97th Cong., 2d Sess. 13, 17, 24, 283, 317-18, 339-40, 365, 480, 569 (1982) (statement of CFTC Chairman Johnson; colloquy of Rep. Jeffords and CFTC Chairman Johnson; colloquy of Rep. Richmond and CFTC Chairman Johnson; statements of Lee H. Berendt, Executive Vice Chairman, Commodity Exchange, Inc., Dr. Clayton K. Yeutter, President, Chicago Mercantile Exchange, David H. Morgan, President, MidAmerica Commodity Exchange, Leo Melamed, President, NFA, John J. Conheeney, Chairman, Merrill Lynch Commodities Inc., and Herbert Evers, President, ContiCommodity Services, Inc.; see also 128 Cong. Rec. H7483, H7485 (daily ed. Sept. 23, 1982) (statement of Chairman de la Garza).

[3] See Section 237 of the FTPA; see also H.R. Rep. No. 964, 97th Cong., 2d Sess. 56-58 (1982).

[4] While the NFA per transaction fee has fluctuated over time, it is currently $0.14 for a futures contract on a round-turn basis and $0.07 for an option contract on a per-trade basis.

tion as a futures association in accordance with Section 17 of the CEAct[5] and Part 170 of the Commission's rules adopted thereunder.[6] If the Commission were to grant such a registration, as it has in the case of NFA, presumably you would then be free to assess a fee as described in your letter that itself would be subject to Commission oversight.

William C. Dunn and Delta Consultants, Inc. v. Commodity Futures Trading Commission, et al., 65 U.S.L.W. 4141 (U.S. Feb. 25, 1997)

The second series of questions in your letter reads as follows:

> In light of the Dunn decision yesterday, if I form a commodity pool, solicit public funds, and confine my trading to off-exchange markets, is such activity now unregulated by the CFTC? What other government agencies, in the alternative, would have regulatory jurisdiction over my management activities in such an off-exchange environment?

The narrow issue decided by the Supreme Court in the Dunn case was whether the phrase "transactions in foreign currency" in the so-called "Treasury Amendment" to the CEAct[7] includes transactions in options to buy or sell foreign currency. The Supreme Court did not address what constitutes a "board of trade" for purposes of delineating the coverage of the so-called "Treasury Amendment" to the CEAct.

In any event, the Dunn case concerned trading in options to buy or sell foreign currency and your question is not limited to foreign currency products. In general, any futures or commodity option transaction in the U.S. must be conducted on or subject to the rules of a board of trade designated by the Commission as a contract market, unless the transaction (1) involves a contract made on or subject to the rules of a foreign board of trade,

[5] 7 U.S.C. §21 (1994).

[6] 17 C.F.R. Part 170 (1996). Any futures association must be able to demonstrate, among other things, that it has: (1) fair and equitable representation of members; (2) a customer protection program to prevent fraudulent and manipulative practices; (3) fair and orderly disciplinary and membership denial proceedings; and (4) the capability to settle customer disputes. Such associations also are required to discharge a number of specific obligations.

[7] Section 2(a)(1)(A)(ii) of the CEAct, 7 U.S.C. §2(ii) (1994).

exchange or market or (2) is exempted by the Commission pursuant to Section 4(c) of the CEAct.[8] Consequently, we believe that the requirements of the CEAct and rules thereunder would apply to the activity you described.

If you have any questions concerning these issues, please contact me or Lawrence B. Patent, Associate Chief Counsel, at (202) 418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel

cc: Daniel J. Roth, NFA

[8] Sections 4 and 4c(b) of the CEAct, 7 U.S.C. §§6 and 6c(b) (1994).

COMMODITY FUTURES
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February 26, 1997

Secretariat
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

ATTN : Jean A. Webb
Secretary of the Commission

BY FAX : 202-418-5521

Dear Ms. Webb;

I have recently requested information regarding two questions from the CFTC. The most recent was yesterday when I spoke to Susan Nathan, "Attorney of the Day".

Ms. Nathan referred me to the "Office of Public Affairs" which, quite clearly, was not qualified to answer my question.

I am thus again requesting an answer to my questions which are;

1. Is the per-transaction tax that NFA charges citizens anywhere authorized in the Commodity Exchange Act? If not, from what does NFA derive its authority for this tax? When I have spoken with the CFTC "Attorney of the Day" in the past, the "Attorney of the Day" was unable to cite any autholzation for this tax and directed me to the National Futures Association. If the tax is lawfully authorized, what is to stop me from declaring myself a Registered Futures Association and taxing all futures contracts in the United States $ .16 per transaction in order to raise a potful of money and pay myself an exorbitant salary as NFA pays its executives?

2. In light of the Dunn decision yesterday, if I form a commodity pool, solicit public funds, and confine my trading to off-exchange markets, is such activity now unregulated by the CFTC? What other government agencies, in the alternative, would have regulatory jurisdiction over my management activities in such an off-exchange environment?

3. Under the provisions of CFTC 13.2, I am hereby petitioning for the following rule changes;

a. Delete 4.13 (a) (2) (i) which presently reads, "The total gross capital contributions it receives for units of participation in all of the pools that it operates or that it intends to operate do not in the aggregate exceed $ 200,000; and".

b. Delete 4.13 (a) (2) (ii) which presently reads, "None of the pools operated by it has more than 15 participants at any time."

I am petitioning for these rule changes for the following reasons;

1. The present levels of $ 200,000 and 15 participants are arbitrary and capricious.

2. The requirement that a United States citizen must register in order to manage funds for more than 15 participants or more than $ 200,000 is a per se unlawful conversion of citizens' Constitutional right to freely pursue one's gainful occupation into a licensed priviledge.

3. The present legislation discriminates against the 16th person and against the person who would contribute the $ 200,001st dollar to an unregistered pool.

4. The present legislation is a restraint of trade against those citizens who prefer to engage in commerce unrestricted by government intervention.

5. Registration subjects a citizen to deregistration.

6. Registration subjects a citizen to NFA and CFTC administrative law proceedings which, in the experience of this citizen, fail to provide Constitutional due process protection.

7. As Justice White stated in SEC v Lowe, the laws of the United States are wholly adequate to prosecute unlawful activity such as fraud and will remain wholly adequate after my proposed change is adopted.

8. The notification provisions of 4.13 (b) would still be in effect.

9. The prohibition stated against that citizen who would otherwise manage funds in excess of $ 200,000 and 15 participants constitutes a Constitutionally prohibited taking of the income that citizen would enjoy were the registration requirement not otherwise in effect.

10. The present registration requirement is a violation of citizens' First Amendment Constitutional right to be compensated for the speech they might employ for the benefit of others.

11. The present registration requirement prevents both the manager-citizen and investor-citizen from freely entering into an agreement of their own choosing unencumbered by government restrictions when the arbitrary levels stated in CFTC 4.13 are exceeded.

12. Pool managers do not directly handle public funds which are deposited into the fund's bank / brokerage accounts. They only have authority to enter trades and bill for services rendered.

I thank you in advance for your consideration and look forward to your prompt reply.

Sincerely,

Frank Taucher
Suite 190
8210 East 71st Street
Tulsa, OK 74133

918-493-3384

918-493-1132 (fax)

MSA 7/7/6

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KANSAS CITY
BOARD OF TRADE

April 27, 2004

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition to amend CFTC Regulation Section 150.2

Dear Ms. Webb:

The Board of Trade of Kansas City, Missouri, Inc. ("KCBT") hereby petitions, pursuant to Commodity Futures Trading Commission ("Commission") Regulation 13.2, that the Commission amends it's Regulation 150.2 (Position Limits). In that regard, KCBT herein requests that the spot month, single month and all-months speculative position limits be eliminated from CFTC Regulation 150.2 for KCBT commodities. Currently, those limits pertaining to KCBT are as follows:

Contract	Spot Month	Single Month	All Months
Wheat	600	3,000	4,000

Core Principle 5 of Section 5(d) of the Commodity Exchange Act, as amended, requires contract markets to adopt position limits or position accountability for speculators to reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, where necessary and appropriate. In Appendix B to Part 38 of its Regulations, the Commission discussed certain acceptable practices that would satisfy Core Principle 5. The Commission notes the level of the spot limit for physical-delivery markets should be based upon an analysis of deliverable supplies and the history of spot month liquidations.

An analysis of the deliverable supplies indicates more than adequate supplies of wheat in deliverable position to make it increasingly difficult for speculative manipulation. Reportable commercial traders continue to hold the majority of open interest in agricultural commodities. That, as well as the large size of deliverable supply, reduces the degree to which speculators can control the market. Specific to our market, hard red winter wheat comprised over 45% of the U.S. wheat production in 2003. Because hard red winter wheat comprises a large share of the U.S. wheat production, the potential supply of delivery wheat minimizes the potential for manipulation or price distortion when compared with other commodities that have "more limited deliverable supplies".

During each delivery period, KCBT staff conducts a heightened surveillance of spot month liquidations. KCBT staff routinely review large trader information and conduct an intensive review of large trader information prior to and during each delivery period. Prior to and during each delivery period, KCBT staff contact clearing members and other position holders with large speculative positions to determine the intentions of the position holder. The staff also performs economic justification calculations throughout this time to help ensure orderly liquidations. An analysis of the history of KCBT spot month liquidations reveals an orderly liquidation of positions.

For these reasons stated above, KCBT is of the opinion that the Commission would be justified in eliminating all spot month, single month and all-months combined speculative position limits for KCBT commodities. If however, the Commission chooses to retain speculative position limit authority then it is imperative that parity be maintained across wheat exchanges, as has been done by the Commission historically. To do otherwise would threaten the KCBT's ability to compete with other exchanges for speculative interest.

Historically, the size of the cash commodity underlying the KCBT wheat contract has often been twice or more that of other wheat contracts and stocks in deliverable position for the Kansas City contract have typically exceeded those of other markets. The potential supply of delivery wheat in Kansas City is much larger than that of other markets due to the hard red winter wheat being the dominant class of wheat produced in the U.S. The larger deliverable supply would make it comparatively more difficult for speculative manipulation in Kansas City than in other markets.

A significant portion of our trading volume is generated from the arbitrage opportunities that exist between our markets. Different position limits between exchanges could dramatically affect the growth potential for intermarket spread volume.

Trading volume and open interest in our hard red winter wheat futures and options contracts have increased since the Commission last revised its position limits in 1999. KCBT wheat and wheat option combined volume have increased 7.34%, 5.49%, 34.25% and 25.65% in 2000, 2001, 2002 and 2003 respectively when compared to 1999. The average month-end futures and futures equivalent open interest (0.5 delta) has increased 8.11%, 17.55%, 20.26% and 3.08% in 2000, 2001, 2002 and 2003 respectively when compared to 1999. It is our opinion that these increases would not have occurred if wheat speculative position limit parity had not been maintained in 1999. The increased volume and open interest since 1999 has also attracted fund business to our market. Fund traders are typically looking to trade in contracts that are very liquid in which they can enter and exit the market with minimum price disturbance. If parity is not maintained, fund business could be lost to other markets if they are afforded higher limits. Appendix A reflects a chart that Exchange staff has compiled from the CFTC Commitment of Traders Reports. In particular, the chart reflects an increase in the number of large traders and the percentage of open interest that is held by large noncommercial traders in KCBT wheat between 1999 and 2003.

Reportable commercial traders continue to hold the majority of open interest. Commercial traders are able to use our market to hedge their risk due to the liquidity provided by our noncommercial traders. Increasing the speculative position limits would aid in increased speculative trading which in turn would increase the liquidity of the market to allow commercial users to hedge their risks more effectively.

In conclusion, the KCBT requests that the Commission consider eliminating the spot month, single month and all-months combined speculative position limits from CFTC Regulation 150.2 as discussed above. If the Commission does not eliminate the speculative limits, then the KCBT requests that parity be maintained across markets.

The filing of this petition was recommended by the Executive Committee and subsequently approved by the Board of Directors in a regularly scheduled meeting on this date. To the knowledge of the Board of Directors and staff of the KCBT, no opposing views have been expressed by members or others to this petition.

If you have any questions pertaining to this petition, please contact either the undersigned or Joseph Ott; Vice President – Compliance at 816-753-7500.

Sincerely,

Jeffrey C. Borchardt
President

Cc: Rick Shilts, Director – CFTC Division of Product Review & Analysis
Fred Linse, CFTC – Washington, D.C.
Jim Lammle – CFTC – Kansas City
William Kokontis, CFTC – Chicago
Marshall Horn, CFTC – New York

APPENDIX A

YEAR	Average Open Interest*	Reportable Noncommercial Average % of Long Open Interest	Reportable Noncommercial Average % of Short Open Interest	Reportable Commercial Average % of Long Open Interest	Reportable Commercial Average % of Short Open Interest	Average # of Long Noncommercial ReportableTraders	Average # of Short Noncommercial ReportableTraders	Average # of Long Commercial ReportableTraders	Average # of Short Commercial ReportableTraders
1999	76162	17	22	63	58	44	42	60	57
2000	80721	22	19	53	64	67	49	64	63
2001	84997	24	25	47	59	67	53	65	54
2002	87397	26	24	49	58	66	50	61	57
2003	75503	26	25	56	57	51	47	64	61

* Average month-end futures and futures-equivalent open interest (0.5 delta)

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OFC. OF THE SECRETARIAT

Alston&Bird LLP

950 F Street, N.W.
The Atlantic Building
Washington, DC 20004

202-756-3300
Fax 202-756-3333

Paul M. Architzel | Direct Dial: 202-756-3492 | E-mail: paul.architzel@alston.com

March 28, 2008

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VIA E-MAIL and U.P.S.

David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition of Eurex Deutschland for Issuance of a Rule Pursuant to Commodity Futures Trading Commission Rule 13.2, 17 C.F.R. §13.2

Dear Mr. Stawick:

On behalf of Eurex Deutschland, we respectfully petition the Commodity Futures Trading Commission ("Commission") under Commission Rule 13.2 to issue a new Rule 30.13, or in the alternative, to amend 17 C.F.R. Part 30, Appendix D—Information That a Foreign Board of Trade Should Submit When Seeking No-Action Relief to Offer and Sell, to Persons Located in the United States, A Futures Contract On a Foreign Non-Narrow Based Security Index Traded on That Foreign Board of Trade to provide for the petitioned procedures. New Rule 30.13 (or amended Appendix D) would establish a fast-track procedure for the review of requests by a foreign board of trade whereby the Commission would deem that a stock index contract traded on the foreign board of trade conforms with the requirements of the Commodity Exchange Act, 7 U.S.C. §1 *et seq.* ("Act") and may therefore be offered or sold to persons located within the United States.

This Petition for Rulemaking would establish a fast-track procedure under the Commission's rules for its review of requests by a foreign board of trade to offer or sell non-narrow based stock index futures contracts to persons located within the United States where such foreign board of trade previously has received either : 1) No-action relief from the Office of the General Counsel with respect to the offer or sale to persons located in the U.S. of a futures contract on a non-narrow based security index; or 2) No-action relief permitting the foreign board of trade to provide direct electronic access to their U.S. members or authorized participants. The proposed rule details the information that is required to be provided by a foreign board of trade requesting Commission fast-track review of a non-narrow based stock index futures contract traded on the foreign board of trade. Forty-five days after a foreign board of trade files a submission--absent notification by the Commission of a 45 day extension to consider complex or novel issues or upon the request of the foreign board of trade, or that additional information is required-- the contract will be deemed to conform to the requirements of the Act and may therefore be offered or sold to persons located within the United States. This rule-based fast-track procedure would be in addition to the current policy whereby the Office of the General Counsel ("OGC") issues a no-action letter in response to such a request. The current policy would continue to apply to foreign boards of trade that have not previously been granted relief under either of the above two no-action procedures.

The proposed rule adheres closely to the guidance provided by the Congress with respect to the procedures for determining whether non-narrow based stock index futures contracts traded on a foreign board of trade can be offered or sold to persons located within the United States.[1] Moreover, it also reflects the substantial streamlining of Commission approval procedures that have been implemented since the OGC no-action procedure for approval of foreign stock indexes was first adopted. As with the Commission's other streamlining efforts, the new fast-track procedure does not in any way reduce the substantive requirements that a foreign board of trade must meet in order to make available its non-narrow based stock index futures contracts to persons located within the United States.

The streamlined procedures of new Rule 30.13 would serve the public interest by making additional hedging instruments available to U.S. persons without unnecessary delay and by conserving Commission staff resources without in any way reducing the protections to the public provided by the Act. Moreover, issuance of new Rule 30.13 would further one of the fundamental purposes of the Act by promoting responsible innovation and fair competition among boards of trade, other markets and market participants.[2] In order to achieve the foregoing public interest benefits, and for the reasons explained in greater detail below, we respectfully petition the Commission to issue new Rule 30.13 and in furtherance of its issuance of the rule, to publish in the *Federal Register* notice of this Petition and the text of proposed Rule 30.13 (or a substantively similar amendment to Appendix D to Part 30 of the Commission's rules) for public comment.

I. Requirements for Petition for Rulemaking

Commission Rule 13.2, 17 C.F.R. §13.2, provides that any person may file a petition with the Secretariat of the Commission for the issuance, amendment or repeal of a rule of general application. The Petition must set forth the text of any proposed rule or amendment. Commission Rule 13.2 requires that the Petition state the nature of the petitioner's interest and permits the petitioner to include in the Petition arguments in

[1] House Report No. 97-565, 97th Cong. 2d Sess. (1982) at p. 85.

[2] See Section 3 of the Act, 7 U.S.C. §5.

support of the issuance, amendment or repeal of the rule. Rule 13.2 further provides that the Secretariat shall refer the Petition to the Commission for such action as the Commission deems appropriate.

II. Statement of Petitioner's Interest

Eurex Deutschland is a foreign board of trade that lists for trading futures, options on futures and equity-related options. Eurex Deutschland is operated by Eurex Frankfurt AG (hereinafter together referred to as "Eurex"). Eurex is headquartered in Frankfurt, Germany, where the vast majority of its employees and management are located. Eurex operates through an all-electronic trading platform and is one of the world's largest futures and options exchanges. More than 1.9 billion contracts were traded on the exchange during 2007. Eurex Trading Members may access the Eurex Trading System via a dedicated communications network from locations around the world. All transactions on Eurex are governed by Eurex rules and the laws of Germany.

With the exception of stock index contracts, no prior qualifying action by the Commission or its staff is required in order for persons located within the United States to enter into futures contracts traded on a foreign board of trade. Such customers are permitted to access the products offered by a foreign board of trade through a U.S. registered futures commission merchant, introducing broker or through a foreign firm that has received an exemption from registration as a U.S. FCM under 17 C.F.R. §30.10.[3]

The offer or sale of stock index futures contacts traded on a foreign board of trade to persons located within the United States, however, requires adherence to special procedures. As explained in greater detail below, OGC has established a process wherein it issues a No-action letter with respect to requests from foreign boards of trade to confirm that a foreign security index may be offered or sold to persons located within the United States. This No-action policy and the information that OGC considers in issuing these No-action letters is found at Appendix D to Part 30 of the Commission's rules. OGC has previously issued to Eurex No-action letters with respect to a number of non-

[3] As a separate matter, members of a foreign board of trade located in the United States may be able to access a foreign board of trade through trading terminals located in the United States pursuant to no-action relief of the CFTC staff. For example, staff of the Commission issued a no-action letter to DTB, the predecessor exchange to Eurex on February 29, 1996. That letter stated that the Commission's Division of Trading and Markets "would not recommend any enforcement action against DTB in connection with the placement of its trading terminals in the United States in order to permit DTB members to execute transactions involving DTB futures and option products which are otherwise approved for trading by U.S. persons, subject to compliance with [a number of] conditions." In 1999, that no-action letter was reissued to Eurex and the relief therein expanded. *See* Commission Staff Letter No. 99-48, http://www.cftc.gov/tm/letters/99letters/tmeurex_no-action.htm. This Petition for rulemaking would apply to any foreign board of trade trading stock index contracts and would govern the process under which a foreign non-narrow based index is approved for the offer and sale to persons located within the United States and is independent of whether the foreign board of trade has been permitted to place its trading terminals in the United States.

narrow based stock index futures contracts,[4] and a number of Eurex's requests for OGC No-action letters are pending.[5] Eurex has also been issued No-action relief by the former Division of Trading and Markets permitting it to provide direct electronic access to its U.S. members and authorized participants.[6]

Eurex is a foreign board of trade that has requested and been granted OGC No-action letters permitting the offer and sale of non-narrow based stock index futures contracts to persons located within the United States and is likely to have additional contracts in the future that would conform with the requirements of the Act for offer or sale to persons located within the United States. Accordingly, Eurex has an interest in the review procedures that are, and will be, used to review and process these requests and in encouraging that those procedures be as efficient and timely as possible consistent with the requirements of the Act.

III. Summary of the Requested Rule

New Rule 30.13 would provide that a foreign board of trade that meets specified conditions may apply to the Commission for a determination that a stock index contract that it trades or plans to trade is deemed by the Commission to conform with the requirements of the Act and may be offered or sold to persons located within the United States. As proposed in this Petition, under new fast-track procedures of Rule 30.13, the stock index futures contract of the foreign board of trade would be deemed to conform with the requirements of the Act and Commission rules 45 days after submission of the request to the Commission, and therefore would be permitted to be offered or sold to persons located within the United States.

Consistent with its other product and rule review procedures, the Commission under the rule may extend the review period an additional 45 days if the stock index futures contract raises novel or complex issues that require additional time for review or

[4] The following stock index futures contracts traded on Eurex have been the subject of OGC no-action letters permitting their offer and sale to persons located within the United States: Dow Jones STOXX® 600 futures contract, Dow Jones STOXX® 200 Mid 200 futures contract, Dow Jones STOXX® 50 futures contract, Dow Jones EURO STOXX® 50 futures contract, DAX® futures contract, STOXX® 600 Banking Sector futures contract, EURO STOXX® Banking Sector futures contract, Dow Jones Italy Titans 30® futures contract, Dow Jones Global Titans 50® futures contract ; the MDAX® futures contracts; RDXxt USD-RDX Extended Index Futures Contract; DJ STOXX 600 Industrial Goods & Services Index Futures Contracts; DJ STOXX 600 Insurance Index Futures Contract; DJ STOXX 600 Media Index Futures Contract; DJ STOXX 600 Personal & Household Goods Index Futures Contract;; DJ STOXX Travel & Leisure Index Futures Contract; DJ STOXX 600 Utilities Index Futures Contract; Dow Jones STOXX Large 200 Index Futures Contract; and the Dow Jones STOXX Small 200 Index Futures Contract;

[5] Eurex requests for OGC No-action that remain pending are for the following non-narrow based stock indexes: VDAX - New Index Futures Contract; Dow Jones Euro STOXX Select Dividend 30 Index Futures Contract; DJ STOXX 600 Retail Index Futures Contract SLI Swiss Leader Index Futures Contract; Swiss Market Index Midcap (SMIM) Futures Contract; and TecDAX Index Futures Contract.

[6] See, http://www.cftc.gov/tm/letters/99letters/tmeurex_no-action.htm

if the foreign board of trade requests an extension of time. Moreover, if the foreign board of trade's request to the Commission for fast-track consideration does not comply with the form or content requirement of Rule 30.13 or if the Commission in its discretion requires additional information to complete its review, the Commission may so notify the requesting board of trade and treat the request as withdrawn. A new review period will begin upon the foreign board of trade's resubmission of its supplemented request.

Under new Rule 30.13, the Commission may also notify a foreign board of trade that the Commission is unable to deem that the stock index futures contract conforms to the requirements of the Act, with a brief statement of the reasons therefore. Such a notification does not preclude the foreign board of trade from submitting a subsequent request if it amends the contract or if the facts and circumstances change in a manner which addresses the issues cited in the Commission's notification.

Existing OGC no-action letters with respect to stock index contracts of a foreign board of trade will remain in effect and would not be affected by the adoption of this new procedure. Moreover, nothing in this Petition is intended to delay OGC's consideration of pending requests during the Commission's consideration of this Petition.

The information, statements and data that the rule would require to be submitted by the requesting foreign board of trade for fast-track review is the same as that which is, and will continue to be required to be provided for review under Appendix D to Part 30. The required information includes a copy of the contract's terms and conditions, rules that may have an effect on trading of the contract such as circuit breakers or position limits, an explanation of the index's design, maintenance and selection criteria and computation, and data supporting the finding that the index is not a narrow based index. In addition, the requesting foreign board of trade must describe information-sharing arrangements and applicable memoranda of understanding, include a statement that the foreign board of trade has the ability and willingness to share information with the Commission either directly or indirectly and a certification as to the truthfulness and accuracy of the information in the request. Finally, proposed Rule 30.13 would permit a foreign board of trade that has been the recipient of a staff No-action letter with respect to placement in the United States of its trading terminals, to include in its Rule 30.13 request the requisite notice and certification to the Commission with respect to the availability of the contract for trading via its U.S. trading terminals.[7]

IV. Issuance of Rule 30.13 furthers the public interest

a. The Act and its legislative history support the fast-track procedures of Rule 30.13.

[7] *See* "Notice of Revision of Commission Policy Regarding the Listing of New Futures and Option Contracts by Foreign Boards of Trade That Have Received Staff No-action Relief to Provided Direct Access to Their Automated Trading Systems From Locations in the Untied States," 74 *Fed. Reg.* 19877 (April 18, 2006),

The Futures Trading Act of 1982, Pub. Law 97-444, 96 Stat. 2294 ("82 Act") added two separate provisions affecting the treatment of foreign stock index contracts under the Act. The first was the addition of the Shad-Johnson jurisdictional accord found in Section 2(a)(1)(B) of the Act and the second was the addition of a new section 4(b) of the Act relating to trading of foreign futures.

The Shad-Johnson accord continued the Commission's exclusive jurisdiction over futures contracts on broad-based security indexes. Section 2(a)(1)(B)(v) as added by the 82 Act provided that "no person shall enter into or confirm the execution of" a stock index contract except as provided by Section 2(a)(1)(B)(ii). The House Committee on Agriculture explained that new Section 2(a)(1)(B)(ii) of the Act provided that no board of trade may be designated as a contract market with respect to such broad-based security indexes unless it demonstrates to the Commission that 1) the contract is cash settled; 2) trading in the contract would not be readily susceptible to manipulation; and 3) such index is a widely published measure of the market for all publicly traded equity or debt issues or a substantial segment thereof.[8] Section 2(a)(1)(B) did not distinguish between the offer or sale of stock index contracts to U.S. persons traded on U.S. markets from those traded on foreign markets.

At the same time, however, the 82 Act with the addition of new Section 4(b) also clarified the Act's applicability with respect to foreign boards of trade. Section 4(b) provides that:

> The Commission may adopt rules and regulations proscribing fraud and requiring minimum financial standards, the disclosure of risk, the filing of reports, the keeping of books and records, the safeguarding of customers' funds, and registration with the Commission by any person located in the United States, its territories or possessions, who engages in the offer or sale of any contract of sale of a commodity for future delivery that is made or to be made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions. Such rules and regulations may impose different requirements for such persons depending upon the particular foreign board of trade, exchange, or market involved. No rule or regulation may be adopted by the Commission under this subsection that (1) requires Commission approval of any contract, rule, regulation, or action of any foreign board of trade, exchange, or market, or clearinghouse for such board of trade, exchange, or market, or (2) governs in any way any rule or contract term or action of any foreign

[8] H.R. Rep. No. 97-565, Part I, at 81. The last criterion of section 2(a)(B)(ii)--that the index be broad-based--was amended by the Commodity Futures Modernization Act of 2000, ("CFMA") which added a definition of "narrow-based index" to the Act and substituted the requirement that the index not constitute a narrow-based security index. The provisions of the Shad-Johnson accord can now be found, as amended in 2000, in section 2(a)(1)(C) of the Act, and the minimum requirements that stock index contracts must meet are now found in section 2(a)(1)(C)(ii)(I) through (IV).

> board of trade, exchange, or market, or clearinghouse for such board of trade, exchange, or market.

7 U.S.C. §6(b).

As the House Committee on Agriculture explained, although "Section 4(b) expressly empowers the Commission to protect the interests of United States residents against fraudulent or other harmful practices by a vendor of foreign futures who is located in the United States. . . .," it

> does not authorize the Commission to regulate the internal affairs of a foreign board of trade, exchange, market, or clearing house for such market (such as terms and conditions of foreign futures created by a foreign exchange) or require Commission approval of any action of any such market or its clearinghouse.

House Report No. 97-565, 97th Cong. 2d Sess., (1982) at p. 85.

The Committee continued however, noting that where the Act establishes minimum requirements for a specifically identified contract, nothing prevented a foreign board of trade from seeking confirmation from the Commission that its contract conforms with the requirements of the Act. *Id.* In this regard, the Committee specifically addressed the requirements of Section 2(a)(1)(B) and how they would relate to stock index contracts traded on a foreign board of trade, advising that

> However, nothing in the provisions prevents a foreign board of trade from applying to the Commission for certification that its futures contracts conform with requirements of this Act where, by its terms, the Act establishes minimum requirements for a specifically identified contract. For example, a foreign board of trade may seek certification from the Commission that a futures contract offered by it that is based upon a group or index of American securities meets the minimum requirements specified in subparagraphs (a) through (c) of section 2(a)(1)(B)(ii) of the Act, without seeking or obtaining designation by the Commission as a contract market. Any such certification is to be conducted under the procedures, and subject to the rights of other persons, set forth in the provision of the Act establishing such minimum requirements. A futures contract, based upon a group or index of foreign securities only, could be certified by the Commission under such criteria as the Commission may deem appropriate. Upon certification by the Commission, the minimum requirements for such contract will be deemed to have been met, and the offering and sale of the contract in the United States, its territories or possessions will be lawful so long as such activity complies with the regulations of the Commission adopted under section 4(b) and the Act.

Id. Thus, the Committee distinguished the Commission's interest in the offer or sale within the United States of contracts on indexes on U.S. securities from indexes on foreign securities, leaving it to the Commission's discretion to establish the criteria under which stock index contracts on indexes of only foreign securities could be offered or sold to persons located within the United States.

The Commission did not adopt the certification procedure suggested by the Committee as a means of confirming which foreign security indexes conform to the requirements of the Act. Rather, OGC established a process wherein it issues a No-action letter with respect to requests from foreign exchanges to confirm that a foreign security index may be offered or sold to persons located within the United States.[9] Under that process, OGC determined to apply the same criteria to evaluate foreign stock indexes as the Act applies to stock indexes on domestic securities.[10]

At the time that OGC developed and adopted its review procedures, the Act required that the Commission review and approve (designate) each new contract prior to its listing for trading on a U.S. designated contract market.[11] Thus, in addition to applying the same substantive review criteria to evaluate broad based stock indexes traded on a foreign board of trade as used to evaluate a domestic stock index, the prior review requirement implicit in the OGC no-action process was roughly comparable to the prior approval requirement of the Act with respect to stock indexes traded on domestic exchanges.

Subsequently, the Congress on December 21, 2000, enacted into law the Commodity Futures Modernization Act of 2000, 114 Stat. 2763 ("CFMA"). One of the purposes of the CFMA was "to streamline and eliminate unnecessary regulation of the commodity futures exchanges and other entities regulated under the Commodity Exchange Act."[12] The CFMA introduced a flexible principles-based approach to regulation of the futures markets. As part of this fundamental redesign of the regulatory scheme, Congress eliminated the requirement that the Commission review and approve new contracts prior to their listing for trading, rather permitting exchanges to list new contracts following exchange certification to the Commission that the new contract

[9] *See* http://www.cftc.gov/intenational/foreignmarketsandproducts/filingreqs.html and 17 C.F.R. Part 30, Appendix D.

[10] OGC in its No-action letters stated that, "The House Committee suggests that the Commission may use such criteria as it deems appropriate in evaluating a foreign stock index contract based on 'foreign securities.' The requirements of Section 2(a)(1)(B)(ii) of the Act were designed to permit futures trading in 'broad-based . . . indices that are not conducive to manipulation or disruption of the market for the underlying securities." CFTC Letter No. 99-25, July 14, 1999 (citations omitted). See also, CFTC-OGC Interpretative Letter No. 86-4 (April 19, 1984).

[11] *See* former Section 5 of the Act, 7 U.S.C. §7 (1999).

[12] CFMA, §2(2).

complies with the Act.[13] Section 5(c) of the Act. This self-certification procedure also applies to non-narrow based stock index futures contracts.[14]

A growing gap has developed between the efficiency of the CFMA-procedures under which a U.S. futures market is permitted to list new non-narrow-based stock index contracts and the OGC procedures that are in place for confirmation that a foreign non-narrow based stock index may be offered or sold to persons located within the United States through a foreign board of trade, particularly with respect to the review of requests that are subsequent to the first such request by a foreign board of trade. This has the unintended consequence of imposing a more burdensome and time-consuming process for granting permission for the offer and sale of indexes on foreign securities to persons located within the United States than is required for the listing of new U.S. stock index futures contracts on designated contract markets (with the requisite expenditure of a greater amount of CFTC staff resources). Whether or not the current situation is contrary to the regulatory structure that existed at the time that the OGC No-action procedure was created and to Congress's intent in enacting section 4(b) of the Act,[15] the Commission should reexamine its procedures for confirming that a stock index contract traded on a foreign board of trade can be offered or sold to persons located within the United States in light of the fundamental changes made by the CFMA to streamline review processes.

Neither the Commission nor OGC reexamined OGC's No-action procedures which apply to broad-based foreign stock indexes following enactment of the CFMA.[16]

[13] If the exchange voluntarily requests that the Commission approve a new contract prior to its listing, the Commission is required by Section 5(c) of the Act to take final action on the request not later than 90 days after submission.

[14] Indeed, security futures contracts are within the definition of "excluded commodities," which, based upon their characteristics, are generally eligible for a lessened degree of regulation compared to exempt or agricultural commodities. See Section 1a(13) of the Act. Under section 5(c) of the Act, the prior approval requirement is applicable only to material rule amendments of futures contracts on the agricultural contracts enumerate in Section 1a(4) of the Act.

[15] In 1982, at a time when domestic markets were required to obtain Commission approval prior to listing new contracts, section 4(b) prohibited the Commission from requiring approval of any rule or contract of a foreign board of trade and Congress instructed the Commission to adopt a process whereby it could certify that a foreign stock index conformed to the requirements of the Act, leaving the minimum criteria that the foreign stock index would have to meet to the Commission's discretion. This clearly evidences Congress' intent that foreign boards of trade be subject to a less burdensome review process than that which applies to Commission review of domestic stock indexes trading on a contract market (or at the least, it evidences clear Congressional intent that foreign indexes trading on a foreign board of trade not be subject to a higher level of process than domestic markets with respect to qualifying new stock index contracts to trade).

[16] OGC's No-action guidance was first added as 17 C.F.R. Part 5, Appendix E in 1999. 64 *Fed. Reg.* 29217 (June 1, 1999). Following enactment of the CFMA, this guidance was merely re-designated as 17 C.F.R. Part 40 Appendix C. 66 *Fed. Reg.* 42255 (August 10, 2001). In 2002 the Commission made technical changes to the OGC No-action guidance to reflect the CFMA's revision of the criteria for determining what indexes would be considered to be "non-narrow-based" indexes. 67 *Fed. Reg.* 62873 (October 9, 2002). In 2003, the Commission added an introductory section providing an explanation of

Such a reexamination is highly appropriate in light of the profound changes made to the regulatory framework by the CFMA. The OGC No-action procedure, when first introduced, was consistent with the Congressional intent of Section 4(b) of the Act that the procedures for review of foreign stock indexes by the Commission not involve approval of the foreign contract and thereby be less burdensome than the process for approval of new futures contracts on domestic stock indexes. Proposed Rule 30.13 would establish fast-track procedures which apply to Commission review of foreign stock indexes where the Commission previously has had an opportunity to conduct a full-scale review of a foreign board of trade under either a request for a prior OGC no-action letter or a foreign terminals no-action letter, and would once again align the relative burden of Commission review with respect to foreign stock indexes traded on a foreign board of trade and domestic stock indexes as Congress intended. These new procedures therefore take into account both the original intent of sections 2a(1)(B) and section 4(b) with respect to foreign stock indexes as well as the changes made to the overall regulatory framework by the CFMA.[17]

Taking these two factors into account, the fast-track procedures of Rule 30.13 follow closely the procedures that the Commission has established in its rules governing voluntary requests by contract markets for Commission review and approval of new products. Proposed Rule 30.13, provides for the same review period as approval of a new product by the Commission. This is appropriate in light of the fact that the Commission will have already had an opportunity to conduct a full review of the foreign board of trade in conjunction with its initial request for OGC No-action for a foreign stock index or for foreign terminals no-action relief.[18] It is also appropriate in light of section 4(b)'s instruction that the qualification of a foreign stock index contract for offer or sale to persons located within the United States should be through a mechanism that is short of an "approval" process. Under the Proposed Rule 30.13 fast-track procedures, the Commission deems that a foreign stock index conforms to the minimum criteria of the Act if it takes no contrary action within the review period of 45 days. This period can be extended by an additional 45 day period for novel or complex issues or if the submitting

how the information submitted is used and by deleting some information that was no longer used. 68 *Fed. Reg.* 33623 (June 5, 2003). All of these amendments were technical in nature and none re-examined the no-action process in light of the fundamental structural changes to futures regulation made by the CFMA.

[17] To the extent that the language of section 2(a)(1)(C) speaks in terms of "no board of trade shall be designated as a contract market with respect to such contracts of sale. . . unless the board of trade . . and the applicable contract meet the following minimum requirements" it need not be read as requiring a *foreign board of trade* to become a contract market in order for a non-narrow based stock index contract to be offered or sold to persons located in the U.S. In this regard, Congress made clear in the report language that through these two provisions, it was authorizing the Commission through a rule adopted under its sections 4(b) and section 8a(5) authority, to establish a certification procedure which would apply to foreign boards of trade. Even if the Commission were to interpret this language differently, the Commission clearly could use its section 4(c) exemptive authority to implement the petitioned for procedure.

[18] This is similar to the distinction made by the CFMA between designation of the contract market and product approval.

foreign board of trade requests an extension. The Commission can refuse to deem a request as conforming with the Act with an explanation of the basis of its refusal. These procedures are equivalent to those which apply to the Commission's approval of new contracts traded on a contract market.

Proposed Rule 30.13 requires that the same information that is currently required (and which will continue to be required for first time applicants) to be submitted under Appendix D to Part 30 be included by the foreign board of trade in its request for fast-track consideration of a non-narrow based stock index contract. Accordingly, the substance of the Commission's review as well as the information that it receives to conduct that review will not change. As with the Commission's post-CFMA product approval procedures, however, Proposed Rule 30.13's fast-track procedures will result in significant streamlining by avoiding the need for OGC to draft a lengthy No-action letter, and thereby also reducing the amount of Commission staff resources that must be devoted to processing a request.

Also similar to the Commission's product approval procedures, the Rule 30.13 fast-track procedures are sufficiently flexible to permit the staff to refuse to deem a foreign stock index as conforming to the Act if the submission is not self-explanatory or if it raises additional questions. A foreign board of trade would be free to resubmit a supplemented application, beginning a new review period.

b. Analysis under Section 15 supports the Petition

Section 15 requires that the Commission, before promulgating any rule, consider the costs and benefits of its action in light of five considerations. These include: protection of market participants and the public; efficiency; competitiveness and financial integrity of futures markets; price discovery; sound risk management practices and other public interest considerations.

Proposed Rule 30.13 serves the public interest in a number of ways. The rule streamlines current procedures, but maintains the same substantive review standards and the same information that is required to be filed with the Commission with respect to qualification of foreign stock indexes. Accordingly, despite the significant procedural savings and greater efficiency that the rule would bring about, there would be no diminution of protections to the public or to market users.

Proposed Rule 30.13, will however, result in greater efficiencies for the futures markets, thus increasing market efficiency. Under this proposal, foreign boards of trade will be able to apply to the Commission to make available to persons located within the United States foreign non-narrow based stock indexes which conform to the criteria of the Act with greater confidence of the time needed for review and, with greater certainty of the timing of the outcome. This will significantly increase the efficiency of the qualification process. Moreover, by increasing the ability of persons located within the United States to trade stock index contracts on foreign boards of trade, greater competition may result between futures exchanges for that trading activity. This proposal has no implications for the financial integrity of futures markets.

Proposed Rule 30.13 will result in enhanced price discovery and risk management by streamlining the process of qualification of foreign stock index contracts. Persons located within the United States may currently be invested in securities traded on foreign markets, and have risks associated with those positions which could be hedged, if they are permitted to enter into a stock index contract on such foreign securities. The Rule 30.13 fast-track procedures will streamline the process by which foreign boards of trade are able to qualify those foreign stock indexes. In this way, persons located within the United States will be better able to hedge risks associated with their holdings of such securities. The participation in the markets of these additional traders may increase price discovery in the futures market, as well.

Finally, it should be emphasized that proposed Rule 30.13 has additional public benefits by enabling the Commission to conserve staff resources and direct those resources to wherever the need is greatest. As discussed above, the petitioned rule will in no way diminish protections to market participants or to the public, but will require fewer staff resources to accomplish the same goal of reviewing and qualifying stock indexes that are traded on a foreign board of trade which has previously received either an OGC No-action letter with respect to the offer and sale in the U.S. of a foreign stock index futures contract or a foreign terminals No-action letter. The savings is generated by reducing the need for staff to craft and issue a detailed and individualized No-action letter in response to each stock index contract of a foreign board of trade and reducing the resources devoted to the internal review and coordination that issuance of any formal, individualized Commission document requires. This streamlining strategy has been successfully used with respect to other Commission review and approval procedures, such as contract approvals, and has resulted in greater efficiencies and saving of staff resources. The application of the same streamlining strategy to the process of responding to requests by foreign boards of trade to offer or sell stock index contracts to persons located within the United States should be no less successful than it has been in the context of Commission review and approval of new contracts listed on designated contract markets.

V. Text of the Proposed Rule

PART 30–FOREIGN FUTURES AND FOREIGN OPTIONS TRANSACTIONS

1. The authority citation for Part 30 is proposed to read as follows:

Authority: 7 U.S.C. 1a, 2, 4, 6, 6c and 12a, unless otherwise noted.

2. Part 30 is proposed to be amended by adding Section 30.13 to read as follows:

§30.13. Fast-track Procedures Relating to the Offer or Sale of Non-narrow-based Security Indexes Traded on a Foreign Board of Trade.

(a) *Request for consideration.* A foreign board of trade may request fast-track Commission consideration under this section of whether a futures contract on a non-narrow-based stock index that trades or is proposed to be traded thereon conforms with the requirements of the Act. Such a contract may be offered or sold to persons located within the United States if it meets the following conditions:

(1) The requesting foreign board of trade has previously requested and received at least one No-action letter of the Commission's Office of the General Counsel permitting a non-narrow based stock index futures contract traded on the foreign board to be offered and sold to persons located in the United States pursuant to the information requirements under Appendix D to this Part; or

(2) The requesting foreign board of trade has previously requested and received a No-action letter from contract market designation and derivatives transaction execution facility registration requirements permitting the foreign board of trade to provide direct electronic access to its U.S. members or authorized participants; and

(3) The requesting foreign board of trade files a submission with the Secretary of the Commission complying with the form and content requirements of paragraph (b).

(b) *Submission Requirements.* A submission requesting such consideration shall:

(1) Be filed electronically with the Secretary of the Commission in a format specified by the Secretary of the Commission;

(2) Include a copy of the submission cover sheet in accordance with the instructions in Appendix D to Part 40 of this Chapter;

(3) Include a copy of the contract's terms and conditions (in English);

(4) Demonstrate that the contract conforms to the minimum requirements of sub-sections 2(a)(1)(C)(ii)(I)-(III) of the Act—that settlement of or delivery on the contract is effectuated in cash or by means other than the transfer or receipt of any security, except an exempted security under section 3 of the Securities Act of 1933 or section 3(a)(12) of the Securities Exchange Act of 1934; trading in such contract (or option on such contract) shall not be readily susceptible to manipulation of the price of such contract (or option on such contract), nor to causing or being used in the manipulation of the price of any underlying security, option on such security or option or a group or index including such securities; and such group or index of securities shall not constitute a narrow-based security index. To demonstrate that the stock index requirement conforms with these requirements, the submission shall include (in English):

(A) A copy of the rules of the exchange, and if applicable, the rules of the underlying securities exchange, that have an effect on the over-all trading of the contract, including if applicable, circuit breakers, price limits, position limits or other controls of trading;

(B) A description of the cash price series, an explanation of the design and maintenance of the index, the method of index calculation, the nature of the index, the breadth and frequency of index dissemination;

(D) A description of the procedures and criteria for selection of individual securities for inclusion in, or removal from, the index, how often the index is regularly reviewed, and any procedures for changes in the index between regularly scheduled reviews;

(E) A description of the method of computation, availability, and timeliness of the index including the method of calculation of the cash-settlement price and the timing of its public release;

(F) Data denoted in U.S. dollars (and the conversion date and rate used) of the total capitalization, number of stocks (including the number of unaffiliated issuers if different from the number of stocks), and weighting of the stocks by capitalization and, if applicable, by price in the index as well as the combined weighting of the five highest-weighted stocks in the index;

(G) Data denoted in U.S. dollars (and the conversion date and rate used) of the average daily volume of trading, measured by share turnover and dollar value, in each of the underlying securities for a six-month period of time and, separately, the dollar value of the average daily trading volume of the securities comprising the lowest weighted 25% of the index for the past six calendar months, calculated pursuant to Commission Rule 41.11;

(H) If applicable, the average daily futures trading volume during the prior six months;

(I) A statement that based upon the data in paragraphs (a)(4)(F) and (G) that the index is not a narrow-based security index as defined in Section 1a(25) of the Act and that:

(i) The index is composed of 10 or more securities;

(ii) No single security comprises more than 30% of the total index weight;

(iii) The five largest securities do not comprise more than 60% of the total index weight; and

(iv) The lowest-weighted securities that together account for 25% of the total weight of the index do not have an aggregate dollar value of average daily trading volume of less than US$30 million (or US$50 million if the index includes fewer than 15 securities);

(J) A statement that the contract is cash settled;

(K) An explanation of why the contract is not readily subject to manipulation or to be used to manipulate the underlying security;

(L) A copy of surveillance agreements between the foreign board of trade and the exchange on which the underlying stocks are traded or a description of the inter-exchange surveillance arrangements that are in effect;

(M) When applicable, information regarding foreign blocking statutes and their impact on the ability of U.S. government agencies to obtain information concerning the trading of such contracts;

(N) A statement of whether a Memorandum of Understanding with respect to information sharing has been entered into by the foreign board of trade's regulator and the Commission;

(O) A statement that the foreign board of trade has the ability and willingness to share information with the Commission either directly or indirectly;

(P) A certification as to the truthfulness and accuracy of the foregoing data, information, facts and statements; and

(Q) When applicable, a request to make the futures contract available for trading in accordance with the terms and conditions of, and through the electronic trading devices identified in, the Foreign Trading System No-Action letter that the foreign board of trade received from Commission staff and a certification from the foreign board of trade that it is in compliance with the terms and conditions of that no-action letter.

(c) *Forty-five day review.* All non-narrow-based stock index futures contracts (or options thereon) submitted for Commission consideration under this paragraph shall be deemed as being in conformance with the requirements of the Act and Commission rules for the purpose of being permitted to be offered for sale to persons located within the United States forty-five days after receipt by the Commission, or at the conclusion of such extended period as provided under paragraph (c) of this subsection, unless notified otherwise within the applicable period, if:

(1) The submission complies with the requirements of paragraph (b) of this section; and

(2) The submitting entity does not amend the terms or conditions of the product or supplement the request for fast-track consideration, except as requested by the Commission or for correction of typographical errors. Any voluntary, substantive amendment by the submitting entity will be treated as a new submission under this section.

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

(1) An additional forty-five days, if the product raises novel or complex issues that require additional time for review, in which case, the Commission would notify the foreign board of trade within the initial forty-five day review period and would briefly describe the nature of the specific issues for which additional time for review would be required; or

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

(e) *Notice of non-conformance.* The Commission at any time during its review under this section may notify the submitting foreign board of trade that it will not, or is unable to, deem the stock index futures contract (or option thereon) as conforming to the criteria of sub-sections 2(a)(1)(C)(ii)(I)-(III) of the Act. This notification will briefly specify the nature of the issues raised and the specific requirement of sub-sections 2(a)(1)(C)(ii)(I)-(III) of the Act or of the form or content requirements of paragraph (a) of this section, with which the stock index futures contract (or option thereon) does not conform or to which it appears not to conform or the conformance to which cannot be ascertained from the submission.

(e) *Effect of notice of non-conformance.* (1) Upon notification to a submitting entity under paragraph (e) of this section of the Commission's refusal to deem a product or instrument as in conformance with the Act, the application for Commission consideration will be treated as having been withdrawn.

(2) Notification to a submitting entity under paragraph (e) of this section of the Commission's refusal to deem a stock index contract as being in conformance with the criteria of sub-sections 2(a)(1)(C)(ii)(I)-(III) of the Act shall not prejudice the foreign board of trade from subsequently submitting a revised version of the contract for Commission consideration or from submitting the product or instrument as initially proposed pursuant to a supplemented submission.

(3) *Existing or initial contracts.* All stock index contracts of a foreign board of trade that are the subject of an existing no-action letter of the Commission's Office of the General Counsel as of the date of the issuance of this section, or a stock index contract of a foreign board of trade which is considered under the provisions of Appendix D to this Part because it is the initial request for consideration by that foreign board of trade, shall

be deemed as being in conformance with the criteria of sub-sections 2(a)(1)(C)(ii)(I)-(III) of the Act under this section.

* * * * * *

The current OCG No-action procedure was established in response to the 1982 Amendments to the Act and has operated without modification since that time. However, the CFMA made a number of profound changes to the regulatory framework.

In light of these changes introduced by the CFMA, the Commission should reconsider the OGC No-action procedure with respect to futures contracts on non-narrow based security indexes. One of the fundamental purposes of the Act is "to provide a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities." Section 3 of the Act. Replacing the OGC No-action procedure with a fast-track procedure for Commission consideration which applies in instances where the Commission or its staff have already reviewed the foreign board of trade under a previous foreign stock index or foreign terminals no-action review request, and which is modeled after its procedures to approve new products for listing on U.S. contract markets, will further the public interest by streamlining the procedures with no substantive change to the review criteria or the information that is available to the Commission for review. Thus, issuance of proposed Rule 30.13 by the Commission is in the public interest by: 1) increasing the efficiency, speed and certainty of the process by which Commission determines that non-narrow based stock index contracts traded on a foreign board of trade can be offered or sold to persons located within the United States; 2) doing so in a manner that in no way diminishes the protections of the Act; and 3) conserving limited Commission resources.

The undersigned hereby certifies that the material facts set forth in this Petition are true and complete to the best of my knowledge, and undertakes promptly to inform the Commission in writing, if at any time prior to the Commission taking action on this Petition, any material representation made in this Petition ceases to be true and complete.

For the foregoing reasons, we respectfully petition the Commission to issue new Rule 30.13 of the Commission's rules, and in furtherance of its issuance of the rule, to publish in the *Federal Register* notice of this Petition and the text of proposed Rule 30.13 for public comment.

Please direct any questions with respect to this Petition to the undersigned at (202) 756-3492 or to Dr. Ekkehard Jaskulla, Director Legal Affairs, Section Markets and Regulatory of Eurex at 011-49-69-2101-5133.

Respectfully submitted,

Paul M. Architzel

cc: Chairman Lukken
Commissioner Dunn
Commissioner Chilton
Commissioner Sommers
Terry Arbit, General Counsel
Richard Shilts, Director Division of Market Oversight
Dr. Ekkehard Jaskulla, Eurex

PAC 8-9

CME Group
A CME/Chicago Board of Trade Company

Craig S. Donohue
Chief Executive Officer

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May 21, 2008

Mr. David A. Stawik
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition for Amendment of Commodity Futures Trading Commission's Part 35 Regulations to Permit the Clearing of OTC Agricultural Swaps

Dear Mr. Stawik:

CME Group, Inc. ("CME Group") hereby requests, pursuant to Commodity Futures Trading Commission ("Commission") Regulation 13.2, that the Commission exercise its exemptive authority under Section 4(c) of the Commodity Exchange Act ("CEA"), by means of an amendment to Part 35 of its Regulations ("Exemption of Swap Agreements"), to permit the clearing of standardized over-the-counter ("OTC") agricultural swaps, subject to appropriate conditions to protect the market and market participants.

I. Overview

OTC agricultural swaps may provide a useful means for hedging risks in a manner that complements the agricultural contracts that are traded in the continuous double-sided auction market conducted by traditional futures exchanges. If permitted to clear such agricultural swaps, a registered derivatives clearing organization ("DCO") could provide numerous benefits to new and existing participants in the OTC agricultural derivatives market, including the reduction of counterparty credit risk by the functioning of an independent central counterparty with significant financial and operational safeguards and sophisticated risk management tools, a margining system based on a daily mark-to-market calculation, and the potential for cross-margining or portfolio margining with respect to related products. Certain OTC agricultural market participants have expressed to CME Group their interest in obtaining central counterparty clearing services for such OTC agricultural products. Several requests have recently been made to the Commission by designated contract markets ("DCMs") and DCOs for exemptions that would permit particular

DCOs to clear specific OTC agricultural swaps. The current practice of securing separate exemptions on a product-by-product basis is inefficient, costly and time-consuming. In our view, it impairs the ability of agricultural producers to efficiently obtain tailored hedge protection that is protected by the counterparty clearing services that could be offered by a DCO.

The Commission should permit DCOs to clear standardized OTC agricultural swaps that meet specified, generally-applicable conditions that ensure consistency with the public interest and the purposes of the CEA and that ensure such transactions would not have a material adverse effect on the ability of the Commission or any DCM or DCO to discharge their respective regulatory and self-regulatory responsibilities. Therefore, CME Group is requesting that the Commission amend its Part 35 Regulations, pursuant to its authority under Section 4(c) of the CEA, to set forth those conditions under which any DCO may clear conforming, standardized OTC agricultural swaps.

II. There is a growing market demand for the clearing of OTC agricultural products

CME Group has seen an increasing market demand for the clearing of OTC agricultural products. Many of the participants in the cash ethanol market, who are users of the Board of Trade of the City of Chicago, Inc.'s ("CBOT") cleared-only OTC Ethanol products, have asked the CBOT to list similar corn basis swaps for clearing-only, to allow them to manage increasingly volatile basis risk among the primary ethanol production areas. The expanding ethanol industry has contributed to multiple changes in the cash merchandising of corn. As the market evolves to serve new ethanol demand and respond to other factors, such as expensive transportation and the emergence of China as a likely importer rather than exporter of corn in coming years, the basis in many locations has become volatile. This volatility is likely to continue for several years as the markets evolve and adjust.

Commercial and brokerage firms servicing this industry have reported increased OTC activity to manage basis risk. CBOT designed a group of OTC corn basis and calendar swap products to provide market participants with an instrument to manage this risk with the benefit of centralized clearing by a registered DCO. Market participants have also expressed an interest in OTC cleared-only swaps involving other agricultural products, including wheat and soybeans. CBOT has responded by developing terms and conditions for OTC wheat and soybean calendar swaps. On April 21, 2008, CBOT filed a petition with the Commission, pursuant to Section 4(c) of the CEA, for an exemption that would allow Chicago Mercantile Exchange Inc. ("CME") to clear, on the CBOT's behalf, standardized Corn Basis Swaps for six ethanol production regions, as well as Corn, Wheat and Soybean Calendar Swaps.[1] Furthermore, CME Group has already been approached by market participants regarding their interest in OTC cleared-only swaps for additional agricultural commodities, and we expect that such interest will continue to grow. For example, the National Grain and Feed Association, a major agricultural trade association, voiced

[1] ICE Clear U.S., Inc. ("ICE Clear") had previously filed a request that the Commission exercise its Section 4(c) exemptive authority to permit ICE Clear to clear standardized OTC swap transactions involving coffee, sugar and cocoa, which was published for comment on December 6, 2007. CME Group filed a comment letter with respect to the ICE Clear petition on February 8, 2008.

its support for cleared OTC agricultural swaps in connection with the CFTC's April 22, 2008 Agriculture Forum.[2]

III. The need to make a product-specific request for an exemption to permit the clearing of an agricultural swap hinders financial innovation

The need to petition the Commission for a product-specific exemption in order to permit a DCO to clear a particular agricultural swap is inconsistent with the efficient development of these markets. The requirements for an exemption under Part 35 for OTC agricultural swaps are currently more restrictive than other exemptions under the CEA for transactions involving non-agricultural commodities.

Part 35 of the Commission's Regulations was adopted in 1993 to exempt swap agreements that met certain conditions from most provisions of the CEA, other than the anti-fraud and anti-manipulation provisions. Part 35 was superseded by several provisions in the Commodity Futures Modernization Act of 2000 ("CFMA") with respect to all commodities other than agricultural commodities. Specifically, the CFMA provided legal certainty for certain off-exchange "excluded swap transactions" (Section 2(g)), and for certain "transactions in exempt commodities" (Section 2(h)). The Section 2(g) exemption applies to " . . . any agreement, contract, or transaction in a commodity other than an agricultural commodity . . . ." if it: (1) is entered into only between "eligible contract participants"[3]; (2) is subject to individual negotiation by the parties; and (3) is not executed or traded on a trading facility. "Excluded swap transactions" are exempt from virtually all provisions of the CEA.[4] Section 2(h)(1) exempts transactions in an "exempt commodity"[5] which: (1) are entered into solely between eligible contract participants; and (2) are not entered into on a trading facility. Transactions in commodities exempt under Section 2(h)(1) generally remain subject to the anti-fraud and anti-manipulation provisions of the CEA. Section

[2] Remarks of Tom Coyle, National Grain and Feed Association, CFTC Agriculture Forum, April 22, 2008. In addition, the NGFA's written statement indicated that:

> The NGFA, in principle, is supportive of the concept of allowing agricultural commodity swaps to be cleared on-exchange. We believe that granting exchanges this regulatory flexibility could be a catalyst for development of new risk management products of benefit to commercial grain hedgers. In a changed market environment, innovative ideas like this may help ease the market's transition during a time of broad change and may enhance short-term market balance.

[3] An "eligible contract participant" is defined in Section 1a(12) of the CEA.

[4] The provisions of the CEA that do apply to transactions exempt under Section 2(g) include Section 5a (to the extent provided in Section 5a(g)), 5b, 5d, and 12(e)(2).

[5] An "exempt commodity" is defined in Section 1a(14) of the CEA as "a commodity that is not an excluded commodity or an agricultural commodity." An "excluded commodity" is defined in Section 1a(13) of the CEA. However, an "agricultural commodity" is not defined in either the CEA or the Commission's Regulations.

2(h)(3) exempts transactions in an exempt commodity which: (1) are entered into on a principal-to-principal basis solely between "eligible commercial entities"[6]; and (2) are executed or traded on an electronic trading facility. Transactions in commodities exempt under Section 2(h)(3) generally remain subject to the anti-fraud and anti-manipulation provisions of the CEA, and the electronic trading facility is subject to certain recordkeeping requirements and reporting obligations, and must disseminate price, volume, and other trading data if the Commission determines that the electronic trading facility performs a significant price discovery function. Sections 2(g) and 2(h) do not cover transactions involving agricultural commodities, and Part 35 of the Commission's Regulations remains applicable only to agricultural swap agreements.

As with the Section 2(h)(1) and 2(h)(3) exemptions, the anti-fraud and anti-manipulation provisions continue to apply to agricultural swap agreements subject to the Part 35 exemption. However, the conditions for exemption under Regulation 35.2 are more restrictive than the conditions in either Section 2(g) or Section 2(h) in certain important respects. An agricultural swap agreement is only eligible for a Regulation 35.2 exemption if:

> (a) the swap agreement is entered into solely between eligible swap participants at the time such persons enter into the swap agreement;
>
> (b) the swap agreement is not part of a fungible class of agreements that are standardized as to their material economic terms;
>
> (c) the creditworthiness of any party having an actual or potential obligation under the swap agreement would be a material consideration in entering into or determining the terms of the swap agreement, including pricing, cost, or credit enhancement terms of the swap agreement; and
>
> (d) the swap agreement is not entered into and traded on or through a multilateral transaction execution facility; . . . .

The requirements set forth in Regulation 35.2(a) and (d) are similar to conditions that apply to both the Section 2(g) and Section 2(h)(1) exemptions.[7] However, the Part 35 exemption also requires that exempted swap agreements must not have standardized material economic terms and must not be cleared. The Commission should amend its Part 35 Regulations to exempt all transactions in agricultural commodities that meet the requirements of Regulation 35.2(a) and (d) from all provisions of the CEA, except the anti-fraud and anti-manipulation provisions, subject to the conditions described in Section IV below. The Commission has the authority to amend Part 35 in this manner, pursuant to Section 4(c) of the CEA.

[6] An "eligible commercial entity" is defined in Section 1a(11) of the CEA.

[7] The definitions of "eligible contract participants" and "eligible swap participants" are similar, but there are some differences. The Commission should harmonize the definition of an "eligible swap participant" in Regulation 35.1 with the definition of an "eligible contract participant" in Section 1a(12) of the CEA.

Section 4(c)(1) of the CEA provides that, "[i]n order to promote responsible economic or financial innovation and fair competition, . . ." the Commission may exempt contracts, and persons who provide services with respect to such contracts, from any applicable requirement that such contracts must be executed on a designated contract market ("DCM") or a registered derivatives transaction execution facility or from any other provision of the CEA (with certain specified exceptions). We believe that it would be far more efficient and useful to producers and commercial interests in the agricultural sector if the Commission were to avoid one-off decision-making on a product-by-product basis, which hinders the development of the market and needlessly delays the efficient deployment of new products.

IV. The Commission should permit DCOs to clear any standardized OTC agricultural swaps that meet generally-applicable conditions

Section 4(c)(2) of the CEA indicates an exemption from the exchange trading requirement requires that the Commission must determine that: (1) the exemption will be consistent with the public interest and the purposes of the CEA[8]; and (2) the contract will be entered into solely between appropriate persons and will not have a material adverse effect on the ability of the Commission or the relevant market to discharge its regulatory or self-regulatory duties under the CEA. An amendment to Regulation 35.2 that would permit any DCO to clear standardized OTC agricultural swaps, if it meets the conditions specified in Regulation 35.2(a) and (d) and the additional conditions specified in this Section IV would be consistent with the public interest and the purposes of the CEA. In particular, it would serve one of the key public interests identified in Section 3(a) of the CEA, ". . . by providing a means for managing and assuming price risks." As described above, market participants have requested that CME clear standardized OTC agricultural products to help them manage certain volatile basis risk.

[8] The applicable public interest and the purposes of the CEA are identified in Section 3 of the CEA, which provides as follows:

(a) FINDINGS. – The transactions subject to this Act are entered into regularly in interstate and international commerce and are affected with a national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.

(b) PURPOSE. – It is the purpose of this Act to serve the public interests described in subsection (a) through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission. To foster these public interests, it is further the purpose of this Act to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this Act and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.

The key purposes of the CEA identified in Section 3(b), in addition to promoting responsible innovation and fair competition, include serving the public interest through a system of effective self-regulation under the oversight of the Commission, deterring and preventing price manipulation, ensuring the financial integrity of transactions and the avoidance of systemic risk, and protecting market participants from fraud and misuses of customer assets. The requested amendment would retain the applicability of the CEA's anti-fraud and anti-manipulation provisions. Clearing of OTC agricultural swap transactions would provide all of the benefits offered by a registered DCO. Moreover, the registered DCOs that would clear these transactions, and the exchanges that may specify their clearing terms, are each subject to Core Principles under the CEA, and as such, will exercise applicable self-regulatory obligations under the Commission's oversight.

The conditions currently contained in Regulation 35.2(a) and (d) require that OTC swaps must be transacted between eligible counterparties. Any additional conditions for agricultural swaps should be designed to ensure consistency with the public interest and the purposes of the CEA and to prevent any material adverse effect on the fulfillment of the regulatory obligations of the Commission or any DCM or DCO. Therefore, appropriate conditions for permissible standardized OTC cleared-only agricultural swaps should include the following:

(1) The swap transactions must be cleared by a registered DCO that is in compliance with the Core Principles applicable to DCOs;

(2) The swap transactions must be subject to appropriate large trader reporting requirements and position accountability requirements; and

(3) The swap transactions' settlement prices, volume and open interest must be reported.

These conditions would further the purposes of the CEA and the ability of the Commission and the relevant DCM and/or DCO to fulfill any applicable regulatory and self-regulatory responsibilities, while enhancing customer protection. In particular, permitting a DCO to clear any OTC agricultural swaps that meet these conditions would bring increased transparency to OTC agricultural markets and would allow regulators to gain a better understanding of the impact of OTC agricultural transactions on exchange markets in the same commodities.

V. Conclusion

For all of the reasons discussed above, CME Group requests that the Commission exercise its exemptive authority under Section 4(c) of the CEA to amend Part 35 of its Regulations to permit the clearing of standardized OTC agricultural swaps, subject to appropriate conditions to protect the market and market participants that would apply to all DCOs. Such an amendment would allow these markets to develop to meet market needs without placing unnecessary burdens on

DCMs, DCOs and the Commission that would result from numerous product-specific exemption requests.[9]

We would be happy to discuss this Petition with Commission staff. Please feel free to contact me at (312) 930-8275 or Craig.Donohue@cmegroup.com; Richard Lamm, Managing Director, Regulatory Counsel, at (312) 930–2041 or Richard.Lamm@cmegroup.com; Anne Polaski, Associate Director and Regulatory Counsel, at 312-338-2679 or Anne.Polaski@cmegroup.com; or David Lehman, Director, Commodity Research and Product Development, at (312) 347-3848 or David.Lehman@cmegroup.com. Thank you for your consideration.

Sincerely,

Craig S Donohue

Craig S. Donohue
Chief Executive Officer
CME Group Inc.

cc: Acting Chairman Walter Lukken
Commissioner Bart Chilton
Commissioner Michael Dunn
Commissioner Jill E. Sommers
Martin Murray
Robert Wasserman
John Lawton
Phyllis Dietz

[9] Until the Commission amends Part 35 or otherwise grants a generally applicable exemption pursuant to this petition, the Commission should promptly address any pending or subsequently filed requests for individual exemptions from the requirements of Regulation 35.2 to permit a DCO to clear standardized OTC agricultural swaps, in a manner that would establish a level playing field for all DCOs.

NFA NATIONAL FUTURES ASSOCIATION

fAC 7-1/17

July 21, 2008

Via Overnight Mail

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend Certain CFTC Part 4 Regulations

Dear Mr. Stawick:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulations 4.26 and 4.36. NFA petitions the Commission to amend these regulations in order to require that CPO and CTA registrants file disclosure documents electronically through NFA's electronic disclosure document filing system. The information required by CFTC Regulation 13.2 follows.

I. Text of Proposed Rule Amendments [additions are underlined deletions are ~~stricken through~~]

Part 4- COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

* * *

§ 4.26 Use, amendment and filing of Disclosure Document.

* * *

(d) Except as provided by 4.8:

(1) The commodity pool operator must electronically file with the National Futures Association, pursuant to the electronic filing procedures of the National Futures Association, ~~one copy of~~ the Disclosure Document and, where used, profile document for each pool that it operates or that it intends to operate not less than 21 calendar days prior to the date the pool

operator first intends to deliver such Document or documents to a prospective participant in the pool; and

(2) The commodity pool operator must electronically file with the National Futures Association, pursuant to the electronic filing procedures of the National Futures Association, ~~one copy of~~ the subsequent amendments to the Disclosure Document and, where used, profile document for each pool that it operates or that it intends to operate within 21 calendar days of the date upon which the pool operator first knows or has reason to know of the defect requiring the amendment.

* * *

§ 4.36 Use, amendment and filing of Disclosure Document.

* * *

(d) (1) The commodity trading advisor must electronically file with the National Futures Association, pursuant to the electronic filing procedures of the National Futures Association, ~~one copy of~~ the Disclosure Document for each trading program that it offers or that it intends to offer not less than 21 calendar days prior to the date the trading advisor first intends to deliver the Document to a prospective client in the trading program; and

(2) The commodity trading advisor must electronically file with the National Futures Association, pursuant to the electronic filing procedures of the National Futures Association, ~~one copy of~~ the subsequent amendments to the Disclosure Document for each trading program that it offers or that it intends to offer within 21 calendar days of the date upon which the trading advisor first knows or has reason to know of the defect requiring the amendment.

II. Supporting Arguments

Currently, while there is nothing to prohibit a firm from filing a disclosure document in hardcopy form, the vast majority of CPO and CTA registrants file disclosure documents with NFA primarily via electronic mail due to its expediency and convenience. While the use of electronic mail has been a significant improvement over hardcopy submissions in terms of filing efficiency, the current approach still requires a considerable amount of staffing resources and has other disadvantages, e.g., the inability of registrants to obtain the status of the review of their filing without calling NFA and the lack of a central location for storing past filings. Accordingly, NFA has developed a new internet-based electronic filing system for disclosure documents that will be significantly less resource intensive while also streamlining and enhancing the filing process for registrants. In order to realize the proposed benefits, however, registrants must be required to file their documents electronically through NFA's new system. Consequently, NFA is petitioning the Commission to amend its regulations accordingly.

As with NFA's other electronic filing systems, e.g., Easyfile for introducing broker and CPO financial statements, NFA's new electronic disclosure document filing system was designed to be easy to use and secure. Although an internet connection is needed to access the system, filers without internet access can use any public internet site, such as those available in most public libraries. Registrants will access the system using the same designated login and password that they use for NFA's Online Registration System ("ORS"). The ORS login process is a well tested authentication model with which participating registrants are already familiar. NFA has taken great care in the development of this system to ensure that the database of disclosure document filings will not be compromised in any way by unauthorized persons.

Once registrants have accessed the system they will be guided through the filing process, which culminates in the electronic transfer of the disclosure document through the secure web-based gateway. The system includes extensive help text to assist registrants with their filings, and the filing process includes a series of questions that will assist in identifying the type of filing as well as provide important background information to assist NFA staff with the analysis of the document itself. After the document is submitted, the system will automatically assign it to an available NFA analyst. By accessing the system, registrants will be able to track the status of their filing and receive comment letters as they are issued. Additionally, the system will serve as an electronic filing cabinet for registrants since it will maintain all previous filings and related comment letters filed through the system.

As noted above, to implement NFA's electronic disclosure document filing system, the CFTC must modify its regulations to require the mandatory filing of disclosure documents through NFA's electronic filing system and eliminate the ability to file hard copy documents. Accordingly, NFA respectfully petitions the Commission to amend Regulations 4.26 and 4.36 as set out above.

Very truly yours,

Thomas W. Sexton, III
Vice President,
General Counsel and Secretary

cc: Ananda K. Radhakrishnan
Director
Division of Clearing & Intermediary Oversight

William Penner
Deputy Director,Compliance and Registration
Division of Clearing & Intermediary Oversight

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DIVISION OF ENF.

LAW OFFICES OF
JEFFREY L. ROSENBERG & ASSOCIATES, LLC

46 MORGAN DRIVE
OLD WESTBURY, NY 11568

212.755.7700
FAX: 212.755.6060
OLD WESTBURY FAX: 516.626.0355
E-MAIL: J.ROSENBERG@JLRLLC.COM

*ALSO ADMITTED IN CALIFORNIA

October 17, 2008

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VIA FEDERAL EXPRESS
Secretariat of the Commission of Issuance,
Commodities Futures Trading Commission,
Three Lafayette Centre
1155 21St Street, NW
Washington, DC 20581

Re: PETITION BY THE PLENUM FUND, LP, PURSUANT TO 7 U.S.C. §§ 5(c) AND 7(d), AND 17 C.F.R. §13.2 TO INVALIDATE OR AMEND CHICAGO MERCANTILE EXCHANGE RULES 578, 600, 606 and 621.

To: Secretariat of the Commission of Issuance, Commodities Futures Trading Commission:

I. Party In Interest Filing This Petition:

This firm is counsel to Plenum Fund, LP ("Plenum"), which is a limited partnership formed, operating and existing under the laws of the State of Delaware, and which maintains its principal office for the conduct of its business at 1709 Langhorne-Newtown Road, Suite 5, Langhorne, Pa., 19047-1010. The Plenum Fund primarily trades and deals in E-Mini S&P 500 futures contracts, which are traded and cleared for and on behalf of Plenum by Fortis Clearing Americas, LLC ("Fortis"), its futures commission merchant, through Account No. "09615", which was opened in the name of Plenum in 2005. In accordance with CFTC Regulation 13.2, and pursuant to 7 U.S.C. §§ 5(c), and 7(d), Plenum demonstrates below its interest and objective in filing and prosecuting this Petition.

II. Jurisdiction of the Commission:

The jurisdiction of the Commission is invoked in pursuance of 7 U.S.C. §§ 5(c) and 7(d), and 17 C.F.R. §13.2, which provisions in various parts establish certain "core principles" for designated contract markets, provide for enforcement of those core principals by the exchange and the Commission, and provide for the invalidation and/or amendment of various Commission and exchange rules of general application.

As a separate element and compelling consideration militating in favor of the Commission exercising jurisdiction in connection with this Petition, it is respectfully submitted that the incidence of erroneous trades on designated contract exchanges, unrelated to legitimate price discovery, resulting from the implementation of automated trading systems featuring algorithmic formulations, has dramatically increased over the past several years, and is likely to expand exponentially over the next several years. As a result, this may be anticipated to increase the number of persons affected or to be affected and wrongfully impinged by the prospective application of CME Rules 578 and Chapter 6, Rules 600, 606 and 621, to the extent incorporated and called into application by Rule 578.

III. Overview of Purpose and Objective of This Petition:

It is the purpose and objective of this Petition, filed pursuant to 7 U.S.C. §§ 5(c) and 7(d), and 17 C.F.R. §13.2, to invalidate all, or to invalidate part of and amend various and so many parts of the Chicago Mercantile Exchange ("CME") Rules 578 and 621 to the extent that CME 578 and that portion of CME Chapter 6, Rules 600, 606 and Rule 621 which is invoked by Rule 578 (as relates to the limitation of time to make and pursue any claim in arbitration): (i) infringe on, or emasculate, one or more "core principles" established under § 7(d) of the CEA, including, without limitation, core principles "(2)", (4)", "(13)" and "(15)"; (ii) seek to require the arbitration of any claim by a person who is entitled to bring a "private right of action" against an exchange for bad faith failure to enforce such exchanges own rules, and imposes artificially short or inappropriate time limits within which to file and thereafter prosecute any claim[1]; and (iii) which concurrently seeks to artificially and mechanistically limit the amount recovery of damages incurred by any person or entity trading on the exchange as may result from the bad faith failure of such exchange to enforce its rules in a manner which is contrary and inconsistent with CEA, § 22 (see, e.g., CME Rule 578 C.)

The text of CME Rule 578 is annexed to this Petition as Exhibit "A". The Text of Chapter 6 and Rules 600, 606 and 621, as incorporated by reference in Rule 578, is annexed to the Petition as Exhibit "B". The text of Rules 578, and Chapter 6 and Rules 600, 606 and 621 are each incorporated into the discussion and showing of this Petition by reference.

As more fully detailed below, it is submitted, that CME Rule 578, inclusive of that portion of CME Chapter 6, and Rules 600, 606 and 621 incorporated therein by reference which imposes artificially and inappropriately short notice provisions to make or perfect and prosecute any claim against the CME, is directly contrary and inconsistent with, and seeks to denude and/or erode § 22 of the Commodities Exchange Act ("CEA") (7 U.S.C. § 1, et seq.), which has been held to be the "exclusive remedy" under the Commodities Exchange Act to redress the foregoing claims of bad faith failure of an exchange to enforce its own rules. § 22 of the CEA states, in pertinent part, as follows:

[1] The 1982 amendment creating in CEA § 22 an express private right of action established a two-year statute of limitations. *Grosser v. Commodity Exchange, Inc.*, 639 F.Supp. 1293, 1299 at fn. 5 (S.D.N.Y. 1986); *see, Fustok v. Conticommodity Services, Inc.*, 618 F.Supp. 1076 (S.D.N.Y. 1985).

> "[A] contract market [such as the CME] ... that fails to enforce any bylaw, rule, regulation or resolution that it is required to enforce by Section 5a(8) and 5a(9) [7 U.S.C. § 7a(8) and 7a(9)] ... of this Act ... shall be liable for ***actual damages*** sustained by a person who engaged in any transaction on or subject to the rules of such contract market ... to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce ... such bylaws, rules, regulations or resolutions." 7 U.S.C. § 25(b)(1).

For the same reasons that CME Rule 578, inclusive of Rule 621, transgresses CEA, § 22 it is inconsistent with and/or transgresses one or more core principles "(2)", (4)", "(13)" and "(15)", established under § 7(d) of the CEA.

It has been unanimously held by Federal Courts that § 22 of the CEA, entitled: "Private rights of action", expressly provides a private right of action in favor of persons actually trading on an exchange against the exchange to recover for ***actual losses*** incurred, resulting from the failure of any exchange to enforce any by-law, rule, regulation or resolution required to be enforced by § 5a(8) or (9) of the CEA or by the CFTC, or from enforcement of any by-law, rule, regulation or resolution in a manner violating the CEA or any CFTC rule, regulation or order.

By way of summary and overview, CME Rule 578, inclusive of the parts of Rule 621 incorporated therein should be invalidated and/or amended to the fullest extent necessary or appropriate so that persons protected by the statutory grant of CEA § 22 are not deprived of their express "private right of action" and their right to recover their "actual damages", as provided for by CEA § 22 not be emasculated or limited by Rule 578 D, and so that the designated core principles of CEA § 7(d) are maintained and preserved; and Rules 578, inclusive of Rule 621 should be invalidated and/or amended so that the two year statute of limitations period established under the 1982 amendments to the CEA are not abrogated.

More specifically, Rule 578 at ¶ C. provides that disputes shall be arbitrated pursuant to Rule 621. In turn, Rule 621A. and B. provide that claims against "GCC" (defined below) personnel, or any other Exchange staff, must be initiated, if at all, by an initial "claim of loss, including a detailed description of any loss suffered" filed within ten days of the date of any incident; and Rule 600.C. declares that any failure to adhere to the "pre-filling requirements" shall be fatal to a claim.

It is respectfully submitted that in light of the clear dictates of CEA § 22, and the Federal Case law interpreting that Statute and the appurtenant regulatory matrix (see Section "V" below), it should readily appear to the Commission that CME Rules 578, 600, 606 and 621 were specifically and intentionally adopted and implemented by the CME to make it more difficult and to avoid many claims which would and could otherwise be asserted under CEA § 22, by imposing arbitration requirements intended to avoid the exclusive remedy provisions of CEA § 22 and have such claims heard in a friendly forum and not in Federal Court, by imposing limitations on the amount to be recovered by an injured party in a manner and scope which is inconsistent with the rights provided under CEA § 22 to recover "actual damages", and by artificially imposing short and unrealistic periods within which any prospective claimant must provide detailed notice of any claim and the amount thereof, inconsistent with in derogation of the two year statute of limitations established by CEA § 22. In this context, it demonstrated below that Congress has already imposed on a claimant seeking to establish liability under CEA § 22 the difficult burden of showing that an exchange acted in "bad faith" in failing to enforce its own rules. As if that burden were not sufficient difficult, the CME seeks to engage in self-legislation, in an attempt to raise the bar established by Congress and thereby even further insulate itself from liability. Given the high bar of the applicable "bad faith" standard this action should be viewed as akin to indemnifying oneself from intentional and/or recklessly wrongful conduct.

Analogous to and bearing upon this self-serving and self-protective impropriety, in *Daniel v. Board of Trade,* 164 F.2d 815, 818-20 (7th Cir.1947), the Seventh Circuit found that a cause of action was stated by a trader who alleged that the members of the Chicago Board of Trade had enacted certain regulations "for their own personal gain" and in order to protect themselves against liability in an antitrust action which had been filed against them. In view of the exchange's duty to act with "utmost objectivity" in the public interest, the Court concluded "that if an exchange enacted a rule for the sole purpose of advancing the private interests of its members, and if the rule damaged the plaintiff, it would not be a defense for the exchange to allege that the rule was reasonable." *Bishop v. Commodity Exchange, Inc.*, 564 F.Supp. 1557, 1562 (S.D.N.Y.1983).

IV. Background of Damages Suffered by Plenum Which Demonstrate its Interest In Filing This Petition:

(b)(4)

not a subject matter and/or objective of this Petition, and such facts and circumstances concerning those damages, and the requirements of Rule 588 are set out herein merely as background information, and to demonstrate the interest of the Plenum Fund in making and filing this Petition.

It will be the separate purpose and objective of a plenary action to be initiated in the Federal District Court for the Northern District of Illinois to recover those damages. Thus, for the absence of doubt, and as set out above in section "III", it is the purpose and objective of this Petition to invalidate the whole, or those portions and provisions of CME Rule 578, inclusive of Chapter 6 and Rules 600, 606 and 621 that is, or are, inconsistent with and which seek to denude or erode the express provisions of CEA, § 22, including as interpreted by applicable Federal Court decisions, and as may hinder or preclude the assertion of Plenum's rights, interests and entitlements, pursuant to CEA, § 22; and to thereby serve the purposes and objectives of 7 U.S.C. §§ 5(c) and 7(d), .

V. Statutory Basis For and Arguments in Favor of the Grant of Plenum's Petition;

(a) CEA, § 22 And Federal Case Law Mandate And Dictate A Private Right of Action and the Recovery of All Actual Damages Incurred In Circumstances Where a Person or Entity Trades On an Exchange and Suffers Damages By Reason of the Bad Faith Failure of the Exchange to Enforce Its Own Rules.

The Court in *Sam Wong & Son, Inc. v. New York Mercantile Exchange*, 735 F.2d 653, 665-666 (2nd Cir. 1984), confirmed that:

> "...§ 22 of the CEA, enacted by the Futures Trading Act of 1982, entitled: "Private rights of action", provides for such actions [private rights of action] against persons other than contract markets and similar organizations in subsection (a) and against the latter in subsection (b). Broadly speaking subsection (b) imposes liability for actual losses resulting from failure to enforce any by-law, rule, regulation or resolution required to be enforced by § 5a(8) or (9) of the CEA or by the CFTC, or from enforcement of any by-law, rule, regulation or resolution in a manner violating the CEA or any CFTC rule, regulation or order. (The text of § 22(b)(4) is set out above)"

Furthermore, "[t]he Futures Trading Act of 1982 ...[which] created § 22(b)(4) of the CEA ... provides that private actions against a commodities exchange or its officers and employees "must establish ... bad faith in failing to take action or in taking such action as was taken." *Jordan v. New York Mercantile Exchange,* 571 F.Supp. 1530, 1536 (S.D.N.Y. 1983)

The heightened standard of proof required to prevail on a claim against a commodity exchange arises from several factors. First, under the self-regulatory scheme established by Congress with the enactment of the Commodity Exchange Act, commodity exchanges are accorded "broad and flexible powers [to] enable them to insure an orderly market and prevent manipulation in prices...." *See, Case & Co. v. Board of Trade of the City of Chicago, 523 F.2d 355, 362 (7th Cir.1975)*; *accord, Miller v. New York Produce Exchange, 550 F.2d 762, 767 (2d Cir.1977)*; P.J. Taggares Co. v. New York Mercantile Exchange, 476 F.Supp. 72, 75-76 (S.D.N.Y.1979). To apply a lesser, negligence-based standard in a claim against an exchange "would conflict with the Congressional scheme of exchange self-regulation" and would "force a court to substitute its judgment for that of experts on the exchange," aided "neither by specific statutory standards nor by any particular financial expertise." *Brawer v. Options Clearing Corp.*, 807 F.2d 297, 302 (2nd Cir. 1986)

· Second, bad faith must be established as the "sole or dominant" reason for the exchange action or inaction because of the possibility, inherent in the scheme of exchange self-regulation, that exchange directors may simultaneously "act[ ] to advance the public interest, as well as to advance their own interests." Bishop v. Commodity Exchange, Inc., supra., 564 F.Supp. at 1562.

As Judge Lasker observed in *Bishop:*

> "the Comex Board is composed of members of the commodities industry, who are called upon, on occasion, to vote on matters which, by the nature of the situation, relate to the industry from which a Governor derives his livelihood. A vote on such questions will then quite likely affect his interests as well as the public's. Should a Governor vote in favor of such a rule in the belief that the rule served the public interest, even if also in the expectation and hope that it would serve his personal interest, his behavior would not give rise to liability. Id.

The Second Circuit Court of Appeals in *Wong* expressed the view that Judge Lasker's opinion in *Bishop* takes substantially the right approach toward passing on the sufficiency of complaints, noting that it takes into account the competing needs of exchanges and their officials and of the trading public. "Although governors must be able to police the markets effectively with the broad discretion accorded by Congress, traders must not be deprived of their right to challenge illegitimate regulatory action." 735 F.2d at 677.

Thus, the Second Circuit stated and found as follows:

> "The Commodity Exchange Act, which embodies the statutory model of exchange self-regulation, mandates that we strike a balance that does not insulate exchange officials from answering serious questions posed by injured traders. To do otherwise would drastically curtail the private right of action deemed essential to the regulatory framework established by Congress. Therefore, when self-interest or other ulterior motive unrelated to proper regulatory concerns is alleged to constitute the sole or the dominant reason for the exchange action, a complaint is sufficient even though the action was not beyond the bounds of reason. On the other hand, if the governors sincerely and rationally believe their action is in the public interest, there should not be

> liability simply because the action has the incidental effect of advancing their private interests or damaging someone whom they do not like."

Wong, supra, 735 F.2d 653 at 657.[2]

In the view of these and other findings of the Federal Courts which have considered the issue of a private right of action under CEA § 22, in circumstances where an exchange has in bad faith failed to enforce its own rules, Plenum has alleged and will recite facts in a plenary action to be brought in the Northern District of Illinois, in which, it is anticipated Plenum will demonstrate that the decision of the GCC to double the "No Bust Range" in the circumstances of Plenums' January 14, 2008, 6.5 second erroneous trading session, was not and could not have been made in the public interest, and was actually made only after discussions and consultations with, and to benefit certain large traders of the CME, individually, as compared to the public at large, and therefore, to benefit the CME as a result of that special favoritism and the emoluments that would flow from such favoritism.

In the foregoing context, CME Rule 578, and so much of CME Chapter 6 as is referred to above, should be invalidated and/or amended to the extent that the CFTC determines that such Rules impinge on, denude, or in any way lessens the scope, ambit and application of CEA § 22 and rights and entitlements provided thereunder; and, more specifically, the Commission should invalidate or amend such Rules to the extent that their application either interferes with or denies any private right of action for an affected party or trader to sue the CME as a contract

[2] Bad faith has been defined by the Honorable Alan K. Hellerstein, *Western Capital Design LLC v. New York Mercantile Exch.*, 180 F.Supp.2d 438, 442-43 (S.D.N.Y.2001), *aff'd*, No. 01-7348, 2002 WL 10253 (2d Cir. Jan. 3, 2002), in the following terms:

> "Bad faith requires wrongful knowledge, and failure to act on that knowledge with a motive ascribable to malfeasance. '[S]elf-interest or other ulterior motive unrelated to proper regulatory concerns must constitute the sole or dominant reason for the exchange action or inaction." *Minpeco, S.A. v. Hunt,* 693 F.Supp. 58, 61 (S.D.N.Y.1988) (citation omitted). "[T]o succeed on a claim of bad faith, plaintiffs must establish 'first, that the exchange acted or failed to act with knowledge [ ] and second, that the exchange's action or inaction was the result of an ulterior motive." ' *Id.* (*quoting Ryder Energy,* 748 F.2d at 780). Although irrational or arbitrary behavior in some circumstances may support an inference of bad faith, the behavior has to be "so arbitrary" as to justify an inference of "constructive bad faith." *See Minpeco,* 693 F.Supp. at 63; *see also Brawer v. Options Clearing Corp.*, 807 F.2d 297, 303 n. 9 (2d Cir.1986) ("We do not mean to foreclose the possibility that [exchange actions] might be so arbitrary as to constitute constructive bad faith."), *cert. denied,* 484 U.S. 819, 108 S.Ct. 76, 98 L.Ed.2d 39 (1987); *Jordon* v. New York Mercantile Exchange, supra., 571 F. Supp 1533, *affirmed in relevant part,Sam Wong,* 735 F.2d 653 (2d Cir.1984)"

exchange, or precludes or limits the right of such party to recover its actual damages, each as provided and championed by CEA § 22.

In the specific context of Plenum's claims against the CME, the CME has asserted that Plenum is bound by the arbitration provisions of Rules 578 and 621, and may not assert its Federal Statutory right to pursue a private right of action, and that its damages are limited to not more than $100,000.00 by reason of Rule 578 D., to the extent damages were suffered on a single day, January 14, 2008. In comparison, as appears above, Plenum's damages exceed $5.4 million damages.

Apart from the fact that the application of Rule 578 would undermine and/or deny Plenum its express statutory rights under the CEA in prospective claims to be asserted against the CME, it portends the same result for a myriad of other unidentified persons covered under CEA § 22. For that reason, and because the imposition of Rule 578, inclusive of Rules 600, 606 and 621 is, in substance, a "contract of adhesion", it should be invalidated to the extent it is inconsistent with, or precluded by, CEA § 22, the case law interpreting the CEA and 7 U.S.C. §§ 5(c), and 7(d). With respect to the "contract of adhesion" argument, it is asserted that Plenum could not reasonably trade S&P 500 Minis on any other exchange other than the CME; and thus, it had no effective choice other than to capitulate to agreeing to be subject to Rule 578, even though such capitulation compromised Plenum's Federal Statutory rights under CEA § 22. Under the circumstances existing in this case, CME Rule 578 as it encompasses and invokes CME Rules 600, 606 and 621 is both substantively and procedurally unfair; as Plenum had no realistic choice in submitting to such Rules, and it was arbitrarily deprived of its Federal statutory rights thereby. This circumstance and such fact pattern is a sufficient ground for Federal Courts to refuse to enforce such a "contract of adhesion"; and in any event the question of whether a contract is arbitrable is a question for Court in any event. [3]

[3] As a general matter, unconscionability which will support a claim that a contract should be set aside or invalidated as a "contract of adhesion", requires a showing that a contract is "both procedurally and substantively unconscionable when made" See, eg., *Gillman v. Chase Manhattan Bank,* 73 N.Y.2d 1, 10, 537 N.Y.S.2d 787, 534 N.E.2d 824 (1988). That is, there must be "some showing of 'an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party' [citation omitted]" See, *Matter of State of New York v Avco Fin. Servs.,* 50 N.Y.2d 383, 389, 429 N.Y.S.2d 181, 406 N.E.2d 1075 1988).

The Supreme Court has determined that whether the parties agreed to arbitrate an issue is for the courts, not the arbitrator, to resolve, unless the contract itself specifies otherwise. *First Options of Chicago, Inc. v. Kaplan,* 514 U.S. 938, 942-43, 115 S.Ct. 1920, 1922-24,131 L.Ed.2d 985 (1995). This holding suggests that the related and antecedent issue of whether an agreement to arbitrate is a contract of adhesion, fraudulently induced, or otherwise revocable, is an issue for the court as well, because essential to the *First Options* inquiry is the assumption that an agreement to arbitrate was made voluntarily. See *Maye v. Smith Barney, Inc.*, 897 F.Supp. 100, 106 n. 3 (S.D.N.Y.1995) "Under our decisions, whether or not the company

Moreover, in support of the notion that CME Rule 57, inclusive of CME Chapter 6, must be invalidated or amended in substantial part because it impinges on the Federal Statutory rights of a designated group or class of persons or entities, the Seventh Circuit has reached a similar conclusion in an action brought under the statute by a national organization representing farmers in *American Agriculture Movement, Inc. v. Board of Trade of Chicago*, 977 F.2d 1147 (7th Cir.1992):

> "By its terms, then, § 22(b) creates the exclusive remedies available to those injured by violations of the CEA, and makes those remedies available only to persons injured in the course of trading on a contract market. It therefore forecloses all other remedies, including any on behalf of non-traders. To the extent (if any) that pre-1974 courts had implied private remedies against exchanges in favor of non-traders, Congress directed them to stop doing so in § 22(b)."

(b) **Statutory Basis For the Filing of this Petition.**

This Petition is filed and made pursuant to 7 U.S.C. §§ 5(c), and 7(d), and 17 C.F.R. §13.2. As a procedural matter 7 C.F.R. §13.2 provides, in pertinent part, as follows:

§ 13.2 Petition for issuance, amendment, or repeal of a rule.

> "Any person may file a petition with the Secretariat of the Commission for the issuance, amendment or repeal of a rule of general application. The petition shall be directed to Secretariat, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581, and shall set forth the text of any proposed rule or amendment ***or shall specify the rule the repeal of which is sought.*** The petition shall further state the nature of the petitioner's interest and may state arguments in support of the issuance, amendment or repeal of the rule. The Secretariat shall acknowledge receipt of the petition, refer it to the Commission for such action as the Commission deems appropriate, and notify the petitioner of the action taken by the Commission. Except in affirming a prior denial or when the denial is self-explanatory, notice of a denial in whole or in part of a petition shall be accompanied by a brief statement of the grounds of denial." (emphasis added)

was bound to arbitrate, as well as what issues it must arbitrate, is a matter to be determined by the Court on the basis of the contract entered into by the parties. . . . 'For arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit'." *Atkinson v. Sinclair Refining Co.*, 370 U.S. 238, 241, 82 S.Ct. 1318, 1320, 8 L.Ed.2d 462 (1962) (citations omitted).

Relevant to the issue of whether the CFTC may invalidate so much of CME Rule 578, inclusive of Rules 600, 606 and 621 as intrudes upon the rights of Plenum and others who are, or may be, or who may become similarly situated, is the Second Circuit's holding in *Wong,* wherein it stated that it agreed "... with the district court's well-reasoned conclusion that there is no private right of action for failure by an exchange to propose amendments to the futures contracts traded upon it." *Wong, supra.,* 735 F.2d at 666. The Court disagreed with the slightly different approach to the same issue raised by the plaintiff in *Wong,* stating: "The CFTC ... urges that a privately enforceable duty to amend the terms of a futures contract may be found in § 5(d), which it reads as requiring an exchange to maintain an orderly market." 735 F.2d at 667.

Rejecting this argument, the Second Circuit held that "a private damages remedy is unavailable against an exchange for failing to amend the terms of its future contracts." *Id.* The issue of seeking to invalidate the CME's rule of general application, necessarily incorporated into all contracts traded on the CME is analogous; and thus, Plenum was motivated to seek to invalidate Rule 578, in whole, or in part, pursuant to the provisions of 7 C.F.R. §13.2; and to protect against any prospective claim that it failed to exhaust its administrative remedies.

Moreover, the Second Circuit has found that CFTC Regulation 13.2 is itself a further indication that "the CEA contemplates that revision of contract terms [and by compelling analogy exchange rules of general application incorporated into or superimposed upon contract terms of contracts traded on such exchanges] should be a matter for the CFTC and the exchanges, not for the courts in private litigation." Wong, supra, 735 F.2d at 668. [4]

Thus, the Second Circuit in *Wong* further held as follows:

> "CFTC regulation 13.2, 17 C.F.R. § 13.2, at 176, provides that "[a]ny person may file a petition with [the CFTC] for the issuance, amendment or repeal of a rule of general application." When acting within § 5a(10), the Commission must first notify the exchange of its concern and "afford the contract market an opportunity to make appropriate changes." If the exchange, after such notification, fails to act, the statute authorizes the Commission to "change or supplement" the contract rules, but only "after granting the contract market an opportunity to be heard."

This is the procedure afforded by 17 C.F.R. §13.2, set out in full above.

[4] Nothing herein contained is intended or shall be deemed to suggest that in the absence of CFTC action invalidating Rule 578, Plenum would not alternatively or otherwise be entitled to challenge the validity of CME Rule 578 in a plenary action in a Federal District Court, on the basis that it is an arbitrary and improper effort by the CME to limit its liability in contravention of Federal Law and is against public policy.

CONCLUSION

Speaking to the issue of the lack of precedental and decisional authority in this limited arena and context, the Wong Court noted that: "According to one commentator, the Commission has not formally exercised its authority under Section 5a(10) but, like the gunboat in the harbor, its existence has proven effective in encouraging the markets to rethink certain of their contracts." *Id., citing to* 1 P. Johnson, *Commodities Regulation* §1.22, at 77. (1982)

Since, the gun boat theory has not had the same effect with respect to CME Rule 578, and because, as applied, or in prospect, Rule 578, net of the incorporation of CME Rules 600, 606 and 621 denudes, emasculates and contradicts the Federally mandated and granted rights to a designated group as provided by CME §22, Rules 578, 600, 606 and 621 should be invalidated in whole or in part, as is the subject of this Petition.

Accordingly, in response to this Petition, Plenum respectfully requests that the Commission provide the CME with all appropriate and due notice of any hearings or further submissions, and that it allow and facilitate participation in any such hearing(s) by Plenum, and that Plenum be heard at such hearing(s), and that Plenum be afforded the right and opportunity to make a responsive submission in opposition and in response to any submissions made by the CME or any other interested party.

Respectfully Submitted,

JEFFREY L. ROSENBERG
& ASSOCIATES, LLC

By: ______________________
Jeffrey L. Rosenberg
(Counsel for Plenum Fund, LP)

JLR/csj

Exchange, it is the duty of the clearing member to ensure that registration is current and accurate at all times. Each individual must use a unique user ID to access Globex. In no event may a person~~member or clearing member~~ enter an order or permit ~~another to enter~~the entry of an order by an individual using~~with~~ a user ID other than the individual's own unique user ID.

577. [RESERVED]

578. LIMITATION OF LIABILITY, NO WARRANTIES

A. EXCEPT AS PROVIDED BELOW, THE EXCHANGE, THE BOARD OF TRADE OF THE CITY OF CHICAGO, INC. ("CBOT"), THE NEW YORK MERCANTILE EXCHANGE INC. ("NYMEX") AND CME ALTERNATIVE MARKETPLACE INC., (INCLUDING EACH OF THEIR RESPECTIVE SUBSIDIARIES AND AFFILIATES), THEIR OFFICERS, DIRECTORS, EMPLOYEES, AGENTS, CONSULTANTS, LICENSORS, MEMBERS, AND CLEARING MEMBERS, SHALL NOT BE LIABLE TO ANY PERSON FOR ANY LOSSES, DAMAGES, COSTS OR EXPENSES (INCLUDING, BUT NOT LIMITED TO, LOSS OF PROFITS, LOSS OF USE, AND DIRECT, INDIRECT, INCIDENTAL, CONSEQUENTIAL OR PUNITIVE DAMAGES), ARISING FROM:

(i) ANY FAILURE, MALFUNCTION, FAULT IN DELIVERY, DELAY, OMISSION, SUSPENSION, INACCURACY, INTERRUPTION, TERMINATION, OR ANY OTHER CAUSE, IN CONNECTION WITH THE FURNISHING, PERFORMANCE, OPERATION, MAINTENANCE, USE OF OR INABILITY TO USE ALL OR ANY PART OF ANY OF THE SYSTEMS AND SERVICES OF THE EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC., OR SERVICES, EQUIPMENT OR FACILITIES USED TO SUPPORT SUCH SYSTEMS AND SERVICES, INCLUDING WITHOUT LIMITATION ELECTRONIC ORDER ENTRY/DELIVERY, TRADING THROUGH ANY ELECTRONIC MEANS, ELECTRONIC COMMUNICATION OF MARKET DATA OR INFORMATION, WORKSTATIONS USED BY MEMBERS AND AUTHORIZED EMPLOYEES OF MEMBERS, PRICE REPORTING SYSTEMS AND ANY AND ALL TERMINALS, COMMUNICATIONS NETWORKS, CENTRAL COMPUTERS, SOFTWARE, HARDWARE, FIRMWARE AND PRINTERS RELATING THERETO~~GLOBEX®, CUBS™, TOPS™, CLEARING 21®, GLOBEX CONTROL CENTER™, GALAX-C™~~; OR

(ii) ANY FAILURE OR MALFUNCTION, FAULT IN DELIVERY, DELAY, OMISSION, SUSPENSION, INACCURACY, INTERRUPTION OR TERMINATION, OR ANY OTHER CAUSE, OF ANY ~~EXCHANGE~~ SYSTEM, OR SERVICE ~~OR FACILITY~~ OF THE EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC., OR SERVICES, EQUIPMENT OR FACILITIES USED TO SUPPORT SUCH SYSTEMS OR SERVICES, CAUSED BY ANY THIRD PARTIES INCLUDING, BUT NOT LIMITED TO, INDEPENDENT SOFTWARE VENDORS AND NETWORK PROVIDERS; OR

(iii) ANY ERRORS OR INACCURACIES IN INFORMATION PROVIDED BY THE EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC. ~~OR THE EXCHANGE~~ OR ANY EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC. SYSTEM, SERVICE OR FACILITY; EXCEPT FOR INCORRECT ORDER STATUSING INFORMATION AS PROVIDED IN RULE 579 (GLOBEX CONTROL CENTER AND ORDER STATUSING); OR

(iv) ANY UNAUTHORIZED ACCESS TO OR UNAUTHORIZED USE OF ANY EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC. SYSTEM, SERVICE OR FACILITY BY ANY PERSON.

THE FOREGOING LIMITATION OF LIABILITY SHALL APPLY WHETHER A CLAIM ARISES IN CONTRACT, TORT, NEGLIGENCE, STRICT LIABILITY, CONTRIBUTION OR OTHERWISE AND WHETHER THE CLAIM IS BROUGHT DIRECTLY OR AS A THIRD PARTY CLAIM.

THE FOREGOING LIMITATION OF LIABILITY SHALL BE SUBJECT TO THE COMMODITY EXCHANGE ACT AND REGULATIONS THEREUNDER. A PARTY WHO HAS BEEN FINALLY ADJUDICATED TO HAVE ENGAGED IN WILLFUL OR WANTON MISCONDUCT MAY NOT AVAIL ITSELF OF THE PROTECTIONS IN THIS RULE.

B. THERE ARE NO EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS (INCLUDING BUT NOT LIMITED TO WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE OR USE) PROVIDED BY THE EXCHANGE, CBOT, NYMEX ~~THE NEW YORK MERCANTILE EXCHANGE INC.~~ OR CME ALTERNATIVE MARKETPLACE INC. (INCLUDING THEIR RESPECTIVE SUBSIDIARIES AND AFFILIATES), THEIR OFFICERS, DIRECTORS, EMPLOYEES, AGENTS, CONSULTANTS, AND LICENSORS RELATING TO ANY

SYSTEMS OR SERVICES OF THE EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC. OR SERVICES, EQUIPMENT OR FACILITIES USED TO SUPPORT SUCH SYSTEMS OR SERVICES, INCLUDING THE GLOBEX SYSTEM.

C. ANY DISPUTE ARISING OUT OF THE USE OF ~~EXCHANGE~~ SYSTEMS OR SERVICES OF THE EXCHANGE OR CME ALTERNATIVE MARKETPLACE INC. OR SERVICES, EQUIPMENT OR FACILITIES USED TO SUPPORT SUCH SYSTEMS OR SERVICES IN WHICH THE EXCHANGE, OR CME AUCTION MARKETS (INCLUDING EITHER OF THEIR SUBSIDIARIES AND AFFILIATES), OR ANY OF THEIR~~ITS~~ OFFICERS, DIRECTORS, EMPLOYEES, AGENTS, CONSULTANTS OR LICENSORS~~, OR EMPLOYEES~~ IS A PARTY SHALL BE ARBITRATED PURSUANT TO RULE 621. ANY ARBITRATION SHALL BE BROUGHT WITHIN THE PERIOD PRESCRIBED BY EXCHANGE RULES. ANY OTHER ACTIONS, SUITS OR PROCEEDINGS AGAINST ANY OF THE ABOVE MUST BE BROUGHT WITHIN TWO YEARS FROM THE TIME THAT A CAUSE OF ACTION HAS ACCRUED. THIS PARAGRAPH C SHALL IN NO WAY BE CONSTRUED TO LIMIT A PARTY'S OBLIGATION TO ARBITRATE ITS CLAIM OR TO CREATE A CAUSE OF ACTION AND SHALL NOT AUTHORIZE AN ACTION THAT WOULD OTHERWISE BE PROHIBITED BY CME RULES. IF FOR ANY REASON, A COURT OF COMPETENT JURISDICTION FINDS THAT SUCH DISPUTE IS NOT ARBITRABLE, SUCH DISPUTE MAY ONLY BE LITIGATED IN THE COUNTY OF COOK IN THE STATE OF ILLINOIS AND WILL BE GOVERNED BY THE LAWS OF THE STATE OF ILLINOIS WITHOUT REGARD TO ANY PROVISIONS OF ILLINOIS LAW THAT WOULD APPLY THE SUBSTANTIVE LAW OF A DIFFERENT JURISDICTION.

D. THE EXCHANGE, AND WITH RESPECT TO "AUCTIONS," CME ALTERNATIVE MARKETPLACE INC., MAY, IN THEIR RESPECTIVE SOLE DISCRETION, ASSUME RESPONSIBILITY FOR DIRECT, OUT-OF-POCKET LOSSES DIRECTLY CAUSED BY THE NEGLIGENCE OF GLOBEX CONTROL CENTER OR OTHER EXCHANGE STAFF AND/OR ORDER STATUS ERRORS PROVIDED BY THE GLOBEX CONTROL CENTER OR AN EXCHANGE SYSTEM, SERVICE OR FACILITY. NOTWITHSTANDING THE ABOVE, i) THE EXCHANGE'S; ii) CBOT'S; AND iii) WITH RESPECT TO AUCTIONS, CME ALTERNATIVE MARKETPLACE INC.'S TOTAL COMBINED AGGREGATE OBLIGATIONS SHALL NOT EXCEED $100,000 FOR ALL LOSSES FROM ALL CAUSES SUFFERED ON A SINGLE DAY; $200,000 FOR ALL LOSSES SUFFERED FROM ALL CAUSES IN A SINGLE CALENDAR MONTH; AND $2,400,000 FOR ALL LOSSES FROM ALL CAUSES SUFFERED IN A SINGLE CALENDAR YEAR. ANY DISPUTED CLAIM PURSUANT TO THIS PARAGRAPH D MUST BE ARBITRATED PURSUANT TO EXCHANGE RULES. **[THE REFERENCE TO CBOT WILL BE ADDED TO THIS PARAGRAPH UPON GLOBEX MIGRATION]**

E. IN NO EVENT SHALL THE EXCHANGE'S, CBOT'S, AND WITH RESPECT TO AUCTIONS, CME ALTERNATIVE MARKETPLACE INC.'S, TOTAL COMBINED AGGREGATE LIABILITY FOR ALL CLAIMS ARISING OUT OF ANY NEGLIGENCE, FAILURES, MALFUNCTIONS, FAULTS IN DELIVERY, DELAYS, OMISSIONS, SUSPENSIONS, INACCURACIES, INTERRUPTIONS, TERMINATIONS, ORDER STATUSING ERRORS OR ANY OTHER CAUSES, IN CONNECTION WITH THE FURNISHING, PERFORMANCE, OPERATION, MAINTENANCE, USE OF OR INABILITY TO USE ALL OR ANY PART OF ANY OF THE EXCHANGE'S, CBOT'S, OR CME ALTERNATIVE MARKETPLACE INC.'S SYSTEMS~~,~~ OR SERVICES, OR SERVICES, EQUIPMENT OR FACILITIES USED TO SUPPORT SUCH SYSTEMS AND SERVICES, OR THE NEGLIGENCE OF EXCHANGE OR CBOT STAFF, EXCEED $2,400,000 IN ANY GIVEN CALENDAR YEAR.

IF THE NUMBER OF ALLOWED CLAIMS ARISING OUT OF ANY FAILURES OR MALFUNCTIONS ON A SINGLE DAY OR SINGLE MONTH CANNOT BE FULLY SATISFIED BECAUSE OF THE ABOVE DOLLAR LIMITATIONS, ALL SUCH CLAIMS SHALL BE LIMITED TO A PRO RATA SHARE OF THE MAXIMUM AMOUNT FOR THE RESPECTIVE PERIOD.

A CLAIM AGAINST THE EXCHANGE, CBOT, OR WITH RESPECT TO AUCTIONS, CME ALTERNATIVE MARKETPLACE INC., ARISING OUT OF ANY FAILURE OR MALFUNCTION SHALL ONLY BE ALLOWED IF SUCH CLAIM IS BROUGHT IN ACCORDANCE WITH THIS RULE.

579. GLOBEX CONTROL CENTER

579.A. Customer Support

The Globex Control Center ("GCC") provides Globex customer support and problem management only to members, clearing members and customers designated by clearing members. In addition, designated NYMEX members and clearing members may also receive customer support and problem management from GCC with respect to contracts traded on Globex. In order to be eligible for GCC

Chapter 6
Arbitration

JURISDICTION

600. DISPUTES SUBJECT TO CME ARBITRATION

600.A. Disputes Among Members

It is contrary to the objectives and policy of the Exchange for members to litigate certain Exchange-related disputes. Disputes between and among ~~M~~members ~~and Non-Member Investors~~ that are described below and that are based upon facts and circumstances that occurred at a time when the parties were ~~M~~members ~~or Non-Member Investors~~ shall be subject to mandatory arbitration in accordance with the rules of this Chapter:

1. claims between members that relate to or arise out of any transaction on or subject to the rules of the Exchange;
2. claims between or among members ~~and Non-Member Investors~~ relating to ownership of, or interests in, trading rights on the Exchange; and
3. claims between members relating to the enforceability of:
    a. non-compete clauses to the extent they relate to the Exchange,
    b. terms of employment on the trading floor, and
    c. financial arrangements relating to the resolution of error trades in Exchange products that are included in any employment agreement entered into on or after August 1, 1998.

Nothing in this rule, however, shall require a member employee to submit to arbitration any claim that includes allegations of a violation of federal, state or local employment discrimination, wage payment or benefits laws.

600.B. Disputes Between Members and Certain Non-Member Employees

The enforceability of the following provisions of an employment agreement entered into on or after August 1, 1998, between a member and a non-member employee registered pursuant to Rule 501 shall be subject to mandatory arbitration in accordance with the rules of this Chapter:

1. non-compete clauses to the extent that they relate to the Exchange; and
2. terms of employment on the trading floor.

Nothing in this rule, however, shall require a non-member employee to submit to arbitration any claim that includes allegations of a violation of federal, state or local employment discrimination, wage payment or benefits laws. A non-member employee shall mean a member's bona fide employee who has been registered by the Exchange to work on the trading floor.

600.C. Claims Against the Exchange

Claims against the Exchange pursuant to the provisions of Rule 578.C., Rule 578.D., Rule 579.C., and/or Rule 587.C. shall be subject to mandatory arbitration in accordance with the rules of this Chapter, provided the claimant has complied with all pre-filing requirements under the applicable rule(s).

600.D. Permissive Arbitrations

The following may be submitted for arbitration at the Exchange and, in the event such a claim is submitted against a member, that member is required to arbitrate the dispute under these rules, unless otherwise provided:

1. claims of a customer against a member that relate to or arise out of any transaction on or subject to the rules of the Exchange;
2. claims against an Exchange clearing member and its ~~CME~~ Globex~~LOBEX~~ user pursuant to Rule 588.C.3.a. and b., where the claimant has complied with the provisions of Rule 588.D., and pursuant to Rule 588.C.3.d., provided that any non-member ~~CME~~ Globex~~LOBEX~~ user has consented to arbitration of the dispute at the Exchange within 20 days of receipt of a claim;
3. claims of a customer against a clearing member responsible for the spot-call delivery performance of a transaction on or subject to the rules of the Exchange and/or against a member in connection with such a transaction;
4. claims of an SGX member against a member that relate to or arise out of transactions subject to or relating to the Mutual Offset System;

5. claims of a non-member (other than those claims required to be arbitrated under Rule 600.B) against a member that relate to or arise out of employment on the trading floor;
6. claims by or against an entity whose majority ownership is held by Exchange members and whose principal business relates to activity on or at the Exchange, where the dispute has a material connection to the business or purpose of the Exchange, provided such entity has consented to arbitration of the dispute at the Exchange within 20 days of receipt of a claim; and
7. at the discretion of the ~~Managing Director of~~Chief Regulatory ~~Affairs~~Officer, any claim involving the interests of the Exchange, its members, their business relations or commodity futures trading in general not otherwise arbitrable under these rules, provided the parties have consented to such arbitration.

600.E. Waiver of Any Objection to Jurisdiction

Any member or non-member who submits a claim or grievance to arbitration or any member who appeals to a hearing committee of the Board from any panel decision, or who takes any steps therein, shall be conclusively presumed to have voluntarily recognized and agreed to the jurisdiction of the panel or hearing committee of the Board to hear and determine the claim or appeal.

600.F. Hearing Panel

Any claim involving only members shall be heard by a Member panel and its decision shall be rendered in accordance with the rules of this Chapter. A Member panel shall mean an arbitration panel consisting of a co-chairman of the Arbitration Committee and five Members as defined in Rule 400.

601. CUSTOMER CLAIMS AGAINST MEMBERS

601.A. Definitions

1. Customer. Customer shall mean any person, not a member of the Exchange, who places an order or for whose account an order is placed for execution on the Exchange or who otherwise executes a transaction on or subject to the rules of the Exchange.
2. Claim. Claim shall mean any dispute arising out of any transaction on or subject to the rules of the Exchange, including mutual offset rules.
3. Mixed Panel. Mixed Panel shall mean an arbitration panel consisting of a co-chairman of the Arbitration Committee~~, two Exchange~~ and five Arbitration Committee members, ~~and~~ three of whom shall be persons who are non-members and who are not associated with any member of a contract market, or employee thereof, and are not otherwise associated with a contract market.
4. Member. Member as used in this Chapter shall mean 1) ~~an individual~~ members ~~or~~ and clearing members of the Exchange, including retired members with floor access privileges and individuals and entities described in Rule 106; 2) ~~and~~ associated persons ("APs") and affiliates of clearing members of the Exchange; 3) ~~its~~ guaranteed introducing brokers of clearing members of the Exchange and their APs; 4) Exchange permit holders; and 5) individuals and entities that have agreed in writing to comply with the rules of the Exchange.
5. Punitive Damages. Punitive damages shall mean an award in excess of actual damages suffered. Punitive damages shall be limited to twice the amount of actual damages and may be awarded only to a customer after a determination that there has been willful and wanton misconduct in the execution or handling of an order by a member or an employee acting on behalf of a member.

601.B. Refusal to Hear Certain Disputes

A chairman may, but shall not be required to, order that a dispute that is otherwise arbitrable under these rules not be arbitrated hereunder if the dispute requires for adjudication the presence of essential witnesses or third parties over whom the Exchange has no jurisdiction or who are not otherwise available, or if the dispute requires the application of the rules of another exchange.

601.C. Initiation of Arbitration

In the event that a complaint is received by the Exchange from a customer, it shall be referred to the Market Regulation Department, which shall inform the customer of alternative dispute settlement forums and, when appropriate, forward to the customer a Consent Form for arbitration at the Exchange. Such form shall inform the customer, by attachment of all pertinent rules, of the customer's rights and liabilities, including costs associated with arbitration, and the option of selecting an arbitration panel consisting of Exchange members or a Mixed Panel to decide the claim and any counterclaims, cross-claims or third-party claims.

A customer who submits a claim for arbitration in accordance with these rules consents thereby to the jurisdiction of the arbitrators and agrees to the arbitration of any counterclaims, cross-claims or third-party claims by any respondent which arise out of the transaction that is the subject of the customer's claim. The claim shall comply with the requirements of Rule 602, and in the case of a request for punitive damages, the claim shall set forth the facts the customer intends to present in support of the claim that the misconduct was willful and wanton.

The customer shall file a completed Consent Form and deposit the arbitration fee with the Market Regulation Department. Notice shall then be given to the member against whom the claim is asserted, who shall respond to the claim in accordance with Rule 603.

601.D. Referral to Arbitration Panel or Mixed Panel

A Customer claim against a member shall be heard by the type of panel selected by the customer and its decision shall be rendered in accordance with the rules of this Chapter. Customer claims (and any counterclaims, cross-claims or third-party claims applicable thereto) that do not exceed $5,000 and do not include any claim for punitive damages may, in the interests of efficiency and economy, be resolved without hearing. The panel shall render its decision based upon the parties' written submissions and any other relevant information obtained and provided to the panel and the parties at the direction of the chairman and/or the panel.

FILING PROCEDURES

602. INITIATING AN ARBITRATION CLAIM

A claimant may initiate a claim by submitting a written description of the dispute, a completed Arbitration Cover Sheet and depositing the appropriate arbitration fee with the Market Regulation Department within the period of eligibility for arbitration claims. The written claim shall include a clear description of the facts and circumstances involved in the dispute, including the transaction(s) or agreement(s) complained of, the names of the persons and firms alleged to be responsible for any loss to the claimant, the dates of all acts or omissions relevant to the claim, a detailed calculation of the amount claimed and any other information necessary to fully describe the dispute.

The Market Regulation Department shall reject for filing any claim that does not fully describe the dispute, is clearly filed after the period of eligibility has expired or is clearly not arbitrable at the Exchange. Such a claim will be promptly returned to the filing party with a notice describing the deficiency. A claimant seeking to correct the deficiency and file an amended claim may do so within 30 days of receiving notice describing the deficiency despite any expiration of the period of eligibility prescribed by Rule 609 during that 30-day period. The acceptance for filing by the Market Regulation Department shall not preclude a challenge to the arbitrability of the claim nor create a presumption that the claim is arbitrable.

603. ANSWERING AN ARBITRATION CLAIM

Each respondent shall file a written response within 21 days after receipt of the written claim. However, if a party has timely filed a challenge to the arbitrability of the dispute, its response shall be due 21 days after receipt of the written decision confirming the arbitrability of the dispute.

The written answer must admit the claim or describe the respondent's basis for denying liability to the claimant(s). The answer may include an admission or denial of each specific allegation contained in the claim and/or the respondent's narrative description of the facts and circumstances involved in the dispute. A respondent may assert in an answer any defense that would be available in a court of law or equity, including any affirmative defense.

604. FAILURE TO ANSWER

A respondent's unexcused failure to file a timely answer shall constitute an admission of the facts alleged in a claim.

605. COUNTERCLAIMS, CROSS-CLAIMS AND THIRD-PARTY CLAIMS

A respondent may assert any counterclaim, cross-claim and/or third-party claim to the extent such claim would be allowable as an original claim under these rules and, in response to claims by a customer against a member, the member may assert any counterclaim, cross-claim and/or third-party claim arising out of the same transaction or incident that is the subject of the customer's claim. Each respondent must file any counterclaim, cross-claim or third-party claim at the same time an answer to a claim is due. Initiating counterclaims, cross-claims, third-party claims and answers thereto shall conform to the requirements for initiating and answering original claims.

A respondent who believes that another member may have a claim to any money or property which is the subject of a dispute in arbitration and that the failure of that other member to assert a claim in the pending arbitration could prejudice the interests of the respondent may submit a request to the chairman to compel the participation of the other member. If a member fails to file such claim after being ordered to assert that claim in the pending arbitration, then notwithstanding any other rule, that member shall be barred from asserting in the future any claim against the respondent that is based on the same transaction, occurrence or subject.

606. REVIEW OF ARBITRABILITY

Any party may file a challenge to the arbitrability of a dispute submitted for arbitration at the Exchange. A party's failure to file a timely challenge to arbitrability shall waive any right to object thereafter to the arbitrability of the dispute.

A challenge to arbitrability by a claimant must be filed no later than 5 days after the claim is submitted for arbitration. A challenge to arbitrability by a respondent must be filed no later than 10 days after the respondent has received notice of the claim. The request must be in writing and state the reasons why the dispute is not arbitrable at the Exchange. Any other party may file a written response in support of or opposition to the challenge no later than 10 days after receiving notice of the challenge to arbitrability.

The chairman may decide the arbitrability of a dispute based on his consideration of the written submissions of the parties. The chairman's decision shall be final and is not appealable.

607. CONSOLIDATION OF ARBITRATION DISPUTES

If a chairman receives notice that two or more arbitration disputes pending at the Exchange are related, the chairman may order that any or all of the disputes be consolidated for purposes of conducting a hearing on the disputes. In determining whether to consolidate the disputes the chairman may consider the efficiencies of consolidation as well as the burdens and benefits to the parties in consolidating the disputes.

608. WITHDRAWAL OF CLAIMS

A. A party may voluntarily withdraw its claim, counterclaim, cross-claim or third-party claim without prejudice at any time before an answer thereto has been filed by notifying the Market Regulation Department in writing of such withdrawal.

B. After an answer to any claim, counterclaim, cross-claim or third-party claim has been filed, the claimant seeking to withdraw the claim, counterclaim, cross-claim or third-party claim must submit to the chairman a written request to withdraw with prejudice or upon such terms and conditions as may be imposed by the chairman.

C. A withdrawal with prejudice under this rule shall bar the claimant from re-filing any claim based on the same acts, transactions or omissions as the dismissed claim.

609. PERIOD OF ELIGIBILITY FOR ARBITRATION

An arbitration must be initiated within two years of the date the claimant knew or should have known of the dispute on which the claim is based, except that claims filed pursuant to Rule 600.C. must be submitted within 10 days of receiving notice that the Exchange has refused to compensate the claimant for the claimed loss.

Counterclaims, cross-claims and third-party claims must be submitted no later than the date on which the answer is due.

610. PARALLEL PROCEEDINGS

No claim will be accepted for arbitration at the Exchange if the Market Regulation Department receives notice that another arbitration, reparations action or civil court proceeding based on the same act, transaction or omission as the arbitration claim is pending at the time of filing.

No claim, counterclaim, cross-claim or third party-claim will be accepted for arbitration against a respondent if the Market Regulation Department has received notice that a stay exists due to the pendency of any bankruptcy proceeding against that respondent. If such a stay arises after a claim is accepted for arbitration or if the Market Regulation Department subsequently learns that such a stay is pending, the claim shall be dismissed without prejudice as to each respondent who is the subject of the stay. Nothing in this rule shall prevent a claim in arbitration from proceeding against any remaining respondent.

PRE-HEARING PROCEDURES

611. REQUESTS FOR DOCUMENTS, INFORMATION OR TESTIMONY

A. The initial schedule for document requests by parties and responses will be set by the Market

Regulation Department. The chairman may require any member, or any person employed by or associated with a member to produce relevant documents in his possession or control at any time after a claim has been filed.

Upon the failure of a party or member to voluntarily produce relevant documents in its possession or control upon request by a party, the party seeking the documents may submit a written request to the chairman for an order compelling the production of such documents.

1. Any request for an order compelling production of documents must:
   a. identify each document or type of document sought with as much specificity as possible;
   b. explain the relevance of each document or type of document sought; and
   c. include a representation that the requesting party has attempted to obtain the documents from the responding party before resorting to a request to the chairman.
2. The party or member against whom an order compelling production is sought shall:
   a. produce copies of the requested documents to the requesting party and the Exchange; or
   b. represent in writing that the documents are not in his possession or control and explain the basis for such representation, and, if applicable, identify who is in possession or control of the requested documents; or
   c. object in writing to a request and provide the basis for each objection.

B. In connection with any claim, counterclaim, cross-claim or third-party claim that seeks relief in excess of $50,000, any party may seek leave from the chairman to serve written requests for information on any other party. The chairman shall have discretion to determine whether and under what circumstances such requests may be permitted.

C. The chairman may require any member, or any person employed by or associated with a member, to appear and to testify at a hearing.

D. Whenever such production or appearance results from the request of a party, all reasonable costs and expenses incurred shall be borne by the party making the request, unless directed otherwise by the panel. A party who incurs costs and expenses recoverable under this rule may, no later than the close of the last hearing date in the matter, submit an application to the panel for such costs and expenses. Such application shall contain a detailed explanation of amounts claimed. The panel may grant or deny all or any portion of the application.

E. Any member or employee thereof failing to appear, testify, produce documents or provide information in accordance with this rule may be ~~guilty of a major offense~~charged with a violation of Rule 432.

612. DOCUMENTS AND WITNESSES TO BE PRESENTED AT HEARING

No later than 10 business days prior to the first scheduled hearing, each party must provide every other party and the Exchange with copies of all documents that the party intends to offer into evidence and a list of the names of all witnesses, including party-witnesses, who the party intends to call at the hearing in support of a claim or defense. Parties are not required under this rule to provide copies of those documents that they may use, or to identify any witnesses whom they may call, only in cross-examination or rebuttal.

613. ADDITIONAL PROCEDURES

The chairman may establish any procedures not otherwise contemplated by these rules necessary to establish a just, equitable and efficient method of resolving a particular dispute, except that the chairman may not decide a motion to dismiss a claim, as motions to dismiss are not permitted under these rules.

HEARINGS

614. ARBITRATION PANEL

614.A. Appointment of Arbitration Panel

The Market Regulation Department shall select a panel of arbitrators from the Exchange's Arbitration Committee to hear and decide a dispute. The panel shall consist of five arbitrators and one chairman.

614.B. Requests to Remove an Arbitrator

1. Each party may request the removal of any arbitrator(s) from a panel for good cause shown. Such request must be made no later than the start of testimony at the first scheduled hearing. Failure of a party to timely request the removal of any arbitrator(s) will be deemed a waiver of that party's

right to any further objection to the arbitrator's participation in the hearing and decision of the dispute.

2. The chairman, after considering a request to remove an arbitrator, another party's objections thereto and/or the statements of an arbitrator whose removal is sought, may deny the request or excuse the arbitrator. The chairman's decision shall be final and may not be appealed.
3. If an arbitrator is excused prior to the date of the first scheduled hearing, the Market Regulation Department shall select another Arbitration Committee member to replace the excused arbitrator at the hearing. Parties may make any appropriate request for the removal of the replacement arbitrator under this rule.
4. If an arbitrator is excused on or after the date of the first scheduled hearing, the dispute may, at the election of the non-requesting party and with the consent of the chairman be heard and decided by the remaining arbitrators.

615. HEARING PROCEDURES

615.A. Chairman

The panel chairman shall preside over the proceeding and shall make such determinations on relevancy and procedure as will promote a fair and expeditious adjudication of any claim. The chairman may administer oaths or affirmations by witnesses. Upon request of the panel chairman, the Market Regulation Department shall submit any documents to the panel and parties in the Exchange's possession that are relevant and readily available.

615.B. Arbitrators

The arbitration panel shall consider all relevant, probative testimony and documents submitted by the parties. The panel shall be the sole judge of the law and the facts, but if the panel is in doubt as to any questions of law, it may refer the question to Exchange legal counsel for an opinion. The panel shall not be bound by the formal rules of evidence. The final decision of the panel shall be by majority vote of the arbitrators, and the chairman shall vote only to resolve a tie.

615.C. Parties and their Representatives

Each party and his representative has the right to examine all relevant documents prior to and during the hearing, to present all relevant evidence in support of a claim or defense or as rebuttal to a claim or defense, and to question during the hearing witnesses presented in connection with a claim or defense. An entity may have one corporate representative of the entity, in addition to any counsel of record, attend the arbitration hearing. Such corporate representative will not be precluded from testifying in the matter.

615.D. Witnesses

All testimony offered to the panel will be under oath or affirmation. Witnesses will be permitted in the hearing room only while providing testimony to the panel. Witnesses shall testify in person at the hearing, except that for good cause shown and in the discretion of the chairman, a witness may be allowed to testify by telephone or other appropriate means.

615.E. Hearing Record

An audio recording of the proceeding shall be made and maintained until the decision becomes final. A verbatim record of such recording shall not be transcribed unless requested by a party, who shall bear the cost of transcription.

DECISIONS

616. AWARDS

616.A. Decision by Panel

After a hearing, or, on customer claims that do not exceed $5,000 upon consideration of the pleadings and other relevant information, the arbitration panel shall issue a written decision signed by the panel chairman and at least a majority of the panel. The panel may decide any matter in controversy and issue any order the panel deems necessary to fully resolve the dispute. The Market Regulation Department shall promptly serve copies on all parties. A monetary award made by the panel may include the following:

1. actual damages;
2. interest thereon;
3. punitive damages of no more than two times the amount of actual damages in accordance with Rule 601.A.5.;

4. the arbitration fee incurred by a prevailing party, or a portion thereof; and
5. all or any portion of the administrative costs of the proceeding and any other reasonable and necessary expenses, including, but not limited to, attorneys' fees (a) incurred by a party by reason of another party's frivolous or bad faith claim, defense, or conduct during the arbitration or (b) where a statutory or contractual basis exists for awarding such fees. Requests for attorneys' fees and costs incurred in the arbitration proceeding must be raised in the proceeding or they are waived.

616.B. Decision by the Chairman

The chairman may order a party who fails to prosecute or defend a claim to pay to the Exchange all or a portion of its administrative costs incurred in connection with the arbitration claim.

616.C. Limitations on Monetary Awards

Monetary awards in claims filed pursuant to Rule 621 shall be limited as set forth in Rule 578.

617. CORRECTION OF AWARD

Any party may, within three days after receipt of the notice of decision, request the arbitration panel to modify or correct its decision where there has been an obvious material miscalculation or misdescription or where the notice is imperfect in a matter of form not affecting the merits of the dispute or decision.

618. SATISFACTION OF AWARD

In the absence of any request to correct an award, the award must be satisfied within three days of receipt of the notice of decision. Any party directed to pay an award shall submit payment of any amounts due directly to the person receiving the award and shall also submit evidence of such payment to the Market Regulation Department.

APPEALS

619. APPEAL

Any decision rendered in a dispute among members resulting in a non-cash award or involving a claim, counterclaim, cross-claim or third-party claim that sought a recovery over $10,000 may be appealed to a hearing committee of the Board. All other decisions rendered by an arbitration panel are final and may not be appealed. In order to appeal a decision, a party must, within three business days after receiving a copy of the decision:

A. File with the Market Regulation Department a written notice stating the grounds for appeal based upon the standards set forth in Rule 620, and

B. Deposit with the Market Regulation Department the applicable fee established by the Exchange, together with a cashier's or certified check payable to CME in the amount of any monetary award against the appellant.

Failure to timely comply with these requirements for appeal, when applicable, shall constitute a waiver of any right to appeal and render the arbitrators' decision final and binding.

Within 14 days after filing a notice of appeal, the appellant shall file with the Market Regulation Department any argument and any documents or information that the appellant intends to use in support of the appeal. The appellee shall have 14 days thereafter to file whatever documents or information he intends to rely upon in opposition to the appeal. An extension beyond the 14-day filing period may be granted by the Market Regulation Department upon a showing of good cause. In the case of a non-cash award, the filing of the notice of appeal shall not stay the decision appealed from unless the panel from which the appeal is taken or the ~~Managing Director of~~Chief Regulatory ~~Affairs~~Officer specifically directs that the decision be stayed.

The appeal shall be heard by a hearing committee of the Board, and the matter shall be heard within 60 days of the end of the appellee's filing period, unless the Market Regulation Department or the chairman of the hearing committee determines that good cause for an extension has been shown. The hearing committee shall consist of three directors appointed by the Chairman of the Board, one of whom the Chairman of the Board shall designate as chairman of the hearing committee. No director may serve on a hearing committee if he has a personal or financial interest in the matter under consideration. A party may strike any member of the hearing committee for good cause shown as determined by the ~~Managing Director of~~Chief Regulatory ~~Affairs~~Officer, in which event that director shall be excused from hearing the matter. The Chairman of the Board shall then select an alternate participant from the Board. Any meeting of the hearing committee shall require the presence of each director appointed to the committee and shall be conducted by the chairman of the hearing committee. The parties may, upon unanimous consent, waive the right to hearing, and the hearing committee may consider the matter based solely on the parties' written submissions.

620. STANDARDS AND PROCEDURES FOR REVIEW UPON APPEAL

In the following cases, the hearing committee may enter an order amending or vacating the award of the arbitration panel:

A. Where the award was procured by corruption, fraud or undue means;

B. Where there was evident partiality or corruption on the part of any of the arbitrators or the chairman;

C. Where the arbitrators were guilty of misconduct in refusing to hear relevant evidence; or of any other behavior by which the rights of any party have been prejudiced;

D. Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the dispute submitted was not made; or

E. Where the arbitrators acted in manifest disregard of the applicable law, including Exchange rules.

The hearing committee shall consider only the record made before the panel and any other evidence submitted by the parties relevant to A. through E. above. In the event that the hearing committee determines to vacate the award, the matter shall be resubmitted to a new panel of arbitrators for a rehearing. In the event that the hearing committee amends the award or denies the appeal, such decision of the hearing committee shall be final and binding.

ADDITIONAL CLAIMS

621. CERTAIN CLAIMS AGAINST THE EXCHANGE INVOLVING TRADING SYSTEMS OR SERVICES

621.A. General

All claims arising out of or relating to the following matters shall be arbitrated in accordance with the specific requirements of this Rule 621 and, to the extent not inconsistent with such requirements, the rules of this Chapter:

1. receipt of an incorrect order status or the failure to have received an appropriate order status;
2. the negligence of GCC personnel or any other Exchange staff; or
3. Phantom Orders, as defined in Rule 587.

Nothing in Rules 621 or 622 shall be construed to create a claim against the Exchange, to limit a defense available to the Exchange, or to obviate or modify any limitation of Exchange liability imposed by any other rule.

621.B. Initial Liability Claim and Demand for Arbitration

The initial claim of loss, including a detailed description of any loss suffered, must be made to the Exchange within ten business days of the date of the incident that caused the loss. The Exchange shall have 30 business days to pay or deny the claim in whole or in part. If the Exchange denies the claim in whole or in part, the claimant must file a written demand for arbitration with the Market Regulation Department within ten business days after the Exchange has notified the claimant of such denial. A claimant's failure to pursue its claim within these time limits shall bar any recovery on such claim.

621.C. Selection of Arbitration Panel

The arbitration panel shall consist of three arbitrators selected from a list of arbitrators maintained by the National Futures Association ("NFA"). The Exchange and the claimant shall each select one arbitrator. If the Exchange and the claimant are unable to agree on the third arbitrator, the President of the NFA or his delegate shall choose the third arbitrator.

621.D. Related Claims

All claims arising out of the same system failure, event or alleged negligent act shall, to the extent practicable in the determination of the chairman, be consolidated for a single hearing.

621.E. Award

Within 30 days of completion of the hearing, the panel shall issue a written decision. The award shall be limited to the lesser of the actual loss or the loss that would have been incurred if the claimant had used its best efforts to mitigate the loss. Punitive damages, loss of profits, loss of use, and indirect, incidental or consequential damages shall not be awarded. The decision of a majority of the panel shall be final and binding, and there shall be no appeal to the Board of Directors. A party may move, within three business days of the award, that the award be corrected to remedy any miscalculation or misdescription or where the award is otherwise imperfect in a matter of form not affecting the merits of the award.

621.F. Satisfaction of Award by Exchange

The Exchange shall satisfy any award against it subject to its limitation of liability rules and the rules respecting proration among claimants where damages allowed for a defined period of time exceed any limit imposed by Exchange rules. The Exchange may delay paying any award until such time as any applicable proration or limitation can be finally calculated.

622. CLAIMS RELATING TO TRADE CANCELLATIONS OR PRICE ADJUSTMENTS

622.A. General

All claims relating to certain price adjustments or trade busts pursuant to Rule 588.C.3.a. and b. shall be arbitrated in accordance with the specific requirements of this Rule 622 and, to the extent not inconsistent with such requirements, the rules of this Chapter. All claims pursuant to Rule 588.C.3.d. shall be arbitrated in accordance with the rules of this Chapter.

622.B. Initiation of Claim

Any claim for loss under Rule 588.C.3.a. or b. must first be submitted to the Exchange as described in Rule 588.D. Following a denial of liability by a party responsible for a trade bust or price adjustment and by the clearing firm through which the trade was placed as described in Rule 588.D., the dispute shall be referred to arbitration. The Exchange shall administer the arbitration and provide notice to all parties.

The party alleged to have made the trade that caused the trade bust or price adjustment and the clearing firm through which that trade was placed both may be respondents in such arbitration. Any party responsible for a trade bust or price adjustment who is not otherwise subject to arbitration under these rules may voluntarily submit to such arbitration by filing a submission agreement with the Exchange within 21 days of that party's receipt of notice of the referral to arbitration. In the absence of the voluntary submission to arbitration by such party, the arbitration shall proceed solely against the clearing firm through which the trade was placed, and that firm shall be liable for any damages awarded by the panel.

622.C. Selection of Arbitration Panel

All claims under Rule 588.C.3.a. and b. shall be heard by a Mixed Panel as defined in Rule 601.A.3.

622.D. Related Claims

All claims arbitrable under this rule that arise out of a trade bust or price adjustment that was caused by the same incident shall, to the extent practicable in the determination of the chairman, be consolidated in a single arbitration.

622.E. Award

Within 30 days of completion of the hearing, the panel shall issue a written decision signed by a majority of the arbitrators.

The total award for a single incident shall not exceed $500,000. Except as provided below, the claims shall be limited to out-of-pocket losses. If the claimants' allowable losses exceed $500,000, the amount awarded to each claimant shall be reduced pro rata so that the total award does not exceed $500,000. Any award shall be made jointly and severally against the respondents. In the event the panel finds the respondent(s) liable for the full amount of the claim (or the capped amount of $500,000), the panel shall also award the claimants their costs and attorneys fees incurred in connection with arbitrating the claim. Punitive damages, loss of profits, loss of use, and indirect, incidental or consequential damages shall not be awarded. The decision of a majority of the panel shall be final and may not be appealed.

A party may move, within three business days of the award, for an order correcting or modifying the award to remedy any miscalculation or misdescription or where the award is otherwise imperfect in a matter of form not affecting the merits of the award.

MISCELLANEOUS

623. RIGHT TO COUNSEL

Every person is entitled to represent his own interests, be represented by an attorney at law of his choosing and at his own expense who is admitted to practice before the highest court in any State, or be represented by any other non-compensated representative at any stage of an arbitration proceeding at the Exchange. An entity must be represented by an officer or owner of the entity or by an attorney at law.

624. COMPUTATION OF TIME

For the purposes of this Chapter, when a period of time is prescribed by a number of days, and not a specific date, the first day counted for the time prescribed is the day after notice is received or other event giving rise to the period of time occurs. Any submission is due or the time to take action shall lapse by the close of business on the last day counted, unless the last day is a weekend or Exchange holiday, in which case the due date shall be the next following day the Exchange is open for business.

For time periods of five days or less only days the Exchange is open for business will be counted. For all other time periods calendar days will be counted.

625. SUBMISSIONS TO OR COMMUNICATIONS WITH THE PANEL

Any submission for consideration by a chairman or panel must be submitted to the Market Regulation Department with copies simultaneously served on each other party or designated representative of a party.

After a dispute has been submitted for arbitration, a person filing the claim or required to respond to the claim and any person asked to provide documents, information or testimony in connection with such claim shall not contact any member of a panel appointed to hear the claim for any purpose related to the dispute described by the claim.

626. ARBITRATION FEES

Any person submitting an arbitration claim or appealing a decision of an arbitration panel shall remit the applicable fees as may be determined by the Exchange at the time of submission or appeal, in order for such action to be effective.

ARBITRATION COMMITTEE

627. ARBITRATION COMMITTEE

Each member of the Arbitration Committee shall:

A. be appointed by the Board Chairman on an annual basis;

B. pledge to the Exchange that he will not publish, divulge, or make known in any manner any facts or information which may come to his attention while performing his duties as a member of the Arbitration Committee, except when reporting to the Board, or to a committee concerned with such information, or when called upon to respond in any judicial or administrative proceeding;

C. comply with the standards of the American Bar Association-American Arbitration Association's "Code of Ethics for Arbitrators in Commercial Disputes" which the Exchange hereby adopts as its own code of ethics for arbitrators;

D. pledge to immediately disclose any matter, relationship or interest with any party or the subject of a dispute which may affect the arbitrator's ability to be, or create the appearance that the arbitrator is not, impartial in deliberating and deciding a dispute; and

E. promptly give notice to the Market Regulation Department of any ex parte communication directed to such Arbitration Committee member which is prohibited by Rule 625.

(End Chapter 6)

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October 29, 2008

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

CONFIDENTIAL TREATMENT REQUESTED

Re: Petition for an Exemption to Permit the Clearing of OTC Agricultural Swap and Swaption Transactions

Dear Mr. Stawick:

Agora-X, LLC ("***Agora-X***") will *provide* electronic communication network ("***ECN***") services for the negotiation of agricultural swap and swaption transactions ("***Agora-X Ag Swaps***"). In addition, Agora-X intends in the future to provide the Commodity Futures Trading Commission ("***Commission***") with notice that, separately from its ECN services, it also will operate as an exempt commercial market ("***ECM***") for the execution of transactions involving exempt commodities. Agora-X intends to contract with a registered derivative clearing organization ("***DCO***") to provide clearing services for Agora-X with respect to Agora-X Ag Swaps.

Agora-X submits this petition ("***Petition***") to the Commission and respectfully requests that the Commission issue an Order, pursuant to both the requirements set out in Section 4(c) of the Commodity Exchange Act, as amended ("***Act***")[1] and Commission Regulation 35 ("***Part 35***")[2] granting an exemption to allow Agora-X Ag Swaps negotiated via the ECN to be cleared by a DCO.

As we demonstrate below: (i) the exemption sought in this Petition is consistent with the public interest and the purposes of the Act; (ii) the Agora-X Ag Swaps will be entered into solely between "appropriate persons;"[3] and (iii) the clearing of the Agora-X Ag Swaps will not have a material adverse effect on the ability of the Commission or any designated contract market ("***DCM***") to discharge its regulatory or self-regulatory duties under the Act.

[1] 7 U.S.C. § 6(c) (2008).

[2] 17 C.F.R. pt. 35 (2008).

[3] *See* 7 U.S.C. § 6(c)(3) (defining "appropriate person").

In the following sections of this Petition, we first describe Agora-X's general business model, the separate venues that will comprise its platform, and the economic terms of the Agora-X Ag Swaps that will be made available for clearing on the DCO. Second, we explain how the proposed clearing arrangement between Agora-X and the DCO satisfies each requirement for an exemption under Section 4(c) and Part 35.[4] Third, we discuss the clearing and margining processes on the DCO and demonstrate why these processes are beneficial and appropriate. Finally, we set out a list of suggested terms and conditions that would apply to the clearing arrangement if the Commission grants the relief requested in this Petition.

Pursuant to the Commission's regulations, we request confidential treatment under the Freedom of Information Act ("***FOIA***") for specified Exhibits included with this Petition.[5]

Because of the current volatile conditions in the U.S. financial markets and the desirability of providing over-the-counter ("***OTC***") derivative market participants with access to enhanced credit management facilities, we respectfully request that the Commission review this Petition on an expedited basis.

I. Agora-X

A. The Separate Venues on the Agora-X Platform

Agora-X is an electronic platform for the negotiation and/or execution of OTC financially-settled contracts on a broad suite of commodities. Agora-X's platform has two separate and distinct components: (i) the ECN where Agora-X Ag Swaps based upon notional quantities of agricultural commodities will be *negotiated*; and (ii) a separate ECM where transactions involving exempt commodities will be *negotiated*, *traded* and *executed*.[6]

[4] Currently, Agora-X is discussing the establishment of the clearing arrangement with CME Clearing360; however, the clearing arrangement described in this Petition will apply to any other registered DCO that can provide similar clearing services to Agora-X.

[5] *See* 17 C.F.R. § 145.9(d) (providing "a procedure by which persons submitting information in any form to the Commission can request that the information not be disclosed pursuant to a request under the Freedom of Information Act, 5 U.S.C. 552").

[6] The ECM venue will operate as an ECM under an exemption provided by Section 2(h)(5) of the Act. This venue will allow participants who qualify as eligible commercial entities (as defined in the Act) to negotiate and execute financially-settled option and swap contracts on a suite of exempt commodities. Each of these participants will have executed a master agreement with other eligible participant prior to trading on the ECM. Agora-X intends to make clearing services of a DCO available for some of the contracts negotiated, traded or executed on the Agora-X ECM. The clearing of the contracts negotiated and executed on the ECM is not subject to this Petition because no CFTC exemption is necessary to clear on a DCO contracts negotiated, traded or executed on the ECM. Agora-X will submit to the Commission the Section 2(h)(5) notice prior to commencing providing services to participants on the ECM venue.

B. Agora-X as an ECN

Agora-X will operate a distinct and separate ECN for the negotiation of transactions eligible for an exemption as provided under Part 35.2 of the Commission Regulations under the Act. This venue will allow participants who qualify as eligible swap participants (as defined in Part 35.1) ("***Participants***") to negotiate Agora-X Ag Swaps, which are financially-settled swaps based upon the notional value of a suite of agricultural commodities. Each of the Participants will have executed a master agreement with other Participants prior to negotiating the contracts via the ECN. In order to make available clearing services for the Agora-X Ag Swaps negotiated via the Agora-X ECN on a DCO, Agora-X petitions the Commission for an exemption.

C. Business Purpose of the Agora-X ECN Venue

Agora-X has developed the ECN platform to promote efficiency in the negotiation of OTC commodities and derivatives transactions that Participants currently negotiate and execute in the OTC market via the telephone, instant messages, email, and similar means of communication. By bringing these Participants into a single marketplace and negotiation network, Agora-X will promote greater liquidity in the OTC market. In addition, by clearing Agora-X Ag Swap contracts on the DCO, and by publishing Agora-X price data, transparency of the market will improve.[7] Consequently, by using the Agora-X ECN venue, Participants will be able to manage better volatile basis risk and to obtain the benefits of centralized clearing.

The Commission will have the ability to collect information regarding the OTC transactions negotiated on the Agora-X platform from the DCO, significant price discovery contracts (in the event that the Commission concludes that such contracts are negotiated, traded, and executed on the Agora-X ECM venue), as well as other transactions that the Commission designates as reportable. Furthermore, in the event that the Commission concludes that it is appropriate and necessary for the Commission, as a market regulator, to request that Agora-X submit data concerning transactions negotiated and/or executed via the facilities of Agora-X, Agora-X will be prepared to submit such aggregated trade data to the Commission as required.

[7] Depending on the clearing procedures, *i.e.*, whether an OTC transaction is cleared into a cleared-only contract (*e.g.*, on the CME Clearing360) or into a futures contract (*e.g.*, on NYMEX Clearport), different reporting obligations apply to DCOs. The scope of reporting obligations of a DCO for a relevant OTC transaction cleared into a cleared-only contract is specified in the relevant Section 4d Commission order.

D. Economic Characteristics and Negotiation of Agora-X Ag Swaps on Agora-X ECN

Agora-X currently intends to make available for negotiation via the ECN the Agora-X Ag Swaps listed in Exhibit A.[8] The typical contract specifications for a swaption are set forth in Exhibit B. In accordance with current Commission rules, the contract specifications state that the contracts will not be cleared. If the Commission grants the relief requested herein, the specifications will be modified as set forth in Exhibit C. If in the future Agora-X lists any Agora-X Ag Swaps in addition to those identified above, they also will be financially-settled Agora-X Ag Swaps with similar economic terms.

The ECN venue of Agora-X will allow Participants to negotiate transactions in Agora-X Ag Swaps according to certain predefined specifications with other eligible Participants via a bilateral electronic negotiation facility (*i.e.*, the ECN). Swap prices and swaption premiums will be established by Participant communications that commence with a Request for Quotation ("***RFQ***"). The RFQ will specify a proposed Agora-X Ag Swap transaction and invite offers from other Participants to be submitted to the RFQ originator. If a response is submitted by another Participant, the RFQ originator may accept or reject that offer, or may counter-offer with different economic terms for the Agora-X Ag Swap. There is no predetermined limit on the number of RFQs, offers, and counteroffers that can be posted and exchanged by Participants until they reach a "meeting of the minds." A legally binding transaction will arise when an offer by one Participant is finally accepted by another Participant.

For clarity, we note that with respect to the ECN venue of Agora-X there will be *no* automatic matching of transactions, *no* trading algorithm will be used, and *no* public auction processes will take place – essentially, the ECN venue of Agora-X will function as a centralized bulletin board or messaging system and not as a "trading facility"[9] or a "multilateral transaction execution

[8] We are requesting confidential treatment of Exhibit A, Exhibit B and Exhibit C.

[9] 7 U.S.C. 1a (34) (defining "trading facility" as "a person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions – (i) by accepting bids or offers made by other participants that are open to multiple participants in the facility or system; or (ii) through the interaction of multiple bids or multiple offers within a system with a predetermined non-discretionary automated matching and execution algorithm. (B) Exclusions.- The term "trading facility" does not include – (i) a person or group of persons solely because the person or group of persons constitutes, maintains, or provides an electronic facility or system that enables participants to negotiate the terms of and enter into bilateral transactions as a result of communications exchanged by the parties and not from interaction of multiple bids and multiple offers within a predetermined, nondiscretionary automated trade matching and execution algorithm;... or (iii) facilities on which bids and offers, and acceptances of bids and offers effected on the facility, are not binding. Any person, group of persons, dealer, broker, or facility described in clause (i) or (ii) is excluded from the meaning of the term "trading facility" for the purposes of this chapter without any prior specific approval, certification, or other action by the Commission").

facility" (as referred to in Part 35[10]). In this regard, we note that the definition of "trading facility" provides that submitting a transaction that has been executed on or through an entity that does not otherwise qualify as a "trading facility" does not cause the entity to become a "trading facility."[11]

Because it is a prerequisite for each Participant to have entered into a bilateral master agreement (*e.g.*, the International Swaps and Derivatives Association, Inc. ("***ISDA***") Master Agreement) with another Participant before the Participants can negotiate via the ECN, the terms and conditions of each Agora-X Ag Swap will be governed by a confirmation and the terms of each individual master agreement negotiated between the Participants. Although Agora-X Ag Swaps will be negotiated on the Agora-X ECN venue, they will be executed under the applicable master agreement between the Participants. Each Agora-X Ag Swap transaction will be based on, and settled by reference to, a futures contract used as an underlying price index. The methodology for calculating these price indices, the futures contracts on which such indices will be based, and the specific terms for the cleared Agora-X Ag Swaps are set forth in Exhibit B and C.

In the absence of clearing, Participants to a negotiated Agora-X Ag Swap transaction will bilaterally settle the transactions according to the terms of their applicable master agreement and according to the bilateral credit arrangements between the Participants under their respective master agreements. However, should the Commission grant the exemption requested herein, the Participants who have entered into an Agora-X Ag Swap transaction will be able to enter the Agora-X Ag Swap into the DCO's clearing system for clearing through their respective DCO clearing members.

II. Exemption under Section 4(c) of the Act

A. Requirements for an Exemption under Section 4(c) of the Act

Section 4(c)(l) of the Act provides that, "[i]n order to promote responsible economic or financial innovation and fair competition" the Commission may exempt contracts, and persons who provide services with respect to such contracts, from any applicable requirement that such contracts must be executed on a DCM or a registered derivatives transaction execution facility or from any other provision of the Act (with certain specified exceptions). Furthermore, to grant an exemption from the exchange trading requirement, the Commission must determine that:

[10] Note that neither Part 35, nor any other Commission rule or regulation define what constitutes a "multilateral transaction execution facility."

[11] 7 U.S.C. § 1a (34) (C) (stating "[a] person or group of persons that would not otherwise constitute a trading facility shall not be considered to be a trading facility solely as a result of the submission to a derivatives clearing organization of transactions executed on or through the person or group of persons").

(a) the exemption will be consistent with the public interest and the purposes of the Act;

(b) the contracts will be entered into solely between "appropriate persons;" and

(c) the exemption will not have a material adverse effect on the ability of the Commission or the relevant market to discharge its regulatory or self-regulatory duties under the Act.

Therefore, in order for a DCO to clear agricultural swaps that are negotiated in OTC markets, such as the Agora-X ECN venue, the relevant OTC market must obtain an exemption under Section 4(c) of the Act and Part 35.2 for an exemption from Sections (b) and (c) of Part 35.2.[12]

Below we first discuss how Agora-X's proposed clearing arrangement satisfies each of the requirements for an exemption under Section 4(c) and then address the swap exemption requirements under Part 35.

B. Public Interest and Purposes of the Act

The President's Working Group on Financial Markets ("***PWG***")[13] expressly supported the clearing of OTC transactions. The Commodity Futures Modernization Act of 2000 ("***CFMA***"),[14] based in part on PWG's recommendations, enacted amendments to the Act to facilitate the clearing of OTC transactions by DCOs. More recently, many U.S. financial regulators, including the Commission have stated on several occasions that clearing of OTC derivatives contracts reduces counterparty risk, increases available credit to market participants and frees up scarce

[12] As noted above, the agricultural Swaps that Agora-X proposes to offer for clearing would meet the requirements of Part 35.2 (a) and (d) in that they would be negotiated and entered into OTC solely between eligible swap participants.

[13] *See* Over-the-Counter Derivatives Markets and the Act: Report of the Presidents Working Group on Financial Markets (November 1999) (noting "[c]learing of OTC derivatives has the potential to reduce counterparty risks associated with such transactions through risk management techniques that may include mutualizing risks, facilitating offset and netting)".

[14] Pub. L. No. 106-554, § 1(a)(5) (The CFMA provided legal certainty for certain off-exchange "excluded swap transactions" (Section 2(g)), and for certain "transactions in exempt commodities" (Section 2(h)). Sections 2(g) and 2(h) do not cover transactions involving agricultural commodities. As noted above, Agora-X ECM venue will list for negotiation, trading and execution of contracts on exempt and excluded commodities in reliance on exemptions and exclusions under Section 2(g), 2(h) (and 2(d) and 2(e), if applicable).

capital, reduces systemic risks, contributes to greater liquidity of OTC trades and improves transparency of the OTC markets.[15]

Clearing of Agora-X Ag Swaps involves the substitution of the creditworthiness of two counterparties to a transaction with the creditworthiness of the clearing organization. The DCO will manage counterparty risk through its system of risk mutualization and by requiring adequate margin.[16] Although cleared-only contracts that are typically used to clear OTC swap agreements are not futures contracts, the substitution process will afford the DCO clearing members which carry the "cleared-only" contracts the same efficiencies and benefits that centralized clearing affords clearing members that carry DCM-listed futures contracts.[17] Accordingly, the DCO will be able to manage the risks associated with the cleared-only positions through the same practices used by the DCO and its clearing members to manage the risks associated with the futures contracts executed on a DCM in either the same or similar underlying commodities.

Permitting the proposed Agora-X Ag Swaps to be negotiated in an OTC environment and to be cleared by a DCO will promote one of the key public interests identified in Section 3(a) of the Act "by providing a means for managing and assuming price risks, [and] discovering prices." This interest will be met: by providing the venue where Participants can negotiate swap agreements (which act as risk transfer instruments); by allowing the buyers and the sellers of the swap agreements to transfer and assume price risks; by reporting aggregated trade data to the Commission; and, if required, by publishing trade data.

[15] Press Release, U.S. Commodity Futures Trading Commission, Commission Announces Agricultural Market Initiatives, (June 3, 2008) (stating "[t]he Commission has tasked CFTC staff to develop a proposal for allowing the clearing of agricultural swaps. This initiative will provide farmers and grain merchandisers with another choice for managing price and basis risk with the benefit of centralized clearing and the regulatory transparency that accompanies clearing"), *available at* http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5504-08.html *See also* Commission Staff Report on Commodity Swap Dealers and Index Traders with Commission Recommendations at page 7 (September 2008)(stating [t]he Commission believes that market integrity, transparency, and availability of information related to OTC derivatives are improved when these transactions are subject to centralized clearing. Accordingly, the Commission will continue to promote policies that enhance and facilitate clearing of OTC derivatives whenever possible"), *available at* http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/cftcstaffreportonswapdealers09.pdf. *See also*, Remarks By Treasury Assistant Secretary Lewis A. Sachs on September 26, 2000, referring to the CFMA 2000 and the benefits of centralized clearing of OTC derivatives (LS-914): "Among other things, this legislation [CFMA 2000] would allow … centralized clearing of derivatives, thereby helping to: reduce counterparty credit risk; promote innovation; make our markets more competitive, transparent, and efficient; and reduce the costs of hedging risk and reducing exposure to other markets." *Available at* http://www.ustreas.gov/press/releases/ls914.html.

[16] *See* below in Section V of this Petition for further discussion of the DCO margin requirements and risk management.

[17] Although cleared-only contracts are not futures contracts, the substitution process will afford the DCO clearing members which carry these "cleared-only" contracts all of the same efficiencies and benefits that centralized clearing affords clearing members that carry DCM-listed futures contracts.

The requested exemption is consistent with the purposes of the Act identified in Section 3(b), which include: promotion of responsible innovation and fair competition; serving the public interest through a system of effective self-regulation and implementation of internal surveillance systems; deterring and preventing price manipulation; ensuring the financial integrity of transactions and the avoidance of systemic risk; and protecting market participants from fraud and misuses of customer assets.

Many Participants who are active in the cash agricultural commodities markets and who will be users of Agora-X Ag Swaps, have asked Agora-X to assist them in managing increasingly volatile basis risk by augmenting the ECN to allow the clearing of these products (similar to contracts on exempt commodities on the Agora-X ECM). The need for the requested exemption is underscored by recent market events – namely, lack of credit, scarcity of capital, dramatically higher margin calls, and general insecurity of OTC market participants with each other's creditworthiness.

Cleared OTC products have not contributed to current unfavorable economic conditions, while uncleared OTC products, such as credit default swaps, appear to have contributed to the problem. Users of Cleared OTC products, such as Agora-X Ag Swaps, will be subject to the discipline of margin; while counterparties to uncleared OTC products must make their own unique credit support arrangements. Prohibiting the clearing of agricultural swaps has no apparent regulatory benefit. Indeed, on the contrary, it may actually increase systemic risk to the market as a whole.

Implementation of the proposed clearing arrangement between Agora-X ECN and the DCO will serve the public interests of:

- increased stability of the OTC markets;
- reduced counterparty risk;
- increased availability of credit to market participants;
- reduced systemic risks;
- greater liquidity in OTC markets; and
- improved price discovery to Participants on the Agora-X system.

In addition, the purposes of the Act will be served by: increased ability of the Commission to oversee the OTC markets; improved ability of market participants to manage counterparty risks; and promotion of reasonable economic and financial innovation and fair competition in U.S. financial and derivatives markets.

C. Negotiation of Agora-X Ag Swaps Between Appropriate Persons

The second requirement for a Section 4(c) exemption order is that the agreement, contract or transaction be entered into solely between "appropriate persons." Under Section 4(c) the category of "appropriate persons" essentially replicates the category of "eligible swap participants" in Part 35. Part 35, however, defines the subcategory of an unregulated business entity more narrowly than Section 4(c).[18]

Because "eligible swap participants" are only those who will enter into master agreements with each other and who also will have access to Agora-X ECN venue as Participants, Section 4(c)'s "appropriate persons" requirement necessarily is met by Agora-X's proposed amendments to Part 35 Swap Exemption.

D. Absence of Material Adverse Effect on the Ability of the Commission or Any DCM to Discharge its Regulatory or Self-Regulatory Duties under the Act

Because of the link between transactions executed via an ECN and cleared on a DCO, the Commission will have additional information available to assist in the performance of its market monitoring and supervision functions. In addition, if required by the Commission, Agora-X will be ready to provide to the Commission aggregated trade data with respect to transactions negotiated via the ECN. Accordingly, the Commission's ability to discharge its regulatory duties under the Act with respect to agreements entered into under the Swap Exemption will be significantly improved.

DCOs will follow the same objective margining, financial and risk management procedures with respect to cleared swap agreements as they follow for all other contracts that they clear. As regulated entities, the DCOs are subject to applicable Core Principles under the Act and the swap agreements cleared by the DCO will remain subject to the Act's anti-fraud and anti-manipulation provisions. Moreover, because the Agora-X Ag Swaps will be subject to all of the protections applicable to transactions cleared on the DCOs, permitting the clearing of swap agreements will enhance the ability of the Commission and the DCOs to discharge their regulatory and self-regulatory responsibilities.

Although Agora-X is not a self-regulatory organization,[19] it is developing a vigorous market surveillance program with respect to both the ECN and the ECM venues. This program will be

[18] 17 C.F.R. pt. 35 (Part 35 requires that such entity have total assets in excess of $10 million, while section 4(c) only set the limit at $5 million).

[19] CFTC Glossary *available at* http://www.cftc.gov/educationcenter/glossary/glossary_s.html (Defining "[s]elf-[r]egulatory [o]rganization as "[e]xchanges and registered futures associations that enforce financial and sales practice requirements for their members").

developed in conjunction with, and will draw on the experience of, the applicable DCO's surveillance program, its policies, and its procedures.

III. Liquidity of the Relevant Underlying Markets

The Agora-X Ag Swaps are each based on price indexes, which are established by trading of highly liquid, well functioning futures contracts on DCMs.[20] Because the Agora-X Ag Swaps are ultimately financially settled based on futures settlement prices and do not, of themselves create delivery obligations with respect to commodities, they are entirely derivative of the futures markets and as a result add liquidity to the general OTC markets. This is especially true if Agora-X Ag Swaps are cleared.[21]

Lastly, Agora-X does not expect the Agora-X Ag Swaps to be Significant Price Discovery Contracts as defined in Section 1a(33) of the Act, because the ECN does not qualify as an ECM and because the contracts are entirely derivative of the underlying futures contracts or applicable price indexes.[22]

IV. The Commission's Legal Authority / Exemption under Part 35

A. Swap Exemption.

The Commission adopted the Part 35 swap exemption ("***Swap Exemption***") 14 years ago. In the intervening period, U.S. Congress has enacted major amendments to the Act and there has been a significant increase in the use of swap agreements by commercial and other participants in the U.S. agricultural industry. The CFMA superseded the Swap Exemption with respect to swap transactions involving exempt and excluded commodities and expressly permitted such transactions to be cleared by a DCO.[23] However, counterparties who intend to enter into swaps on agricultural commodities must continue relying on the Part 35 Swap Exemption.

The Swap Exemption affords relief from the exchange trading requirement of the Act if:

[20] The use of prices established on futures contracts as a basis for price terms of OTC, cash contracts, and cash forward contracts is very nearly universal for agricultural commodities. Clearing of OTC contracts for agricultural commodities will neither add to, nor subtract from, this practice.

[21] OTC volume tends to bring volume to the futures market as OTC risk is offset by futures or cleared-only contracts, as applicable. Agora-X expects that increasing clearing will increase this effect by reducing the OTC volume that is not offset by futures or cleared-only contracts.

[22] 7 U.S.C. § 1a(33).

[23] Pub. L. No. 106-554, § 1(a)(5) (The CFMA provided legal certainty for certain off-exchange "excluded swap transactions" (Section 2(g)), and for certain "transactions in exempt commodities" (Section 2(h)). Sections 2(g) and 2(h) do not cover transactions involving agricultural commodities).

(a) the swap agreement is entered into solely between eligible swap participants at the time such persons enter into the swap agreement;

(b) the swap agreement is not part of a fungible class of agreements that are standardized as to their material economic terms;

(c) the creditworthiness of any party having an actual or potential obligation under the swap agreement would be a material consideration in entering into or determining the terms of the swap agreement, including pricing, cost, or credit enhancement terms of the swap agreement; and

(d) the swap agreement is not entered into and traded on or through a multilateral transaction execution facility.[24]

Part 35.2 also states that subsections (b) and (d) above shall not be deemed to preclude arrangements or facilities between the parties that provide for netting of payments or payment obligations.

Pending the Commission's approval of this Petition, Agora-X may consider implementing the netting and payment arrangement with respect to Agora-X Ag Swaps negotiated by the Participants on the Agora-X ECN venue.

B. Application for an Exemption from Part 35 Requirements

Part 35.2 provides that any person may apply to the Commission for an exemption from any of the provisions of the Act for other arrangements or facilities (such as the clearing arrangement) that the Commission would deem appropriate.[25]

As currently designed, the transactions that will be negotiated via the Agora-X ECN venue meet all of the requirements of Part 35. However, in order to provide for clearing services with respect to Agora-X Ag Swaps, Agora-X must obtain an exemption from the Commission as provided for in Part 35.2 and according to the procedures set forth in Section 4(c) of the Act, which we discussed above.[26]

[24] 17 C.F.R. pt. 35.2(a)-(d) (2008).

[25] 7 U.S.C. § 1a(34)(C) noted above for a special rule to the definition of "trading facility."

[26] Part 35 was promulgated by the CFTC pursuant to its authority under Section 4(c); as discussed above, Section 4(c) provides the specific procedures for applying for such exemptions.

V. Margin Treatment after the Agora-X Ag Swaps Have Been Cleared

The DCOs calculate performance bond/margin requirements for DCO's clearing firms using their proprietary software. This software will continue to be used for the purpose of determining customer level margin for Agora-X Ag Swaps.

The DCO will continue to utilize its normal and customary margin procedures, as described above, with respect to the Agora-X Ag Swaps negotiated on the Agora-X ECN venue. Based on both the expected correlation between the Agora-X Ag Swaps and the reference commodities and the futures contracts on these reference commodities, the DCO may apply inter-market spread credits for accounts with identical ownership that hold such spread positions.

Participants on the Agora-X ECN venue may be able to rely on the existing Section 4d relief granted by the Commission with respect to applicable products cleared on the applicable DCO.[27] For those products that are not yet subject to such Section 4d relief, Agora-X intends to submit a Section 4d petition together with the applicable DCO. If the Commission grants relief under Section 4d of the Act, customer funds with respect to Agora-X Ag Swaps additional products will be eligible for commingling with other Customer Funds in segregated accounts thus affording greater efficiencies in risk management of customers' futures and OTC positions.

VI. Terms and Conditions

Agora-X seeks an exemption under Section 4(c) of the Act and Commission Regulation 35.2 that would permit the DCO to clear standardized Agora-X Ag Swaps.

The relief requested herein would be subject to the following terms, conditions and representations:

1. This relief will apply to, and is limited to, cleared-only Agora-X Ag Swaps (as defined above).

2. Agora-X Ag Swaps will be exempt from the requirements of Commission Regulation 35.2(b) and (c), but will remain subject to all other requirements of Part 35 of the Commission's Regulations.

3. Agora-X will adopt appropriate position accountability levels for each of its Agora-X Ag Swaps for single months and for all-months-combined.[28]

[27] *See, e.g.*, October 2008 CFTC Order allowing CBOT to clear ethanol on the CME DCO.

[28] All of these swap and swaption products would be cash-settled prior to the spot month.

4. Each Agora-X Ag Swaps will be marked-to-market on a daily basis, and final settlement prices will be established, as described in this submission.

5. For Agora-X Ag Swaps, if requested by the Commission, Agora-X will make available aggregated trade data. The DCO will be obligated to report and disclose cleared settlement data to the extent required.by the relevant Section 4d Commission order.

6. Such relief shall not provide an exemption from any provision of the Act or Commission regulations not specified herein.

We would be happy to discuss this Petition with Commission staff. Please feel free to contact: Brent M. Weisenborn, President and CEO of Agora-X at (816) 412-3000 brentw@agora-x.com; or Paul J. Pantano, Jr., at (202) 756-8026 ppantano@mwe.com or Peter Y. Malyshev at (202) 756-8067 pmalyshev@mwe.com (as regulatory counsel for Agora-X) if you have any questions about this Petition.

Thank you for your consideration.

Respectfully submitted,

Agora-X

Brent M. Weisenborn
President/CEO
Agora-X, LLC

cc: Acting Chairman Walter Lukken
Commissioner Bart Chilton
Commissioner Michael Dunn
Commissioner Jill E. Sommers
Ananda K. Radhakrishnan
Richard A. Shilts

Paul J. Pantano, Jr.
Peter Y. Malyshev
McDermott Will & Emery LLP
600 13th Street, NW
Washington DC, 20005

Richard A. Malm
Dickinson, Mackaman, Tyler & Hagen, P.C.
699 Walnut Street, Suite 1600
Des Moines, Iowa 50309
Tel. (515) 246-4516
Fax (515) 246-4550
rmalm@dickinsonlaw.com

Exhibit A

Agora-X Ag Swaps Expected to Be Made Available for Negotiation

Sugar No.11;

Sugar No.16;

Cotton No. 2;

Chicago Wheat;

Kansas City Wheat;

Corn;

Soy Beans;

Soy Meal;

Bean Oil;

Bean Crush Spread;

Cocoa;

Coffee "C";

Coffee "Robusta";

Orange Juice "FCOJ-A";

Dry Whey;

Class 4 Milk;

Butter;

Canola;

Class 3 Milk;

Pork Bellies;

Lean Hogs;

Feeder Cattle;

Live Cattle.

Exhibit B

Agora-X Ag Swaps Contract Specification (No Clearing)

REPRESENTATIVE SAMPLE FORM

Product Specification
European Put Swaption
(No Clearing)

Product Number: AX00000

1) **General Description**:

This Product is a European Style Put Swaption that is based on the official settlement price of the Applicable Futures Contract for the specified Futures Contract Month. It is established by bilateral negotiation between two (2) Users by means of the request for quotation process on the Platform. It is exercised at the option of the Commodity Swaption Buyer into a financially-settled Underlying Swap Transaction on the Swaption Exercise Date. Capitalized terms used in this Product Specification shall be as defined in this Product Specification, the Agora-X Platform Rules, the Agora-X User Agreement, or the Applicable Master Agreement and the 2005 ISDA[1] Commodities Definitions, as applicable, and in such order of priority.

2) **Defined Terms and Transaction Parameters**:

The following Terms shall apply or shall be established on the Platform for this Product with respect to each Put Swaption transaction ("***Transaction***").

a) The following terms and definitions shall apply to each Transaction:

Product Name:	**Corn European Put Swaption**
Product Symbol:	**CPE**
Applicable Futures Contract:	**CBOT[2] Corn futures contract**
Swaption Style:	**European**
Units:	**Bushels**
Units Per Put Swaption:	**5,000 bushels**
Minimum Price Fluctuation	**One hundredth of one cent ($0.0001)**
Eligibility for Clearing:	**No**

[1] ISDA is a registered trademark of the International Swaps and Derivatives Association, Inc., which does not offer, endorse or sponsor this Product.

[2] CBOT is a registered trademark of the Chicago Mercantile Exchange which does not offer, endorse or sponsor this Product.

b) The following parameters ("*Specified Terms*") shall be specified by means Platform for each Transaction:

Transaction Date:	**[date]**
Futures Contact Month:	**[specified month of the Applicable Futures Contract selected from among months enabled on the Platform]**
Specified Number of Swaptions:	**[Number of Swaptions purchased]**
Commodity Swaption Seller:	**[User identification]**
Commodity Swaption Buyer:	**[User identification]**
Premium Per Unit:	**[amount]**
Strike Price:	**[amount selected from among strike prices enabled on the Platform]**

c) **Swaption Definitions and Transaction Terms**. The following definitions and transaction terms shall apply to each Put Swaption Transaction:

i) "***Applicable Futures Contract***" shall be the applicable futures contract for the Futures Contract Month as specified for the Transaction.

ii) "***Exercise***" shall mean the exercise of the Put Swaption, at the option of the Commodity Swaption Buyer, -into a financially-settled Underlying Swap Transaction on the Swaption Exercise Date.

iii) "***Expiration Date***" shall be the standard option expiration date corresponding to the Futures Contract Month for the Applicable Futures Contract.

iv) "***Commodity Swaption Buyer***" shall be specified for the Transaction and shall be the "***Fixed Price Payer***" after the Put Swaption is exercised.

v) "***Commodity Swaption Seller***" shall be specified for the Transaction and shall be the "***Floating Price Payer***" after the Put Swaption is exercised.

vi) "***Futures Contract Month***" shall be the month and year of the Applicable Futures Contract and shall be specified for the Transaction from the standard months from time to time enabled on the Platform for this Product.

vii) "***Notional Quantity***" shall be the Specified Number of Put Swaptions multiplied by the Units per Put Swaption for the Transaction.

viii) "***Platform***" shall be the ECN, *i.e.*, the electronic communications network.

ix) "***Premium Per Unit***' shall be specified for the Transaction and shall be expressed in United States dollars per Unit and stated in full increments of the Minimum Price Fluctuation.

x) "***Specified Number of Swaptions***" shall be specified for the Transaction and shall be the number of Put Swaptions issued in the Transaction.

xi) "***Strike Price***" shall be specified for the Transaction from the strike prices from time to time enabled on the Platform for this Product expressed in United States dollars per Unit.

xii) "***Total Premium***" shall be the Premium per Unit multiplied by the Notional Quantity per Transaction rounded up to the next whole [dollar or cent].

xiii) "***Transaction Date***" shall be the date upon which the Transaction is established by Acceptance of a Responsive Offer between the Commodity Swaption Buyer and the Commodity Swaption Seller on the Platform and in accordance with the terms and conditions of the Applicable Master Agreement between the Commodity Swaption Buyer and Commodity Swaption Seller.

xiv) "***Units***" shall be specified in the Specified Terms for the Transaction.

xv) "***Units per Put Swaption***" shall be as specified in the Specified Terms for the Transaction.

d) **Payment, Exercise and Settlement Terms**. The following payment, exercise, and settlement terms shall apply to each Transaction:

i) The Commodity Swaption Buyer shall pay the Total Premium to the Commodity Swaption Seller within two (2) Business Days of the Swap Termination Date, if applicable, according to the terms of the Applicable Master Agreement.

ii) If the Strike Price is equal to, or greater than, the Floating Price on the Expiration Date, then the Put Swaption shall expire without exercise.

iii) If the Floating Price is lower than the Strike Price on the Expiration Date, then the Swaption, at the option of the Commodity Swaption Buyer, may be Exercised into the Underlying Swap Transaction.

iv) If the Swaption is exercisable, then Exercise shall be deemed to have occurred unless Commodity Swaption Buyer notifies Commodity Swaption Seller that it declines to exercise on or before [•] o'clock PM on the Expiration Date.

e) **Underlying Swap Terms**. The following definitions and transaction terms shall apply to each underlying swap transaction. The "***Underlying Swap Transaction***" shall mean a financially-settled transaction executed on the following terms:

i) The "***Cash Settlement Amount***" shall be the difference between the Fixed Price and the Floating Price multiplied by the Notional Quantity. If the Fixed Price is greater than the Floating Price then the Floating Price Payer shall pay the Cash Settlement Amount to the Fixed Price Payer. If the Floating Price is greater than the Fixed Price then the Fixed Price Payer shall pay the Cash Settlement Amount to the Floating Price Payer. If the Fixed Price and the Floating Price are equal, then no payment shall be made.

ii) "***Early Swap Termination Date***" shall be a Business Day that is not earlier than two (2) Business Days after the Expiration Date that is designated by either party by written notice to the other for termination and settlement of the Underlying Swap Transaction.

iii) "***Fixed Price***" shall be the Strike Price.

iv) "***Floating Price***" shall be the official settlement price per Unit of the Applicable Futures Contract for the Futures Contract Month as specified for the Transaction.

v) "***Swap Termination Date***" shall mean [•] Business Days after the Expiration Date or the Early Swap Termination Date, whichever first occurs.

Exhibit C

Agora-X Ag Swaps Contract Specification (Cleared)

Product Specification
European Put Swaption
(Cleared)

Product Number: AX00000

3) **General Description**:

This Product is a European Style Put Swaption that is based on the official settlement price of the Applicable Futures Contract for the specified Futures Contract Month. It is established by bilateral negotiation between two (2) Users by means of the request for quotation process on the Platform. It is exercised at the option of the Commodity Swaption Buyer into a financially-settled Underlying Swap Transaction on the Swaption Exercise Date. Capitalized terms used in this Product Specification shall be as defined in this Product Specification, the Agora-X Platform Rules, the Agora-X User Agreement, or the Applicable Master Agreement and the 2005 ISDA[1] Commodities Definitions, as applicable, and in such order of priority.

4) **Defined Terms and Transaction Parameters**:

The following Terms shall apply or shall be established on the Platform for this Product with respect to each Put Swaption transaction ("***Transaction***").

a) The following terms and definitions shall apply to each Transaction.

Product Name:	Corn European Put Swaption
Product Symbol:	CPE
Applicable Futures Contract:	CBOT[2] Corn futures contract
Swaption Style:	European
Units:	Bushels
Units Per Put Swaption:	5,000 bushels
Minimum Price Fluctuation	One hundredth of one cent ($0.0001)
Eligibility for Clearing:	Yes

[1] ISDA is a registered trademark of the International Swaps and Derivatives Association, Inc., which does not offer, endorse or sponsor this Product.

[2] CBOT is a registered trademark of the Chicago Mercantile Exchange which does not offer, endorse or sponsor this Product.

b) The following parameters ("***Specified Terms***") shall be specified by means of the Platform for each Transaction.

Transaction Date:	**[date]**
Futures Contact Month:	**[specified month of the Applicable Futures Contract selected from among months enabled on the Platform]**
Specified Number of Swaptions:	**[Number of Swaptions purchased]**
Commodity Swaption Seller:	**[User identification]**
Commodity Swaption Buyer:	**[User identification]**
Premium Per Unit:	**[amount]**
Strike Price:	**[amount selected from among strike prices enabled on the Platform]**

c) **Swaption Definitions and Transaction Terms**. The following definitions and transaction terms shall apply to each Put Swaption Transaction:

i) Each Put Swaption Transaction shall be submitted to the Clearing Organization for Clearing. This Product is not eligible for Routing.

ii) "***Applicable Futures Contract***" shall be the applicable futures contract for the Futures Contract Month as specified for the Transaction.

iii) "***Exercise***" shall mean the exercise of the Put Swaption, at the option of the Commodity Swaption Buyer, into a financially-settled Underlying Swap Transaction on the Swaption Exercise Date.

iv) "***Expiration Date***" shall be the standard option expiration date corresponding to the Futures Contract Month for the Applicable Futures Contract.

v) "***Clearing***" shall mean substitution of Put Swaption Transaction for cleared contracts or futures contracts, as applicable, on the DCO.

vi) "***Clearing Organization***" shall be [•], a registered derivatives clearing organization.

vii) "***Commodity Swaption Buyer***" shall be specified for the Transaction and shall be the "***Fixed Price Payer***" after the Put Swaption is exercised.

viii) "***Commodity Swaption Seller***" shall be specified for the Transaction and shall be the "***Floating Price Payer***" after the Put Swaption is exercised.

ix) "***Futures Contract Month***" shall be the month and year of the Applicable Futures Contract and shall be specified for the Transaction from the standard months from time to time enabled on the Platform for this Product.

x) "***Notional Quantity***" shall be the Specified Number of Put Swaptions multiplied by the Units per Put Swaption for the Transaction.

xi) "***Platform***" shall be the ECN, *i.e.*, the electronic communications network.

xii) "***Premium Per Unit***" shall be specified for the Transaction and shall be expressed in United States dollars per Unit and stated in full increments of the Minimum Price Fluctuation.

xiii) "***Specified Number of Swaptions***" shall be specified for the Transaction and shall be the number of Put Swaptions issued in the Transaction.

xiv) "***Strike Price***" shall be specified for the Transaction from the strike prices from time to time enabled on the Platform for this Product expressed in United States dollars per Unit.

xv) "***Total Premium***" shall be the Premium per Unit multiplied by the Notional Quantity per Transaction rounded up to the next whole [dollar or cent].

xvi) "***Transaction Date***" shall be the date upon which the Transaction is established by Acceptance of a Responsive Offer between the Commodity Swaption Buyer and the Commodity Swaption Seller on the Platform and in accordance with the terms and conditions of the Applicable Master Agreement between the Commodity Swaption Buyer and Commodity Swaption Seller.

xvii) "***Units***" shall be specified in the Specified Terms for the Transaction.

xviii) "***Units per Put Swaption***" shall be as specified in the Specified Terms for the Transaction.

d) **Payment, Exercise and Settlement Terms**. The following payment, exercise, and settlement terms shall apply to each Transaction:

i) If the Transaction is accepted for Clearing, payment of the Cash Settlement Amount shall be made in accordance with the rules of the Clearing Organization. If the Transaction is not accepted for Clearing, the Commodity Swaption Buyer shall pay the Total Premium to the Commodity Swaption Seller within two (2) Business Days of the Transaction Date according to the terms of the Applicable Master Agreement.

ii) If the Strike Price is equal to, or greater than, the Floating Price on the Expiration Date, then the Put Swaption shall expire without exercise.

iii) If the Floating Price is lower than the Strike Price on the Expiration Date, then the Swaption, at the option of the Commodity Swaption Buyer, may be Exercised into the Underlying Swap Transaction.

iv) If the Swaption is exercisable, then Exercise shall be deemed to have occurred unless Commodity Swaption Buyer notifies Commodity Swaption Seller that it declines to exercise on or before [•] o'clock PM on the Expiration Date.

e) **Underlying Swap Terms**. The following definitions and transaction terms shall apply to each underlying swap transaction. The "***Underlying Swap Transaction***" shall mean a financially-settled transaction executed on the following terms:

i) The "***Cash Settlement Amount***" shall be the difference between the Fixed Price and the Floating Price multiplied by the Notional Quantity. If the Fixed Price is greater than the Floating Price then the Floating Price Payer shall pay the Cash Settlement Amount to the Fixed Price Payer. If the Floating Price is greater than the Fixed Price then the Fixed Price Payer shall pay the Cash Settlement Amount to the Floating Price Payer. If the Fixed Price and the Floating Price are equal, then no payment shall be made.

ii) "***Early Swap Termination Date***" shall be a Business Day that is not earlier than two (2) Business Days after the Expiration Date that is designated by either party by written notice to the other for termination and settlement of the Underlying Swap Transaction.

iii) "***Fixed Price***" shall be the Strike Price.

iv) "***Floating Price***" shall be the official settlement price per Unit of the Applicable Futures Contract for the Futures Contract Month as specified for the Transaction.

v) "***Swap Termination Date***" shall mean [•] Business Days after the Expiration Date or the Early Swap Termination Date, whichever first occurs.

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October 29, 2008

David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Dear Mr. Stawick,

Please see attached Agora-X's filing under Part 13 of CFTC Regulations and Section 4(c) to amend Part 35. Mr Richard Shilts and Mr. Ananda K. Rahdakrishnan have been advised of this filing previously. We respectfully request that you post this filing on your website at your earliest convenience.

Respectfully submitted,

Brent Weisenborn
President/CEO
Agora-X, LLC
816-412-3000
brentw@agora-x.com

October 29, 2008

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition for an Amendment to Commission Regulation 35 to Permit the Clearing of OTC Agricultural Swap Transactions and Provide for Reporting of Certain Cleared Swap Agreements to the Commission

Dear Mr. Stawick:

Agora-X, LLC ("***Agora-X***") submits this petition ("***Petition***") in accordance with Commodity Futures Trading Commission ("***Commission***") Regulation 13[1] and respectfully requests that the Commission exercise its authority under Section 4(c) of the Commodity Exchange Act ("***Act***")[2] and amend Commission Regulation 35 ("***Part 35***")[3] to:

(a) Allow "swap agreements" (as defined in Part 35) to be cleared by derivative clearing organizations ("***DCO***"); and

(b) Implement a pilot program to require that certain cleared swap agreements under Part 35 be reported to the Commission.

The precise amendments that are requested by this Petition are attached as Exhibit A hereto.

As we demonstrate below: (i) the proposed amendments are consistent with the requirements and conditions of Section 4(c) of the Act; and (ii) clearing of swap agreements under Part 35 and the new reporting requirements for certain cleared swaps will have a positive effect on the ability of the Commission, DCOs, and applicable designated contract markets ("***DCM***") to discharge their regulatory or self-regulatory duties under the Act.

[1] 17 C.F.R. pt. 13.2 (2008). (**Petition for issuance, amendment, or repeal of a rule**. Any person may file a petition with the Secretariat of the Commission for the issuance, amendment or repeal of a rule of general application.... The petition shall be directed to Secretariat, ... and shall set forth the text of any proposed rule or amendment or shall specify the rule the repeal of which is sought. The petition shall further state the nature of the petitioner's interest and may state arguments in support of the issuance, amendment or repeal of the rule.)

[2] 7 U.S.C. § 1 *et seq*, as amended.

[3] 17 C.F.R. pt. 35 (2008).

Because of the current volatile conditions in the U.S. financial markets and the desirability of providing over-the-counter ("***OTC***") derivative market participants with access to enhanced credit management facilities, we respectfully request that the Commission review and approve this Petition on an expedited basis.[4]

I. The Commission's Legal Authority / Exemption under Part 35

A. Swap Exemption

The Commission adopted the Part 35 swap exemption ("***Swap Exemption***") 14 years ago.[5] In the intervening period, Congress has enacted major amendments to the Act and there has been a significant increase in the use of swap agreements by commercial and other participants in the U.S. agricultural industry. The Commodity Futures Modernization Act of 2000 ("***CFMA***") superseded the Swap Exemption with respect to swap transactions involving exempt and excluded commodities and expressly permitted such transactions to be cleared by a DCO.[6] However, counterparties who enter into swaps on agricultural commodities must continue relying on the Part 35 Swap Exemption. The Swap Exemption affords relief from the exchange trading requirement of the Act if:

(a) the swap agreement is entered into solely between eligible swap participants at the time such persons enter into the swap agreement;

(b) the swap agreement is not part of a fungible class of agreements that are standardized as to their material economic terms;

(c) the creditworthiness of any party having an actual or potential obligation under the swap agreement would be a material consideration in entering into or determining the terms of the swap agreement, including pricing, cost, or credit enhancement terms of the swap agreement; and

(d) the swap agreement is not entered into and traded on or through a multilateral transaction execution facility.[7]

Part 35.2 also provides that subsections (b) and (d) above do not preclude arrangements or facilities between the parties that provide for netting of payments or payment obligations.

[4] See also 17 C.F.R. pt 13.5(b)(2) and pt 13.6(a).

[5] Exemption for Certain Swap Agreements, 58 Fed. Reg. 5587 (January 22, 1993).

[6] Pub. L. No. 106-554, § 1(a)(5) (The CFMA provided legal certainty for certain off-exchange "excluded swap transactions" (Section 2(g)), and for certain "transactions in exempt commodities" (Section 2(h)). Sections 2(g) and 2(h) do not cover transactions involving agricultural commodities.

[7] 17 C.F.R. pt. 35.2(a)-(d) (2008).

II. Proposed Amendments to Part 35

A. Summary of Proposed Revisions

The proposed revisions to Part 35 are intended to:

(a) permit the clearing by DCOs of swaps entered into between eligible swap participants under Part 35;

(b) replace the undefined term "multilateral transaction execution facility" ("***MTEF***") with the term "trading facility" as defined in Section 1(a)(34) of the Act; and

(c) include a requirement to electronically report certain cleared swap agreements entered under Part 35 to the Commission.

Below we explain in more detail the rationale for each of the suggested revisions and provide in a redlined version of the proposed revisions to Part 35 attached hereto as Exhibit A.

B. Limited Conforming Amendments to Part 35

Agora-X requests that the Commission make a limited number of amendments to the Swap Exemption to permit clearing and to conform defined terms in the amendment to certain terms in the CFMA.

First, we request that the requirement that the swap agreements must not be a "part of a fungible class of agreements that are standardized as to their material economic terms" be changed to require only that swap agreements must be subject to individual negotiation between eligible swap participants. This revision will make it possible to clear swap agreements on a DCO. It also will make it easier to negotiate swap agreements via electronic communication networks ("***ECNs***") and bulletin boards which should increase liquidity in the market and make prices more transparent to users of the system.

Second, we request that the requirement that the "creditworthiness of any party ... be a material consideration" be amended to state that the creditworthiness of the counterparty must be a material consideration at the time when the swap agreement is made.

Third, we request that the term "multilateral transaction execution facility" be replaced with the term "trading facility" as defined in the Act.

C. Promotion of Clearing of Swaps

The "creditworthiness" requirement creates uncertainty about the permissibility of clearing of swap agreements under Part 35 because when a contract is cleared, it is novated to a third party. At that point, the creditworthiness of original counterparties to a swap agreement is substituted with the creditworthiness of a clearing house, such as a DCO. By amending Part 35, to require that creditworthiness be a material consideration only when eligible swap participants enter into a-swap agreement, this requirement is retained, but the amendment also allows the subsequent clearing of swap agreements.

Clearing of swap agreements will reduce counterparty credit risk and, by reducing bilateral collateral requirements, should promote increased liquidity in the market. In addition, clearing of swap agreements will enhance the financial stability of the market because once cleared, the credit of individual counterparties will be substituted by the credit of a DCO. Furthermore, it is likely that systemic risks will be reduced because the failure of any one swap trader will have a lesser effect on the market if transactions with that swap trader were novated to a DCO. Clearing of OTC agricultural swaps, in particular, is also likely to increase the credit available to agricultural aggregators, agricultural cooperatives, and other agricultural market participants.

D. Replacement of MTEF with the Term Trading Facility

The term "multilateral transaction execution facility" is not defined in either the Act or any of the Commission rules and regulations. The absence of a definition creates uncertainty in the market because the line between an undefined MTEF and an ECN used for bilateral negotiations is unclear. In addition, the Swap Exemption does not expressly provide that the clearing of a swap agreement negotiated via an ECN does not convert the ECN into an MTEF, which then would render the transaction ineligible for the safe harbor of the Swap Exemption. The uncertainty surrounding scope of the undefined term MTEF is compounded by the fact that the Act has been amended several times since 1993 and now includes a revised definition of "trading facility".[8] Significantly, the definition of "trading facility" provides that submitting for clearing to a DCO a transaction that has been executed on or through an entity that does not otherwise qualify as a "trading facility" does not cause the entity to become a "trading facility."[9] Accordingly, to

[8] 7 U.S.C. 1a (34) (defining "trading facility" as "a person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions – (i) by accepting bids or offers made by other participants that are open to multiple participants in the facility or system; or (ii) through the interaction of multiple bids or multiple offers within a system with a predetermined non-discretionary automated matching and execution algorithm. (B) Exclusions.- The term "trading facility" does not include-- (i) a person or group of persons solely because the person or group of persons constitutes, maintains, or provides an electronic facility or system that enables participants to negotiate the terms of and enter into bilateral transactions as a result of communications exchanged by the parties and not from interaction of multiple bids and multiple offers within a predetermined, nondiscretionary automated trade matching and execution algorithm;... or (iii) facilities on which bids and offers, and acceptances of bids and offers effected on the facility, are not binding. Any person, group of persons, dealer, broker, or facility described in clause (i) or (ii) is excluded from the meaning of the term "trading facility" for the purposes of this chapter without any prior specific approval, certification, or other action by the Commission").

[9] 7 U.S.C. § 1a (34) (C) (stating "[a] person or group of persons that would not otherwise constitute a trading facility shall not be considered to be a trading facility solely as a result of the submission to a derivatives clearing organization of transactions executed on or through the person or group of persons)".

promote legal certainty in the negotiation and execution of agricultural swaps and to promote the clearing of agricultural swaps, this provision of Part 35 should be revised.[10]

E. Pilot Program for Electronic Reporting of Certain Cleared OTC Agricultural Swaps

Several legislative efforts during the summer and fall of 2008 indicate a growing consensus that the access to more information about cleared OTC swap transactions would enhance the Commission's ability to effectively carry out its statutory mandate of market regulation and supervision.[11] Because in practice Part 35 Swap Exemption applies to only a limited class of swap agreements – *i.e.*, entered with respect to agricultural commodities – rather than swaps on all other commodities entered under Section 2(g) (which carves out swaps on agricultural commodities from its exclusion), the Commission has an opportunity through this request to amend Part 35 to institute a pilot program to implement reporting rules immediately without waiting for legislative amendments to the Act. Instituting a pilot reporting program will allow the Commission to evaluate the benefits of reporting in the context of a single class of commodities on an expedited basis. Furthermore, the information derived from the pilot program will assist the Commission in developing legislative proposals, if appropriate, to implement a statutory reporting requirement for cleared OTC agricultural swaps.[12]

Agora-X's proposed revision to Part 35 includes a specific provision under which a swap agreement that is entered into or negotiated via an ECN or similar facility, that is cleared, and that meets certain minimum quantitative parameters (*i.e.*, is not *de minimis*) must be reported to the Commission. It will not be burdensome for any ECN or DCO to comply with this pilot requirement because they already collect and maintain electronic records of transactions negotiated on or cleared through them.

The Commission's ability to collect data concerning cleared agricultural swap transactions on a pilot basis will significantly expand the information available to the Commission as a regulator of commodities markets. The increased legal certainty and reduced credit risk that adoption of Agora-X's proposed amendments to Part 35 Swap Exemption would provide for agricultural

[10] Given that the definition of "trading facility" excludes facilities that serve as ECNs, bulletin boards or computer messaging systems, greater legal certainty concerning the parameters of permissible electronic systems for negotiating swaps will promote efficient execution of swap agreements that until now routinely have been executed over the telephone or via an AOL, Yahoo, Google or any other online chat-box or messaging system.

[11] *See* Commodity Markets Transparency Act of 2008, H.R. 6604, 110th Cong. § 14 (2008) (requiring routine monthly reporting to CFTC of OTC transactions exempt commodities, excluded commodities, excluded swap transactions or transactions entered into under an exemption issued by the CFTC rule, regulation, or order that are fungible with agreements, contracts, or transactions traded on or subject to the rules of any board of trade or electronic trading facility, with respect to a significant price discovery contract).

[12] *See also,* Staff Report on Commodity Swap Dealers & Index Traders with Commission Recommendations, September 2008, where the Commission recommended enhanced reporting with respect to OTC commodity swaps.

swap transactions should increase liquidity in the market and the transparency to the Commission of the extent of, and exposures created by, such transactions.

III. Requirements of Section 4(c) of the Act

Because the Commission adopted Part 35 under its authority granted by Section 4(c) of the Act, the Commission must apply the same criteria in deciding whether to adopt Agora-X's proposed amendments to the Swap Exemption.

A. Requirements for an Exemption under Section 4(c) of the Act

Section 4(c)(I) of the Act provides that, "[i]n order to promote responsible economic or financial innovation and fair competition" the Commission may exempt contracts, and persons who provide services with respect to such contracts, from any applicable requirement that such contracts must be executed on a DCM or a registered derivatives transaction execution facility or from any other provision of the Act (with certain specified exceptions). Furthermore, to grant an exemption from the exchange trading requirement, the Commission must determine that:

(a) the amendment will be consistent with the public interest and the purposes of the Act;

(b) the contracts will be entered into solely between "appropriate persons;" and

(c) the amendment will not have a material adverse effect on the ability of the Commission or the relevant market to discharge its regulatory or self-regulatory duties under the Act.

Below we discuss how Agora-X's proposed revisions to Part 35 satisfy each of the requirements for an exemption under Section 4(c).

B. Public Interest and Purposes of the Act

The President's Working Group on Financial Markets ("***PWG***")[13] expressly supported the clearing of OTC transactions. The CFMA, based in part on PWG's recommendations, enacted amendments to the Act to facilitate the clearing of OTC transactions by DCOs. More recently, many U.S. financial regulators, including the Commission have stated on several occasions that clearing of OTC derivatives contracts reduces counterparty risk, increases available credit to

[13] *See* Over-the-Counter Derivatives Markets and the Act: Report of the Presidents Working Group on Financial Markets (November 1999) (noting "[c]learing of OTC derivatives has the potential to reduce counterparty risks associated with such transactions through risk management techniques that may include mutualizing risks, facilitating offset and netting").

market participants, reduces systemic risks, contributes to greater liquidity of OTC trades and improves transparency of the OTC markets.[14]

Clearing of OTC swap agreements involves the substitution of the creditworthiness of two counterparties to a transaction with the creditworthiness of the clearing organization. The DCO manages counterparty risk through its system of risk mutualization and by requiring adequate margin.[15] Although cleared-only contracts that are typically used to clear OTC swap agreements are not futures contracts, the substitution process will afford the DCO clearing members which carry the "cleared-only" contracts the same efficiencies and benefits that centralized clearing affords clearing members that carry DCM-listed futures contracts. Accordingly, the DCO will be able to manage the risks associated with the cleared-only positions through the same practices used by the DCO and its clearing members to manage the risks associated with futures contracts executed on a DCM in either the same or similar underlying commodities.

Amending Part 35 to permit the clearing of swap agreements by a DCO will promote one of the key public interests identified in Section 3(a) of the Act "by providing a means for managing and assuming price risks, [and] discovering prices." The requested amendment of Part 35 is consistent with the purposes of the Act identified in Section 3(b), which include: promotion of responsible innovation and fair competition; serving the public interest through a system of effective self-regulation and implementation of internal surveillance systems; deterring and preventing price manipulation; ensuring the financial integrity of transactions and the avoidance of systemic risk; and protecting market participants from fraud and misuses of customer assets.

[14] Press Release, U.S. Commodity Futures Trading Commission, Commission Announces Agricultural Market Initiatives, (June 3, 2008) (stating "[t]he Commission has tasked CFTC staff to develop a proposal for allowing the clearing of agricultural swaps. This initiative will provide farmers and grain merchandisers with another choice for managing price and basis risk with the benefit of centralized clearing and the regulatory transparency that accompanies clearing"), *available at* http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5504-08.html *See also* Commission Staff Report on Commodity Swap Dealers and Index Traders with Commission Recommendations at page 7 (September 2008) (stating [t]he Commission believes that market integrity, transparency, and availability of information related to OTC derivatives are improved when these transactions are subject to centralized clearing. Accordingly, the Commission will continue to promote policies that enhance and facilitate clearing of OTC derivatives whenever possible"), *available at* http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/cftcstaffreportonswapdealers09.pdf. *See also*, Remarks By Treasury Assistant Secretary Lewis A. Sachs on September 26, 2000 (LS-914), referring to the CFMA 2000 and the benefits of centralized clearing of OTC derivatives: "Among other things, this legislation [CFMA 2000] would allow ... centralized clearing of derivatives, thereby helping to: reduce counterparty credit risk; promote innovation; make our markets more competitive, transparent, and efficient; and reduce the costs of hedging risk and reducing exposure to other markets," *available at* http://www.ustreas.gov/press/releases/ls914.htm.

[15] In a system which does not allow clearing, counterparty credit risk is managed on a bilateral basis and in practice this may result in counterparties trading without adequate collateral. As the September and October 2008 events in the U.S. financial markets have demonstrated, this can increase systemic risks. Making clearing available leads to 3rd party margining (*i.e.*, by the DCO) and, in turn, can reduce this risk.

Cleared OTC products have not contributed to current unfavorable economic conditions, while some uncleared OTC products, such as credit default swaps, appear to have contributed to the problem. Users of Cleared OTC products will be subject to the discipline of margin; while counterparties to uncleared OTC products must make their own unique credit support arrangements. Prohibiting the clearing of agricultural swaps has no apparent regulatory benefit. Indeed, on the contrary, it may actually increase systemic credit risk to the market as a whole.

Implementation of the amendment of Part 35 that promotes clearing will serve the public interests of:

- increased stability of the OTC markets;
- reduced counterparty risk;
- increased availability of credit to market participants;
- reduced systemic risks; and
- greater liquidity in, and improved transparency of, the OTC markets.

In addition, the purposes of the Act will be served by:

- increased ability of the Commission to oversee the OTC markets;
- improved ability of market participants to manage counterparty risks; and
- the promotion of reasonable economic and financial innovation and fair competition in U.S. financial and derivatives markets.

C. Negotiation of Swaps Between Appropriate Persons

The second requirement for an amendment under Section 4(c) is that the agreement, contract or transaction be entered into solely between "appropriate persons." Under Section 4(c) the category of "appropriate persons" essentially replicates the category of "eligible swap participants" in Part 35. Part 35, however, defines the subcategory of an unregulated business entity more narrowly than Section 4(c).[16] Accordingly, Section 4(c)'s "appropriate persons" requirement necessarily is met by Agora-X's proposed amendments to Part 35 Swap Exemption.

[16] 17 C.F.R. pt. 35 (Part 35 requires that such entity have total assets in excess of $10 million, while section 4(c) only set the limit at $5 million).

D. Absence of Material Adverse Effect on the Ability of the Commission or Any DCM or Derivatives Transaction Execution Facility to discharge its Regulatory or Self-Regulatory Duties under the Act

Because of the link between transactions executed via an ECN and cleared on a DCO, the Commission will have additional information available to assist in the performance of its market monitoring and supervisory functions. Accordingly, the Commission's ability to discharge its regulatory duties under the Act with respect to agreements entered into under the Swap Exemption will be significantly improved.

DCOs will follow the same objective margining, financial and risk management procedures with respect to cleared swap agreements as they follows for all other contracts that they clear. As regulated entities, the DCOs are subject to applicable Core Principles under the Act and the swap agreements cleared by the DCOs will remain subject to the Act's anti-fraud and anti-manipulation provisions. Because the swap agreements will be subject to all of the protections applicable to transactions cleared on the DCOs, permitting the clearing of swap agreements will enhance the ability of the Commission and the DCOs to discharge their regulatory and self-regulatory responsibilities.

IV. **Conclusion**

Agora-X respectfully submits that the proposed revision to Part 35 will serve the public interest and the purposes of the Act by promoting:

- the clearing of OTC swap agreements;
- the harmonization of the definitions used in Part 35 with those in the Act; and
- greater transparency of cleared OTC swap agreements through a pilot requirement that certain cleared swap agreements be reported to the Commission.

Please contact: Agora-X representatives – Brent M. Weisenborn, President and CEO of Agora-X at (816) 412-3000 brentw@agora-x.com; or Paul J. Pantano, Jr., at (202) 756-8026 ppantano@mwe.com or Peter Y. Malyshev at (202) 756-8067 pmalyshev@mwe.com (as regulatory counsel for Agora-X) if you have any questions about this Petition.

Thank you for your consideration.

Respectfully submitted,

Agora-X

Brent M. Weisenborn
President/CEO
Agora-X, LLC
Tel. (816) 412-3000
brentw@agora-x.com

cc: Acting Chairman Walter Lukken
Commissioner Bart Chilton
Commissioner Michael Dunn
Commissioner Jill E. Sommers
Richard A. Shilts
Ananda K. Radhakrishnan

Paul J. Pantano, Jr.
Tel. (202) 756-8026
ppantano@mwe.com
Peter Y. Malyshev
Tel. (202) 756-8067
pmalyshev@mwe.com
McDermott Will & Emery LLP
600 13th Street, NW
Washington DC, 20005

Richard A. Malm
Dickinson, Mackaman, Tyler & Hagen, P.C.
699 Walnut Street, Suite 1600
Des Moines, Iowa 50309
Tel. (515) 246-4516
Fax (515) 246-4550
rmalm@dickinsonlaw.com

Exhibit A

Redline of the Revised Part 35

§ 35.1 Definitions.

(a) *Scope*. The provisions of this part shall apply to any swap agreement which may be subject to the Act, and which has been entered into on or after October 23, 1974.

(b) *Definitions*. As used in this part:

(1) *Swap agreement* means:

(i) An agreement (including terms and conditions incorporated by reference therein) which is a ~~rate~~ swap agreement, basis swap, forward rate agreement, commodity swap, interest rate option, forward foreign exchange agreement, ~~rate~~ cap agreement, ~~rate~~ floor agreement, ~~rate~~ collar agreement, currency swap agreement, cross-currency rate swap agreement, currency option, any other similar agreement (including any option to enter into any of the foregoing);

(ii) Any combination of the foregoing; or

(iii) A master agreement for any of the foregoing together with all supplements thereto.

(2) *Clearing* means the novation and clearing of swap agreements on or through a derivatives clearing organization.

(3) *Eligible swap participant* means, and shall be limited to the following persons or classes of persons:

(i) A bank or trust company (acting on its own behalf or on behalf of another eligible swap participant);

(ii) A savings association or credit union;

(iii) An insurance company;

(iv) An investment company subject to regulation under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, *Provided* That such investment company or foreign person is not formed solely for the specific purpose of constituting an eligible swap participant;

(v) A commodity pool formed and operated by a person subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, *provided* that such commodity pool or foreign person is not formed solely for the specific purpose of constituting an eligible swap participant and has total assets exceeding $5,000,000;

(vi) A corporation, partnership, proprietorship, organization, trust, or other entity not formed solely for the specific purpose of constituting an eligible swap participant (A) which has total assets exceeding $10,000,000, or (B) the obligations of which under the swap agreement are guaranteed or otherwise supported by a letter of credit or keepwell; support, or other agreement by any such entity referenced in this paragraph (b)(~~2~~3)(vi)(A) of this section or by an entity referred to in paragraph (b)(~~2~~3) (i), (ii), (iii), (iv), (v), (vi) or (viii) of this section; or (C) which has a net worth of $1,000,000 and enters into the swap agreement in connection with the conduct of its business; or which has a net worth of $1,000,000 and enters into the swap agreement to manage the risk of an asset or liability owned or incurred in the conduct of its business or reasonably likely to be owned or incurred in the conduct of its business;

(vii) An employee benefit plan subject to the Employee Retirement Income Security Act of 1974 or a foreign person performing a similar role or function subject as such to foreign regulation with total assets exceeding $5,000,000, or whose investment decisions are made by a bank, trust company, insurance company, investment adviser subject to regulation under the Investment Advisers Act of 1940 (15 U.S.C. 80a–1 *et seq.*), or a commodity trading adviser subject to regulation under the Act;

(viii) Any governmental entity (including the United States, any state, or any foreign government) or political subdivision thereof, or any multinational or supranational entity or any instrumentality, agency, or department of any of the foregoing;

(ix) A broker-dealer subject to regulation under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible swap participant: *Provided, however,* That if such broker-dealer is a natural person or proprietorship, the broker-dealer must also meet the requirements of either paragraph (b)(2~~3~~) (vi) or (xi) of this section;

(x) A futures commission merchant, floor broker, or floor trader subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible swap participant: *Provided, however,* that if such futures commission merchant, floor broker, or floor trader is a natural person or proprietorship, the futures commission merchant, floor broker, or floor trader must also meet the requirements of paragraph (b)(2~~3~~) (vi) or (xi) of this section; or

(xi) Any natural person with total assets exceeding at least $10,000,000.

§ 35.2 Exemption.

(a) *Exemption.* A swap agreement is exempt from all provisions of the Act and any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to such agreement, is exempt for such activity from all provisions of the Act (except in each case the provisions of sections 2(a)(1)(B), 4b, and 4o of the Act and §32.9 of this chapter as adopted under section 4c(b) of the Act, and the provisions of sections 6(c) and 9(a)(2) of the Act to the extent these provisions prohibit manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market), provided the following terms and conditions are met:

(~~a~~1) The swap agreement is entered into solely between eligible swap participants at the time such persons enter into the swap agreement;

(~~b~~2) The swap agreement is ~~not part of a fungible class of agreements that are standardized as to their material economic terms;~~ subject to individual negotiation by the parties;

~~(c) The~~3) At the time when the parties enter into the swap agreement, the creditworthiness of any party having an actual or potential obligation under the swap agreement would be a material consideration in entering into or determining the terms of the swap agreement, including pricing, cost, or credit enhancement terms of the swap agreement; and

(~~d~~4) The swap agreement is not entered into and traded on or through a ~~multilateral transaction execution~~ trading facility~~;~~.

~~*Provided, however,* That paragraphs (b) and (d~~(b) *Netting of Payment Obligations and Clearing.* Paragraphs (2), (3) and (4) of Rule 35.2(a) shall not be deemed to preclude arrangements or facilities between parties to swap agreements, that provide for netting of payment obligations resulting from such swap agreements or clearing of such swap agreements nor shall these subsections be deemed to preclude arrangements or facilities among parties to swap agreements, that provide for netting of payments resulting from such swap agreements~~; *Provided further,* That any~~ or clearing of such swap agreements.

(c) *Reporting.* Any swap agreement entered into under this exemption that:

(1) is cleared on a derivatives clearing organization; and

(2) is entered into, on or through the means of any electronic communication network or any other similar negotiation platform that is excluded from the definition of the trading facility; and

(3) has more than *de minimis* value

shall be reported by the DCO to the Commission in the form and to the extent specified by the Commission. For the purpose of this Paragraph (c), *de minimis* value shall mean [TO BE DETERMINED BY CFTC].

(d) *Applying to Commission for Additional Exemptions.* Any person may apply to the Commission for exemption from any of the provisions of the Act (except 2(a)(1)(B)) for other arrangements or facilities, on such terms and conditions as the Commission deems appropriate, including but not limited thereto, the applicability of other regulatory regimes.

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LAW OFFICES OF
JEFFREY L. ROSENBERG & ASSOCIATES, LLC

46 MORGAN DRIVE
OLD WESTBURY, NY 11568

212.755.7700
FAX: 212.755.6060
OLD WESTBURY FAX: 516.626.0355
E-MAIL: J.ROSENBERG@JLRLLC.COM

*ALSO ADMITTED IN CALIFORNIA

December 8, 2008

VIA FEDERAL EXPRESS
Secretariat of the Commission of Issuance,
Commodities Futures Trading Commission,
Three Lafayette Centre
1155 21St Street, NW
Washington, DC 20581

Re: SUPPLEMENTAL SUBMISSION WITH RESPECT TO: PETITION BY THE PLENUM FUND, LP, PURSUANT TO 7 U.S.C. §§ 5(c) AND 7(d), AND 17 C.F.R. §13.2 TO INVALIDATE OR AMEND CHICAGO MERCANTILE EXCHANGE RULES 578, 600, 606 and 621.

By letter dated December 8, 2008, this firm supplemented the captioned Petition filed on behalf of Plenum Fund, LP. Under cover of this letter, we respectfully request that the commission accept, review and consider as a further and final supplement to that Petition, certain affidavits and a memorandum of law submitted in an action entitled: *The Plenum Fund, LP v. Chicago Mercantile Exchange, GLOBEX Control Center, and CME Group, Inc.*; O8 Cv 6091, pending in the United States District Court for the Northern District of Illinois.

As may be seen from those papers, in particular the Declaration of Jeffrey L. Rosenberg, dated December 18, 2008, the CME rules that are the subject of Plenum's petition do not provide adequate procedures and infrastructure to support a mandatory arbitration of member claims against the Exchange, including pursuant to CEA, §22(b)(4) (7 U.S.C. § 1, et seq.); and to the extent that those rules are applied as the CME would suggest, including its claim that Rule 621 compels mandatory arbitration, they afford so much discretion to the Exchange as to effect the outcome of an arbitration, making such rules violative of the Core Principles. It is equally demonstrated the CME rules are intended to unfairly impede and denude the application of CEA, §22(b)(4), as a means to protect the CME from claims under that statute. (Copies of all rules referred to are enclosed, but no all exhibits referred to in Rosenberg Declaration)

Respectfully Submitted,

JEFFREY L. ROSENBERG
& ASSOCIATES, LLC

By: Rosenberg
Jeffrey L. Rosenberg
(Counsel for Plenum Fund, LP)

JLR/csj
CC: David Van Wagner,
Chief Counsel, Division of Market Oversight

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS,
EASTERN DIVISION

THE PLENUM FUND, LP	)	
	)	**Case No. 08 CV 6091**
Plaintiff	)	
	)	**(EEB) (ECF)**
-against-	)	
	)	
CHICAGO MERCANTILE EXCHANGE, INC.,	)	
CME GLOBEX CONTROL CENTER, AND	)	ECF CHAMBERS COPY
CME GROUP, INC. and JOHN DOES 1-20.	)	DOCUMENT # 22
	)	
Defendants.	)	

PLAINTIFF'S MEMORANDUM OF LAW IN OPPOSITION TO MOTIONS TO STAY PROCEEDINGS AND TO COMPEL ARBITRATION

A. Background Of Action And Preliminary Statement.

The background facts and circumstances which underlie this action, including "Plenum Fund's"[1] claim that it incurred more than $6 million in trading losses due to the alleged "bad faith" conduct of Defendants in failing to enforce CME Rule 588.C, are set out in ¶¶ "2" through "12" of the accompanying Opposition Affidavit of Steven LaPierre (the "LaPierre Affidavit").

"Defendants' Memorandum" is a practiced exercise in misdirection and deflection, primarily intended: (i) to prop up a motion that is not justified by the facts and any reasonable interpretation of Defendants' documentary evidence; and (ii) to delay and put off disclosure and which publicly air and unmask Defendants' bad faith conduct in derogation of its duty to protect the public interest. (See Ex. "F" to Rosenberg Declaration) To demonstrate these points, as a hallmark of Plaintiff's

[1] Plaintiff incorporates by reference herein the defined terms used in the accompanying Affidavit of Steven A. LaPierre, denoted quotation marks upon first usage herein. Except as to references to CME Rules 110, 400 and 440, which are annexed as exhibits to the accompanying Rosenberg Declaration, all citations to CME Rules refer to exhibits Exs. "A" 1 and 2 to Defendants' Memorandum.

Opposition to demonstrate that Defendants' claim that Rule 621 provides the specific procedures for a mandatory arbitration of the claims asserted by Plenum Fund, nowhere do Defendants specify or identify what those procedures are; and those proclamations are shown to be unsupported. If this Court references Rule 621, it will unavoidably appear that there are no fair, workable or applicable rules or procedures governing a claim to be made against the Exchange. The Rosenberg Declaration demonstrates this, and with equal felicity shows that such Rules, as applied to a claim by a member against the Exchange are unfair, as compared to a claim by a member against a member, not presented here, provide disabling discretion to the CME in a proceeding in which claims are made against it; and therefore, the Rosenberg Declaration concludes that the Court must find that such Rules are unenforceable as violative of the statute embodying the Core Principles. Further, Defendants' motions are rendered unavailing by the fact that any consent to arbitrate was only obtained by reason of Defendants' monopolistic coercion, and affirmative culpable conduct in deflecting from and hiding, even if in plaint sight, the Arbitration Rules, which circumstances, taken together, vitiate any purported consent by reason of unconscionability.

Defendants' recitation of what are essentially well-known and widely accepted "head note" propositions of general statements of law in relation to the favorable status to be accorded to agreements to arbitrate are not disputed; but nor are they controlling at this time. This results because Plaintiff's Opposition demonstrate that there was no valid and enabling initial agreement to arbitrate, and/or that the Arbitration Rules otherwise sought to be enforced are not workable and/or applicable to the specific instance of a claim by a member against the Exchange, and are otherwise not enforceable for reasons unrelated to any consent. By way of summary and overview, Plaintiff submits that:

(1) contrary to the contentions of "Defendants' Memorandum", Rule 621 does not set forth the procedures for a "mandatory arbitration" of a member's claim against the CME; or does not set forth such procedures with sufficient clarity and precision so that they could be followed in any proposed "mandatory arbitration";

(2) any consent by Plenum Fund to arbitrate was coerced or obtained unwittingly, and was vitiated by coercion borne of the combination of monopolistic power on the part of the CME and "substantive" and "procedural" unconscionability in relation both the text of the Arbitration Rules, and the manner of obtaining any purported consent as to their application;

(3) this Court, but not the Chairman of the CME[2] must ascertain the efficacy of any agreement to arbitrate in the first instance; and

(4) the CME Arbitration Rules, in the context of a claim by a member against the CME, are patently unfair and advantage the CME in any dispute resolution, including by affording the CME with unfair substantive and procedural discretion to affect an outcome, in violation of the CEA, 7 U.S.C. §§ 5(c) and 7(d), which impose upon "contract markets" the obligation to adopt and maintain certain "Core Principles" (See 7 U.S.C. §7(d)), and therefore the Rules are unenforceable.

Separately, although Defendants' Memorandum, at pp. 4-5, claims that Plenum filed a claim with the CEA, embracing protections afforded by CME rules, and thereby waiving any claims of unenforceability, it is shown that in October, 2008, Plenum Fund filed a Petition with the Commodities Futures Trading Commission ("CFTC") specifically seeking to invalidate those rules. That Petition expressly stated that Plenum was not filing to recover its trading losses. (See, Rosenberg Declaration, ¶¶ "87"–"90", and Exs. "F" and "G" thereto).

B. Argument.

(a) The Court Must First Decide If There Was An Agreement To Arbitrate.

For purposes of the within motions, Plaintiff does not contest the Defendants' citation of general propositions of law under the Federal Arbitration Act ("FAA"). However, any such propositional mandates to stay this action and to compel arbitration are subject to the predicate requirement that Defendants demonstrate the existence of a valid agreement to arbitrate. Framing this issue, Plaintiff contests the validity of any agreement to arbitrate specifically in the context of a claim under CEA,§22(b)(4), but does not seek invalidation of the broader agreement which admitted Plenum Fund to CME corporate membership. (LaPierre Affidavit, ¶ "29").

[2] See, CME Rule 606.

Contrary to Rule 606, the validity of the "Arbitration Rules" is for the Court to determine in the first instance, not the "chairman" of the CME Board of Directors. It would be a sham if the chairman's decision on arbitrability were deemed final.[3] See, *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 444, 126 S.Ct. 1204, 1208, 163 L.Ed.2d 1038, 1042 (2006); *Bess v. DirectTV, Inc.*, 381 Ill.App.3d 229, 236, 885 N.E.2d 488, 495, 319 Ill.Dec. 217, 224 (5th Dist., Ill., 2008). It is equally Plaintiff's position that even if there was a valid consent to arbitrate as related to claims by members against members, the Arbitration Rules cited by Defendants do not apply to claims by members against the Exchange, as present here, including for the reason that they fail to provide sufficient and workable procedures for such an arbitration. *First Options of Chicago, Inc. v. Kaplan,* 514 U.S. 938, 947, 115 S.Ct. 1920, 1926 131 L.Ed.2d 985 (1995); "[A] disagreement about whether an arbitration clause ... applies to a particular type of controversy is for the court [to decide].' "*JLM Indus. v. Stolt-Nielsen SA,* 387 F.3d 163, 170-71 (2d Cir.2004).

Therefore, without the need for a Jury Trial, it is submitted that if the analysis of the Rosenberg Declaration is correct, to the effect that the rules of Chapter 6 must be found to be overwhelmingly inappropriate and unenforceable as related to claims by a member against the Exchange, including by reason of their inconsistency with the Core Principles, then this Court should summarily deny the motions, and move forward with discovery and trial of the issues.

(b) The CME Arbitration Rules Are Rendered Unfair and Unworkable By Investing Such Discretion in the Exchange, As To Affect The Outcome Of A Proceeding, Making Them Violative of the "Core Principles"And Therefore Unenforceable.

The Rosenberg Declaration (¶¶ "6"-"77"), in analyzing the Arbitration Rules, concludes that: (i) they do not provide sufficient or workable procedures, and/or the required governance to support Defendants' claim of "mandatory arbitration"; and (ii) such Rules, as sought to be applied

[3] See fn. "8" of Rosenberg Declaration.

to claims by a member against the Exchange, instead of the situation for which they were plainly designed and intended to apply, are unfair and one-sided, including because they invest unfair discretion in the Exchange, so as to advantage it as to the outcome of a proceeding; and that by reason of that discretion and advantage there is a conflict of interest antagonistic to and proscribed by the Core Principles—which makes the Arbitration Rules unenforceable in this action.

In support of this contention, and to provide background for the additional claim that the CME had a duty to disclose all material facts to Plenum Fund in connection with its membership application, in its role as a fiduciary charged with protecting the "public interest", it is noted that the CME is a designated Board of Trade and "contract market" for futures contract trading, pursuant to § 5 of the CEA. 7 U.S.C. § 7. As such, the CME's activities are regulated by the CFTC, pursuant to the CEA, 7 U.S.C. § 1, et seq. The CME's status as a "contract market" imposes upon it a duty of self-regulation in the public interest. As part of those duties, the CME must enact and enforce rules that are fair and governable; and it is obligated to use due diligence in maintaining a continuing affirmative action program to secure compliance with all rules and regulations which the CME is required by the CEA to maintain and enforce. "Section 7(d) ... sets forth 'core principles' with which designated contract markets...must comply in order to maintain [such] designation.... See 7 U.S.C. § 7(d))." *New York Mercantile Exchange, Inc. v. Intercontinental. Exchange, Inc.*, 323 F.Supp.2d 559, 569 (S.D.N.Y. 2004).

7 U.S.C.A. § 7(d), provides, in pertinent part as follows:

"(d) Core principles for contract markets:

> (1) In general
> To maintain the designation of a board of trade as a contract market, the board of trade shall comply with the core principles specified in this subsection. The board of trade shall have reasonable discretion in establishing the manner in which it complies with the core principles. ...

> (13) Dispute resolution
> The board of trade shall establish and enforce rules regarding and provide facilities for alternative dispute resolution as appropriate for market participants and any market intermediaries. ...; and
>
> (15) Conflicts of interest
> The board of trade shall establish and enforce rules to minimize conflicts of interest in the decision making process of the contract market and establish a process for resolving such conflicts of interest."

In substance, these Core Principles mandate and impose on CME, as a contract market the overriding and paramount requirement that it enact and enforce comprehensive and cohesive rules, including as related to alternative dispute resolution, which are fair, workable and predictable by parties consulting such rules and seeking to comply with them--including adequate provisions "to minimize conflicts of interest in the decision making process of the contract market, and that it establish a process for resolving such conflicts of interest." Implicitly, this precludes arbitration rules that invest discretion to the Exchange as advantages the outcome of a dispute initiated by a member against such exchange. Since Chapter 6 plainly appears to apply to member/member claims, this discretion and unfairness is not readily observable from a reading of that Chapter within the context of member/member claims; but the unfairness and uneven discretion of that same section becomes patently obvious when the CME seeks to invoke those Rules to remedy the lack of procedures provided by Rules 621 and 600.C in a dispute by member vs. the Exchange. It is that application which creates the disabling conflicts of interest, and in respect of which that those Rules are unfair and unenforceable—an issue not previously considered.

(c) **Any Purported Consent of Plenum Fund To Arbitrate Was Vitiated By Substantive and/or Procedural and Unconscionability.**

At the outset it is critical to note that the specific contention that any consent to arbitrate Plenum's claims against the CME is vitiated under the circumstances of this case, relates to the particular situation presented here--involving a claim by a member the Exchange's "bad faith" failure to enforce its own rules (Rule 588.C), pursuant to CEA, §22(b)(4). It is suggested that in this context an agreement to arbitrate was not "part of the bargain" between the parties, was not "brought to the attention" of Plenum, including in pursuance of a fiduciary duty of disclosure on the part of the CME. Moreover, it is contended that the import of any such agreement was not able to be discerned by Plenum, in relation to the manner in which the adverse, but known (by the CME), consequences of such an agreement would preclude Plenum's access to the type and nature of liberal discovery necessary to uncover evidence of "bad faith", and that, in fact the CME regularly and here engaged in a course of conduct in to obfuscate and make less or not apparent the import of the Arbitration Rules. It is contended that this is a matter of first impression, especially considering the absolute monopoly of the CME, and its fiduciary or quasi-fiduciary duty to disclose all material facts to Plenum, as are with that fiduciary duty.

In that context and otherwise, the LaPierre Affidavit and Rosenberg Declaration collectively demonstrate the bases for Plenum Fund's contentions that any purported agreement to arbitrate was vitiated by reason of the CME's monopoly as the only place on earth that E-Mini S&P 500 futures contracts can be traded (see, LaPierre Aff., ¶¶ "21"-"28"), and otherwise, by reason of the "substantive" and "procedural unconscionability" of the Arbitration Rules, including, as created in conjunction with such monopoly position, by the fact that the CME intentionally adopts a practice by which Arbitration Rules are intended to hidden from ready view, which has the effect to keep them from an applicant's specific purview.

Irrespective of any predisposition favoring arbitration as a means to resolving disputes (*Jenkins v. Trinity Evangelical Lutheran Church*, 356 Ill.App.3d 504, 507, 292 Ill.Dec. 195, 825 N.E.2d 1206 (2005)), Plaintiff contends that it is immutable that a contract arbitration provision will not be enforced if it is unconscionable, or if there is no agreement to arbitrate. See, *Atkinson* *v. Sinclair Refining Co.*, 370 U.S. 238, 241, 82 S.Ct. 1318, 1320, 8 L.Ed.2d 462 (1962) Whether the parties actually agreed to arbitrate is determined under state law principles. *Penn v. Ryan's Family Steak Houses, Inc.*, 269 F.3d 753, 758-59 (7th Cir. 2001); and, for purposes of this argument Plaintiff will assume that Illinois law applies on that question.

Unconscionability may be either procedural or substantive, or a combination of both. See, *Kinkel v. Cingular Wireless*, LLC, 223 Ill.2d 1, 21, 306 Ill.Dec.157, 857 N.E.2d 250 (2006). Here, it is contended to be both, and also to be vitiated by the mandates imposed upon the CME by the CEA in relation to the Core Principles.

"Procedural unconscionability refers to a situation where a term is so difficult to find, read, or understand that the plaintiff cannot fairly be said to have been aware he was agreeing to it." *Kinkel*, 223 Ill.2d at 22, 306 Ill.Dec. 157, 857 N.E.2d 250, quoting *Razor v. Hyundai Motor America,* 222 Ill.2d 75, 100, 305 Ill.Dec. 15, 854 N.E.2d 607 (2006). This analysis incorporates and takes into account the disparity of bargaining power between the drafter of the contract and the party claiming unconscionability. *Razor*, 222 Ill.2d at 100, 305 Ill.Dec. 15, 854 N.E.2d 607.

The Court in *Kinkel,* borrowed heavily from the exposition on procedural unconscionability proffered in *Frank's Maintenance & Engineering, Inc. v. C.A. Roberts Co.*, 86 Ill.App.3d 980, 989-90, 42 Ill.Dec. 25, 408 N.E.2d 403 (1980). As noted in *Williams v. Jo-Carroll Energy, Inc.*, 379 Ill.App.3d 214, 228, 882 N.E.2d 157, 171, 317 Ill.Dec. 583, 597 (2008) "...the issue in *Frank's Maintenance* was the procedural and substantive fairness of a limitation on liability, but [Kinkel] held that the following remarks were applicable as well to an attack on an arbitration provision:

> " 'Procedural unconscionability consists of some impropriety during the process of forming the contract depriving a party of meaningful choice. [Citations.] Factors to be considered are all the circumstances surrounding the transaction including the manner in which the contract was entered into, whether each party had a reasonable opportunity to understand the terms of the contract, and whether important terms were hidden in a maze of fine print; both the conspicuousness of

> the clause and the negotiations relating to it are important, albeit not conclusive factors in determining the issue of unconscionability. [Citation.] To be a part of the bargain, a provision limiting the defendant's liability must, unless incorporated into the contract through prior course of dealings or trade usage, have been bargained for, brought to the purchaser's attention or be conspicuous.' " Kinkel, 223 Ill.2d at 23, 306 Ill.Dec. 157, 857 N.E.2d 250…."

(See, also, *Bess v. DirectTV, Inc.*, 381 Ill.App.3d 229, 236, 885 N.E.2d 488, 495, 319 Ill.Dec. 217, 224 (2008). Thus, *Frank's Maintenance* appears to mandate a jury trial on the issue of procedural unconscionability, based on its directive to consider all of the surrounding facts and circumstances underlying the agreement to arbitrate; which necessarily encompasses concomitant discovery, necessary to uncover and present those circumstances—unless this Court denies Defendants' motions based on competing submissions of the parties.

Substantive unconscionability, "concerns the actual terms of the contract and examines the relative fairness of the obligations assumed and is indicated by 'contract terms so one-sided as to oppress or unfairly surprise an innocent party, an overall imbalance in the obligations and rights imposed by the bargain, and other disparities." *See, Hutcherson v. Sears Roebuck & Co., 342 Ill.App.3d 109, 121, 276 Ill.Dec. 127, 793 N.E.2d 886 (2003), quoting, Maxwell v. Fidelity Financial Services, Inc.*, 184 Ariz. 82, 89, 907 P.2d 51, 58 (1995).

The facts and circumstances set out in the LaPierre Affidavit and the analysis presented by the Rosenberg Declaration directly address these respective considerations and focus on the issues of unconscionability established by *Kinkel.* Thus, the LaPierre Affidavit speaks to the issue that the Arbitration Provisions are contained within a broader agreement regarding membership on the Exchange, which by virtue of the fact that the CME is the only place on earth to trade E-Mini S&P 500 futures contracts portends of a contract of adhesion. While *Kinkel* teaches that "contracts of adhesion", typified by terms that are "nonnegotiable and presented in fine print in language that the average consumer might not fully understand" are not *per se* unconscionable from a procedural standpoint, and some added coercion or overreaching is necessary (*Kinkel*, 223 Ill.2d at 26), in the circumstances of this case, those necessary additional factors of procedural coercion are presented here as shown by the LaPierre Aff.

Unlike the other situations most frequently considered by Illinois Courts, the Arbitration Rules here were not merely a "take it or leave" situation, presented in circumstances where there are alternatives available, even if on less advantageous terms. (See, Bess, supra.) Rather the agreement to arbitrate was coerced upon Plenum Fund not only by reason of the CME's absolute monopoly in controlling the entire realm of trading for E-Mini S&P 500 futures contracts (see, LaPierre Aff., ¶¶ "29"-"32"), a situation not present in the other cases reviewed, but also by the intentional methodology of the CME in not presenting the CME Rules, including and especially the Arbitration Provisions, at the time of membership application, and by securing any consent to arbitrate solely by indirect and imputed means, which were intended or had the effect of deflecting attention from the material and adverse impact that such an agreement would have the later circumstance of claim against the Exchange in regard to the bad faith failure to enforce its own rules, pursuant to CEA, §22(b)(4). (See LaPierre Aff. ¶¶ "33"-"42" and "46"-"51", and Rosenberg Declaration, ¶¶ "78"-"82").

It is the supposition of the LaPierre Affidavit that the CME was aware of the CEA amendments which added the requirement of bad faith in regard to a member's claim that an Exchange failed to enforce its rules, as imposed by CEA, §22(b)(4); and, in inserting provisions requiring mandatory arbitration of claims by members against the Exchange, the CME expressly intended to make that proof requirement exponentially more difficult to achieve than was contemplated by CEA, §22(b)(4). The LaPierre and Rosenberg submissions demonstrate this was accomplished by terse insertions in the midst of existing Rules, which were both incomplete in providing a sufficient procedural framework, and in imposing sufficient governance for mandatory arbitration in that circumstance. Thus, those submissions show that in attempting to import the otherwise inconsistent provisions of Chapter 6 into mandatory arbitration of member claims against the Exchange, this created a matrix that was not workable, including because of the importation of rules that afforded discretion to the Exchange only intended to apply in arbitrations in which the CME was not a party; which, in turn, created impermissible conflicts of interest and advantages in proceedings in circumstances in which the CME was both a party and had supervisory and/or other discretionary power, likely to effect the outcome in its favor. Plainly this is a situation which, if accurately assessed by the Rosenberg Declaration, invalidates the Arbitration Rules.

The Rosenberg Declaration, at ¶¶ "81"-"82", leaning on the LaPierre Affidavit for its basis, succinctly describes the CME's methodology of intentionally seeking and obtaining only indirect consent to arbitrate, as a means of impinging a would-be member's ability to appreciate the CME's self-serving purpose to impose an arbitration requirement as a means to deter and inhibit the recovery of damages against it by virtue of claims by member, including under Rule 588.C and pursuant to CEA,§22(b)(4). It plainly appears that not a passive, but rather a planned an intentionally orchestrated machination. Mechanically, in this circumstance, it is unavoidable that the purported consent to arbitrate is a product of the proverbial "smoke and mirror" illusion, existing solely by virtue of the mechanism and device that the Membership Application provides that a "corporate member" "will abide by all rules", while indirectly imputing CME Rule 400 to the effect that a member is deemed to be familiar with all rules of the CME. This must be viewed to be an instance of a "three card monte" or "shell game", since the arbitration rules are never directly presented to a member, but rather, are hidden, even if in plain sight, within the context of hundreds of other extremely complex rules relating to the trading commodities on the Exchange; and the problem of cognitive recognition is further thwarted here by the veritable inability of a member to appreciate at the time of its application how such mandatory arbitration will virtually stultify its ability at some time in the future to uncover evidence of the Exchange's bad faith, pursuant to CEA, CEA,§22(b)(4). It is for this reason also that it is contended that this is a matter of first impression—making a jury trial and discovery necessary or appropriate.

In this context, it is notable and disabling that the CME does not warn applicants regarding this known and likely disadvantage, that may later adversely impact the unsuspecting member. This is especially troublesome because it is commonly understood and acknowledged that proof of "bad faith" is, by its nature, hidden and secreted, and does not lie in the open for public view and scrutiny. For that reason proof of bad faith, fraud, and other culpable conduct is the most difficult type of proof to unveil and present. In this context, it is simply not subject to any genuine or good faith argument that a party is eminently better served in its burden to present and prove "bad faith" by the myriad of discovery mechanisms, including electronic data and depositions permitting cross-examination of witnesses and documents afforded by the Federal Rules, administered in the Federal Courts; and is concomitantly disadvantaged with respect to its ability to satisfy that burden of proof if the dispute is subject to arbitration, effective discovery is substantially retarded, absent the very provisions starkly absent from the Arbitration Rules.

The Rosenberg Declaration demonstrates two additional points of great import and consequence: (i) curative measures in this regard could have been taken, but were not, that might preserved the validity of the Arbitration Rules, including, by example, if the CME had grafted into Chapter 6 the arbitration provisions, including for discovery, maintained by the NFA or the AAA, and if the Exchange itself was precluded from the impermissible discretion which currently infects the Arbitration Rules, existing when those Rules are applied to claims by a member against the Exchange. (Rosenberg Declaration, ¶¶ "3","61"-"63"); and (ii) perhaps most damaging to Plenum's claims, that there is no remedial provision in the CME Arbitration Rules, as compared to remedies in Federal Court litigations, for the willful or other disposal of electronic data, or other documents that may be the most likely source to unmask evidence of bad faith. (See, Rosenberg Declaration, ¶¶ "54"-"55"; and see, *Zubulake v. UBS Warburg LLC, et., al.*, 217 F.R.D. 309 (S.D.N.Y. 2003)

Furtherance it is submitted that the CME is a quasi-governmental instrumentality, charged under the CEA with protecting the public interest; and therefore, at the time of submission of Plenum's Membership Application, had an affirmative duty to disclose to Plenum Fund, and others similarly situated, all material facts concerning the substantive disadvantages associated with an agreement to submit a prospective claim under CEA, §22(b)(4) to mandatory arbitration. It is well recognized that "when a fiduciary, in furtherance of its individual interests, deals with the beneficiary of the duty in a matter relating to the fiduciary relationship, the fiduciary is strictly obligated to make full disclosure of all material facts."[4]

In consideration of the issue of procedural unconscionability, Plaintiff takes cognizance of cases such as *Frank's Maintenance*, *Kinkel*, *Bess* and *Williams*, but it is submitted that the circumstances here are different from those cases for a host of reasons—not the least of which is the fact that a governmental instrumentality is involved, which is charged by the CEA with the

[4] A fiduciary relationship exists where there is special confidence in one who, in equity and good conscience, is bound to act in good faith with due regard to the interests of the other. *Wolinsky v. Kadison*, 114 Ill.App.3d 527, 533, 70 Ill.Dec. 277, 449 N.E.2d 151 (1983). "Courts have imposed on a fiduciary an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation 'to employ reasonable care to avoid misleading his clients." *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194, 84 S.Ct. 275, 284 11 L.Ed.2d 237 (1963). Even one in the posture of a quasi-fiduciary has an affirmative common law duty to disclose material facts to the beneficiary of that fiduciary relationship. See, e.g., *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1043 (7th Cir. 1977)

protection of the public interest; and because the underlying non-disclosure of the mechanisms employed by the CME are intended to protect it from the very rights that the CEA, §22(b) was intended to create and preserve for Plenum Fund, and those similarly situated. For reasons outlined in the LaPierre Affidavit it is therefore suggested that facts and circumstances of this case present a matter of first impression on the issue of procedural unconscionability, including by virtue of the intentional acts of the CME to deflect attention away from the Arbitration Rules, as part of its intention to limit claims for damages by members, pursuant to CEA, §22(b).

In this inquiry, *Frank's Maintenance* and *Kinkel* require the Court to take into account all circumstances surrounding the transaction. This speaks directly to the need for a jury trial on these issues, and appurtenant discovery to uncover the intentional efforts of the CME to make the disadvantage of an agreement to arbitrate less noticeable in the context of a CEA,§22(b) claim. It has been held that "[t]o be a part of the bargain, [an arbitration provision] must, unless incorporated into the contract through a prior course of dealing or trade usage, have been bargained for, brought to the purchaser's attention or be conspicuous." *Frank's Maintenance & Engineering, supra.*, 86 Ill.App.3d 980, 989-90. Whatever may be a Court's decision as to the enforceability of agreements to arbitrate in general, at least here, in the context of the overriding procedural disadvantage an arbitration and the restricted availability of discovery and cross examination of witnesses and documents, as related to the difficulties inherent in proving the high level of culpability required by the "bad faith" requirement of CEA, §22(b)(4), the Court must find that in this circumstance, including by reason of the CME's monopoly and its course of deceptive deflection, it was impractical or impossible for Plenum Fund to have cognitively appreciated the significance of any agreement to arbitrate its claims against the Exchange; and therefore such "mandatory arbitration" was not "part of the bargain" as to Plenum's application for membership to the CME; and was not brought to the attention of Plenum Fund, including because the CME intentionally orchestrated procedures intended to obfuscate and deflect from any such recognition.

C. **Conclusion: Summary of Points.**

This Court should not and can not enforce the CME Arbitration Rules, and should deny Defendants' motions; or, alternatively should order a jury trial of the issues presented.

Respectfully Submitted,

JEFFREY L. ROSENBERG
& ASSOCIATES, L.L.C.

BY: ______________________
Jeffrey L. Rosenberg (JR-3597)
40 Morgan Drive
Old Westbury, New York 11568
(516) 626-1325 (Tel)
(516) 626-0355 (Fax)
Attorneys for Plaintiff,
Plenum Fund, LP

Law Offices of James A. McGurk, P.C.
10 South LaSalle Street
Suite 3300
Chicago, Illinois 60603
James A. McGurk, Of Counsel
(312) 236-8900 (Tel)
(312) 277-3497 (Fax)

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS,

EASTERN DIVISION

THE PLENUM FUND, LP	)	
	)	**Case No. 08 CV 6091**
Plaintiff	)	
	)	**(EEB) (ECF)**
-against-	)	
	)	**DECLARATION PURSUANT**
CHICAGO MERCANTILE EXCHANGE, INC., CME GLOBEX CONTROL CENTER, AND CME GROUP, INC. and JOHN DOES 1-20.	)))	**TO 28 U.S.C. § 1746**
	)	
Defendants.	)	

Jeffrey L. Rosenberg affirms under penalties of perjury as follows:

1. I am counsel to the Plaintiff, Plenum Fund, LP ("Plenum Fund" or "Plaintiff); I am familiar with all of the facts herein, and I submit this Declaration in opposition to Defendants' motions: (1) to stay the Case Management Procedures of this action; and (2) to compel arbitration; and I further submit this Declaration (3) in support of Plenum Fund's "Demand for a Jury Trial" on the issues which underlie any claimed consent to arbitrate.

Demand For Jury Trial.

2. As part of Plaintiff's opposition to Defendants' motions to stay proceedings and to compel arbitration, on December 1, 2008, in pursuance of 9 U.S.C. § 4, I filed with this Court Plenum Fund's "Demand for Jury Trial" (ECF Document # 18), seeking a jury trial on the issues of the enforceability and efficacy of Defendants' "Arbitration Rules"[1], and the claim

[1] To avoid duplication, I shall use, adopt and incorporate herein the defined terms and definitions set forth in the accompanying opposition affidavit of Steven A. LaPierre.

that Plenum Fund agreed to arbitrate claims against the CME. (A copy of Plaintiff's "Demand for Jury Trial" is annexed as Exhibit "A" hereto).[2]

Rebuke to Plaintiff's Attempt to Avoid Protracted, Unnecessary and Deflective Motion Practice.

3. Subsequent to the service of Defendants' motions to stay and to compel arbitration, with the purpose of avoiding protracted and deflective motion practice, and the costs associated therewith, and to more quickly enter upon a procedure to remediate more than $6 million in trading losses suffered by Plenum Fund, I importuned Defendants' counsel to enter into an arrangement to retrench from the pending motions, and to agree to arbitrate Plenum Fund's claims subject to the following conditions: (1) that the CME would not claim Plenum Fund failed to timely file a detailed claim in accordance with the Arbitration Rules; and (2) that any agreed upon arbitration proceeding encompass the facilities afforded by the Federal Rules of Civil Procedure (the "Federal Rules") as to discovery and disclosure. It was also implicit in that letter that we would have to adopt some external Arbitration Rules, such as those employed by the National Futures Association ("NFA") and/or the American Arbitration Association ("AAA"), since it is the ultimate conclusion of the analysis of this Declaration that the CME Arbitration Rules do not set out a workable and fair procedure for an arbitration of claims by a member against the Exchange.

4. Accordingly, I wrote to Jerrold E. Salzman, Esq., counsel for Defendants, by my letter dated, December 2, 2008. (A copy of that letter is annexed hereto and incorporated herein under cover of Exhibit "B")

[2] Thus, it is the purpose of Plaintiff's submissions in Opposition, not only to oppose Defendants' motions, but to establish a "question of fact" in relation to the efficacy and enforceability of the Arbitration Rules as will support and require such a jury trial.

5. Among other things, my December 2, letter advised Defendants' counsel that Plaintiff had filed a Demand for a Jury Trial, and that if allowed and ordered, that proceeding would entangle the parties in protracted trial procedures and various expanses of discovery, which would substantially approximate the procedures that would be involved in the underlying matter in any event; and which would represent a substantial duplication of efforts—which should therefore militate in favor of an agreement between counsel to submit the underlying controversy to arbitration, albeit not the arbitration contemplated by the CME Rules.[3] Mr. Salzman wasted no time in eschewing my importunity, and by e-mail transmitted to my office at 9:05pm on Friday evening, December 5, 2008, rejected my proposal stating: "We are not prepared to waive any substantive or procedural defenses."

CME Rule 621 and the Rules of Chapter "6" Do Not Set Forth A Sufficient Procedure For the Mandatory Arbitration of Plenum Fund's Claims Against the CME; and Plenum Fund Could Not Cognitively Understand Those Rules.

a.) Overview of Lack of Fairness and Workability.

6. It is submitted that the below analysis of the CME Arbitration Rules demonstrates that Defendants erroneously claim that Rule 621 provides the "specific requirements" and sufficient procedures to the "mandatory arbitration" of Plaintiff's claims against CME.

[3] My letter also announced Plaintiff's intent to oppose the motion to compel arbitration by virtue of the claim that that there was not any valid consent and agreement with respect to the Arbitration Rules, and they were substantively and procedurally unconscionable, and provided with Mr. Salzman with an early preview of Mr. LaPierre's contentions in that connection; which were subsequently more fully developed upon a more detailed analysis of CME Rules 578, and 600 through 627--which position is now more fully set forth within the context of the accompanying LaPierre Affidavit and herein. It was therefore equally the purpose of that letter to create the appearance of a risk/reward ratio that would favor withdrawal of the motion to compel arbitration in favor of an agreement between counsel.

7. Defendants' argument that the claims of the Complaint are subject to mandatory arbitration commences at ¶ "A", p. "3" of Defendants' Memorandum, where it is asserted that: "CME Rule 600.C states that '[c]laims against the Exchange pursuant to the provisions of Rule 578.C...shall be subject to mandatory arbitration." (See Ex. A-1 thereto).

8. Paragraph "A: continues with the following unconditional assertion:

> "CME Rule 578.C provides that "ANY DISPUTE ARISING OUT OF THE USE OF SYSTEMS OR SERVICES OF THE EXCHANGE...SHALL BE ARBITRATED PURSUANT TO RULE 621."

9. The argument concludes by implying, without expressly stating, that Rule 621 sets forth the specific provisions for the mandatory arbitration of claims asserted by members against the Exchange.

10. Thus, any analysis of Defendants' claims regarding compulsory arbitration must begin with (while also encompassing to the other facts set out in the accompanying LaPierre Affidavit, pertaining to whether there was a volitional and valid consent to arbitrate), an analysis of Rule 621 and the rules of Chapter "6".

11. Analysis of Rule 621, incorporating text of Rules 600 through 627, unmasks those rules in the aggregate to be overwhelmingly dedicated to and governing with respect to claims asserted by members against members, but not claims by members against the Exchange. To the extent there are any provisions regarding mandatory arbitration of a claim by a member against the Exchange they are terse, but incomplete provisions which do not provide the requisite or guiding requirements for an arbitration in that circumstance; and in the scope and ambit of the overall Arbitration Provisions encompassed by Rule 621 and Chapter 6, they appear to be an afterthought, intended to make the proof of the "bad faith" requirement

under CEA, §22(b)(4) more difficult, and to truncate the time allowed to file those claims down to 10 days, as a means to inhibit the number of claims that can or will be brought, and to make proof in those cases initiated against the CME, exponentially more difficult.

12. Even a superficial analysis of Rule 621 demonstrates that it does not provide any of the otherwise requisite procedures and guidelines for an efficacious arbitration process. Thus, such analysis requires one to inculpate reliance on the remaining rules of Chapter 6 to fill the void left by Rule 621. Those Rules, individually, and in the aggregate, also do not provide sufficient mechanisms and procedures for a workable arbitration proceeding in the circumstance of a claim by a member against the Exchange; and, in fact, such Rules are inconsistent and in conflict *inter se*, and invest such discretion in the Exchange as to allow the Exchange, by its agents, to materially and adversely impact the ability of a member to make out and pursue its claims against the CME in any such arbitration.

13. Prefatory to the comments and analysis which follows below, it is necessary and appropriate to set the table for the claim that the regulation and procedures afforded by Rule 621 and Chapter 6, Rules 600-627, taken individually and collectively, if applied to compel arbitration of a claim by a member against the Exchange, demonstrate that such Rules invest so much discretion in and on the part of the Exchange and its instrumentalities (e.g., the Market Regulation Department, and its chairman), so as to be unfair and unworkable, and so as to vitiate any notion of fairness, and thereby impermissibly contravene the "core principles" imposed upon CME by 7 U.S.C. §§ 5(c) and 7(d)) (the "Core Principles"), in and with respect to its status as a "contract market".[4]

[4] As a contract market, the CME's activities are regulated by the Commodity Futures Trading Commission ("CFTC"), pursuant to the CEA, 7 U.S.C. § 1, et seq.

14. 7 U.S.C.A. § 7(d), entitled: "Designation of boards of trade as contract markets", provides in pertinent part as follows:

> "(d) Core principles for contract markets:
>
> (1) In general
> To maintain the designation of a board of trade as a contract market, the board of trade shall comply with the core principles specified in this subsection. The board of trade shall have reasonable discretion in establishing the manner in which it complies with the core principles.
>
> (2) Compliance with rules
> The board of trade shall monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market. ...
>
> (13) Dispute resolution
> The board of trade shall establish and enforce rules regarding and provide facilities for alternative dispute resolution as appropriate for market participants and any market intermediaries.
>
> (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).
>
> (15) Conflicts of interest
> The board of trade shall establish and enforce rules to minimize conflicts of interest in the decision making process of the contract market and establish a process for resolving such conflicts of interest."

15. In substance, it is submitted that these Core Principles, mandated for and imposed on contract markets such as the CME, include the overriding and paramount requirement that there be fair, workable and predicable rules for alternative dispute resolution, including arbitration; and there be adequate provisions established and enforced "to minimize conflicts of interest in the decision making process of the contract market and establish a

process for resolving such conflicts of interest." The Core Principles therefore implicitly preclude rules of arbitration that invest discretion in an exchange as may favor or advantage such exchange and thereby impact the outcome of a dispute with one of its members, or which create or promote conflicts of interest in that connection.

16. As detailed more fully below, it is submitted that it is an essential element of these considerations that the terse statements in the Arbitrations Rules which touch upon "mandatory arbitration" were mere afterthoughts, and otherwise inchoate efforts to circumscribe the import and application of Commodity Exchange Act ("CEA"), §22, which requires that a member prove the exchange was guilty of bad faith in failing to enforce its rules, and were intended to make the recovery of damages claims by members against the CME more difficult than was intended by or provided for in CEA §22(b)

17. Moreover, it is respectfully submitted that the essential and constituent question of whether the CME's Arbitration Rules are fair, workable and in compliance with the Core Principles imposed on the CME, is a matter of first impression, which, based on this Declaration and the accompanying LaPierre Affidavit must be answered in the negative, in that such Rules are shown to be inconsistent with and contrary to the Core Principles; or, alternatively, the resolution of such question, at a minimum, if the motion to compel arbitration is not denied outright, requires a jury trial for its resolution.

b.) **Analysis of Text of Rules 621 and Chapter 6.**

18. The text of Rule 621.A reads as follows:

> "All claims arising out of or relating to the following matters shall be arbitrated in accordance with the *specific requirements* of this Rule 621, and, to the extent not inconsistent with such requirements, the rules of this Chapter [6] [Emphasis added]:
>
> ...
>
> 2. the negligence of GCC personnel or any other Exchange staff...."

19. For purposes of Plaintiff's opposition, it is not disputed that Plenum Fund's claims would appear to come within the purview of Rules 621.A.2. and 588.C.

20. However, Plenum Fund denies that Rule 621 provides such "specific requirements"; and denies that a claim by a member, such as Plenum Fund, against the Exchange, is, or can be fully and fairly governed by Rule 621, consistent with the Core Principles.

21. The only remaining provisions of Rule 621 that even purport to provide any procedural guidance or governance as to a putative "mandatory arbitration" are set out in Rule 621.B and C. While these provisions purport to govern the "initiation of the claim", and the "selection of an arbitration panel", respectively, they provide none of the "specific requirements" for a "mandatory arbitration"; and do not otherwise provide any semblance of a sufficient infrastructure to support such a proceeding.

22. Plaintiff's claims as to a lack of requisite fairness and evenhandedness begins with the observation that Rule 621.B requires that: (i) a "detailed description" of any loss must be submitted to the Exchange within ten (10) business days of the incident of the loss; (ii) the Exchange has "thirty days to pay or deny the claim in whole or in part"; (iii) that if denied, "the claimant must file a written demand for arbitration with the Market Regulation

Department within ten days" of any denial of a claim by the Exchange; and (iv) that the failure to comply with these time constraints shall bar a recovery—without provision for extension.

23. In the context of Plaintiff's claims regarding unfairness and discretion on the part of the CME, the Court should consider how this process is infected by the requirement that the written specification of the claim is submitted to the Market Regulation Department, rather than a panel of neutral arbitrators. (See, Exhibit "C"--CME form of consent to arbitrate, and discussion at ¶¶ "34"-"36"—which ensures that at least two members of the arbitration panel will be associated with the Exchange, directly contradicting all required notions of a lack of conflict of interest.)

24. It is not disputable that, other issues aside, Rule 621.B provides no guidance or instruction as to the conduct or procedures that apply to any arbitration with respect to which a claim is putatively required to be filed.

25. Rule 621. C. specifies that the arbitration panel shall consist of three (3) arbitrators selected from the roster of arbitrators maintained by the National Futures Association, and describes how the three arbitrators shall be selected in the event of a dispute. (In contrast and in conflict, see provisions in the standardized form of consent to arbitration, Exhibit "C" hereto.)

26. Apart from Rule 621.F which describes how an "award" is satisfied, there are no substantive provisions within the remaining text of Rule 621 that illuminate a member as to the required conduct of a "mandatory arbitration".

27. Therefore, a member, such as Plenum Fund, seeking instruction as to where, when and how such a "mandatory arbitration" is to be conducted, must be guided by the

phraseology at the beginning of Rule 621, to the effect that "the matters listed in Rule 621.A, 1., 2., and 3., shall be arbitrated in accordance with the specific requirements of this Rule 621, and, *to the extent not inconsistent with such requirements,* the rules of this Chapter". [Emphasis Added] A member such as Plenum Fund, or another similarly situated is thus compelled to start at the beginning of Chapter 6, Rules 600 et. seq.

28. Significantly for purposes of the contention that the Rules of Chapter 6 apply to claims by a member against a member, the caption to Rule 600.A is: "Disputes Among Members". In its opening statement Rule 600.A provides that:

> "It is contrary to the objectives and policy of the Exchange for members to litigate certain Exchange-related disputes. *Disputes between and among members* that are described below and that are based upon facts and circumstances that occurred at a time when the parties were members shall be subject to mandatory arbitration in accordance with the rules of this Chapter." (Emphasis added)

29. Thereafter, it must be concluded that none of the "disputes described below" in Rule 600.A, items "1." to "3.", relate to any claims asserted by a member against the Exchange.

30. In contrast, like Rule 621, Rule 600.C, captioned: "Claims Against the Exchange", portends that: "Claims against the Exchange pursuant to the provisions of Rule 578.C., [and] Rule 578.D., ...shall be subject to mandatory arbitration in accordance with the rules of this Chapter...." However, like Rule 621, nowhere in that provision, or elsewhere in Rule 600.C are there any procedures for such arbitration; and again a member is referred back to the overall application of Chapter 6.Rule 601 in its caption, proclaims that it applies to: "CUSTOMER CLAIMS AGAINST MEMBERS", and the provisions of that Rule are not relevant herein.

31. Rule 602, under the primary heading: "Filing Procedures", in its heading purports to govern "Initiating an Arbitration Claim." Thus, perhaps this is one of the rules that Rule 621 and 600.C seek to incorporate to regulate "mandatory arbitration", or the appearance thereof.

32. Rule 602 provides that a claim shall be initiated by a claimant submitting a written description of the dispute on a completed "Arbitration Cover Sheet", and depositing it with the Department of Market Regulation within the period permitted to initiate arbitration claims.

33. Rule 602, requires the submission of a claim under a "completed Arbitration Cover Sheet". Since this seemed to prescribe the use of an existing or specific form, I searched the CME website for a designated and proper form. The only form to be found there is a "Consent to Arbitration", a copy of which is annexed hereto as Exhibit "C"; and Chapter 6 does not otherwise provide any assistance in locating or completing such a form.

34. A review and analysis of this standardized form is revealing, if not dispositive in several important respects, including in relation to the fact that no other form is identified or proffered by the Arbitration Rules:

(a) First, this form expressly provides in pertinent parts that:

> "When you (the "Claimant") complete and submit this consent form you have agreed to have your dispute with a Chicago Mercantile Exchange Inc. ("CME") member, an introducing broker guaranteed by a CME member, or an employee thereof (the "Respondent") resolved through arbitration at the CME... Among other things, this form will ask you to identify yourself and the person(s) or firms against which you are claiming, to clearly describe the cause and the amount of the damages claimed, and to choose an arbitration panel...."

(b) Second, the form then specifies that the "completed form" ... shall be submitted to the CME's Division of Market Regulation, rather than to the Arbitrators;

(c) Third, both the foregoing language and the language thereafter appearing later in the form (e.g., the first paragraph under "Section II", at page "3") expressly refers to claims between members, or a member and an introducing broker or an employee thereof, but there is no reference to or provision for any arbitration between a member and the Exchange; and

(d) Fourth, and perhaps most dispositively, both of the choices for arbitration panels, as appear at "Section IV", at page "5", contemplate a panel which includes members of a division of the Exchange—which is hardly a provision that would engender or constitute fairness in a dispute by a member against the Exchange; and to the extent there might be any claim that this form of the rules pursuant to which it is issued or used is applicable to a dispute between a member and the Exchange, this too would offend and transgress the Core Principles.

35. It is not without dispositive significance that this form of consent is itself expressly the mechanism that confirms the parties' agreement to arbitrate and be bound, thereby suggesting that the CME tacitly recognizes the unavailing nature and insufficiency of its attempt to indirectly create the appearance of such consent by the deemed familiarity of its members with all of its Rules. (See, Rule 400 annexed as part of Exhibit "D" hereto, and the related textual discussion below).

36. Rule 602 further provides that a claim filed shall be rejected if it does not "fully describe the dispute"; but that Rule fails to provide any specification, test, or safe harbor, in regard to what it means to "fully describe the dispute".

37. In comparison, and looming as a part of the unfettered and improper discretion afforded by the Rules of Chapter 6 in favor of the Exchange, claimed to be inconsistent with the "Core Principles", Rule 602 invests the Department of Market Regulation with discretion to reject any writing "initiating an arbitration claim" "that does not fully describe the dispute."

38. Although Rule 602 provides that the Department of Market Regulation shall promptly return a claim which is not "sufficiently detailed", together with a notice describing the deficiency, since there is no standard with regard to the "sufficiency of the claim", such a deficiency notice from Market Regulation may be so broad or expansive, or so specific and narrow, or otherwise so discretionary, as to make the required correction incapable of achievement within the narrow time frame provided, or not at all, absent the type of discovery afforded by the Federal Rules.

39. An example of the dilemma posed by this imprecision and discretion, in the context of Plenum Fund's Complaint, is presented by the potential that the Market Regulation Department, upon a filing of a claim by Plenum Fund, might reject such claim as deficient because it did not name the specific persons alleged to have engaged in the "bad faith" comprised by discussions with CME personnel regarding their profit and loss situation in regard to the Erroneous Trades at a time prior to the time that the CME was to make a decision whether to "bust" all such trades, which is claimed to rise to the level of "bad faith" conduct as required by CEA, §22(b). To the extent that this requirement was imposed at a time prior to discovery and disclosure, and to the extent that the Federal Rules were not applicable and available to obtain a sufficient breadth of such disclosure, then Plenum Fund would be unlikely to be able to comply with the requirement of specificity, even in the face of the CME's admissions referenced at ¶¶ "65"-"67" of the LaPierre Affidavit.[5]

[5] This imprecision and broad discretion is all the more problematical where, as here, "bad faith" must be established, which may only be accomplished by uncovering otherwise secret e-mails and telephone conversations, including by document discovery, including discovery of electronic discovery and by depositions impeaching assertions of good faith or innocence. Thus, while there might appear to be an opportunity to make a corrective filing, the reality of that corrective ability may be greatly disparate from the theory. This is an unacceptable procedural ambiguity.

40. Further evidencing the inadequacy of the CME Arbitration Rules, Rule 602 does not provide any guidance for the situation where the Department of Market Regulation deems any attempt to cure the deficiency as itself deficient; suggestive of the potential that a claim could be sequentially and perhaps perpetually insufficient, to the extent that the Exchange wanted to derail or stultify a claim against it.

41. Rules 603 through 605 do not aid Rules 621 and/or Rule 600.C in their direction that claims against the Exchange are subject to "mandatory arbitration."

42. Rule 606 provides that a party may challenge the "arbitrability" of a dispute, but only if such challenge is filed "no later than 5 days after the claim is submitted for arbitration." Rule 606 problematically then provides that the chairman of the Department of Market Regulation may decide the "arbitrability" of a dispute on written papers, and such decision will be final and not appealable.

43. Apart from the fact that this provision is inconsistent with Federal case law, for the reason that the enforceability of an arbitration provision, which is severable from the validity of the broader agreement within which it is situated, is to be determined by the courts and not the arbitrator, or, in this case the Exchange itself[6], it is inconceivable here too that any notion of fairness and justicability would permit the Exchange to finally and without appeal

[6] In *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 444, 126 S.Ct. 1204, 1208, 163 L.Ed.2d 1038, 1042 (2006), the Court made it very clear that an arbitration agreement is severable from a claim that a contract as a whole is invalid, including because it is unconscionable, and that, when the arbitration provision itself is challenged, a court can decide whether it is enforceable. See, *Bess v. DirectTV, Inc.*, 381 Ill.App.3d 229, 236, 885 N.E.2d 488, 495, 319 Ill.Dec. 217, 224 (5th Dist., Ill., 2008)

decide the "arbitrability" of a claim asserted against it by a member; and/or that any such provision would not be found contrary to the "Core Principles".

44. Rule 609 is obviously inconsistent with the Core Principles, including for the reason that it openly seeks to disadvantage a member in asserting a claim against the Exchange, in comparison to a member asserting a claim against another member. Thus, Rule 609 provides that an arbitration claim must be initiated "within two years of the date when the claimant knew or should have known of the dispute on which the claim is based, except that disputes filed pursuant to Rule 600.C [claims against the Exchange] must be submitted within 10 days of [the notice of a rejection]...." (See Rule 602)

45. It is inescapable that the CME is seeking to dramatically limit and narrow the window for the filing of claims against it by a member, as compared to claims by members against members, and thus seeks to contravene the purposes and intent of CEA, §22(b), which provides a two year statute of limitations period. It thus unavoidably appears that by this Rule and provision, the CME seeks to advantage itself and protect itself with respect to claims by members, as compared to claims by members against members; and that by this Rule also it contravenes the purposes and application of the Core Principles.

46. Rule 610 does not have application to the pending motions.

47. Unfairness borne of impermissible and advantaged discretion also emanates from Rule 611, in that this Rule affords the right and entitlement to the Market Regulation Department to set the initial schedule for document requests by parties. That should be the function and province of independent arbitrators. Moreover, Rule 611does not provide any

fixed schedule or time limit for document requests and responses by the parties; but rather provides that such schedule shall be set by Market Regulation, without discernible guidelines.

48. The Market Regulation Department is an instrumentality of the Exchange, and not an independent entity, which is free from the self-interest and internal conflicts of interest proscribed by the Core Principles. The danger is therefore great that an arbitrary schedule could be interposed advantaging the Exchange. It is unassailable that the fixing of a discovery and disclosure schedule may itself be an unfair procedural device, holding in prospect that it may adversely interfere with or disadvantage the prosecution of a claimant's ability to make requests for documents and respond to those of the Exchange.[7]

49. Furthermore, due to the lack of evenhanded protections in Rule 611.A, a party's ability to make the necessary requests for document production and informational disclosure may be particularly prejudiced in the absence of the type of compulsory and voluntary disclosure and production of information and materials provided by Fed. Rule Civ. P., Rule 26, which requires broad based disclosure without demand by the other party of a host of specific categories of information.

50. Similarly inequitable and impermissibly unfair in its actual and/or potential application Rule 611.A. provides that "the chairman may require any member, or any person employed by or associated with a member, to produce relevant documents in his possession or control at any time after a claim is filed", while, in contrast, there is no corresponding provision requiring the Exchange to produce such documents or information.

[7] This is all the more apt where, as here, the employees and representatives who are believed to have engaged in the underlying "bad faith" conduct, and the third parties who conspired with them are unknown, and are the subjects or authors of undisclosed and secretive communications.

51. In the absence of objectively fair provisions and restrictions placed upon the Chairman of Market Regulation, this provision also and further may be utilized by the Exchange, through the Chairman, to advantage the Exchange over a member making a claim, including by requiring the member, in the first instance, to disclose documents that may reflect what evidence it has and does not have; and this may, in turn, impact on what documents the Exchange discerns it has to or should disclose—in a debilitating game of "cat and mouse".

52. While Rule 611.A. does have a provision allowing a party seeking documents to complain that the other party has not produced documents, there is no compulsion on the Chairman to require the Exchange to produce documents in the first instance. In addition, even if this could be implied as a curative measure, that remedy may be more apparent than real. This results because relief to the aggrieved or complaining party is available only to the extent that the party seeking such documents "identifies each document or type of document sought with as much specificity as possible".

53. Again the chairman, as an interested party, burdened by conflicts of interest, has discretion in determining whether sufficient specificity has been demonstrated. Therefore, and perniciously, absent preliminary discovery of electronic data and/or the conduct of depositions which might assist in identifying such documentation, the party seeking document production or information may be unable to satisfy its burden to identify documents required and/or documents not produced.

54. Even more problematical for a claimant, and specifically for the Plenum Fund in the context of the CME Arbitration Rules, neither Rule 611, nor any other provision in the Arbitration Rules makes any provision for remedial action in the perilous circumstance where

documents or information are not preserved or are destroyed, intentionally or by virtue of a systematic disposal system or procedure, as that culpable conduct may adversely impact the ability of a claimant to prove the elements of its claim. The effects of such culpable conduct as they may adversely or irretrievably impact a claim, and the appropriate remedy in such circumstances is discussed in *Zubulake v. UBS Warburg LLC, et., al.,* 217 F.R.D. 309 (S.D.N.Y. 2003), and its progeny.

55. This may be important, if not dispositive in this controversy because the non-production of documents, including documents which may have been destroyed or willfully disposed of, and/or which are no longer in the possession of the party otherwise obligated to produce such documents, is essentially non-remedial under the CME Arbitration Rules--even in circumstances where such destruction or disposal may have been intentional. Such a circumstance of culpable disposal may frequently occur or be in prospect when there are claims involving "bad faith". In comparison, and representing a difference of enormous proportions, under the Federal Rules and the cases applying and interpreting the Federal Rules, if such Rules were invoked, including in this action, there would be a procedure to require a recalcitrant or culpable party to assist in the recovery of those documents and any such information, including by way of the imposition of an adverse inference. (See, *Zubulake v. UBS Warburg LLC, supra.)*

56. Similarly, although there is provision in Rule 611.B. for a party making a claim in excess of $50,000.00 to seek leave from the Chairman to serve written requests for information on the other party (i.e., the Exchange), the Chairman has discretion to determine whether and under what circumstances such requests may be permitted. Again, this Rule

invests the kind of discretion in the hands of an interested and conflicted party that could adversely affect the outcome in favor of the Exchange, and therefore, must similarly be viewed to be proscribed by the Core Principles.[8]

57. The same may be said with respect to the provisions of Rule 611.C, which allows the chairman (selected by the Exchange), and not necessarily an independent arbitrator, to "...require any member, or any person employed by or associated with a member, to appear and to testify at a hearing. As applied to a mandatory arbitration in regard to a claim by a member against the Exchange, there is no corresponding provision allowing or permitting the chairman to require any member of the Exchange to appear and to testify at a hearing. Thus, this provision also must be deemed to contravene the Core Principles if applied to a mandatory arbitration.

58. While Rule 612 provides the appearance of a procedure in the infrastructure for a mandatory arbitration between a member and the Exchange, upon any close inspection which pierces the surface of that Rule, it is unmasked as being insufficient for that purpose, and to also apply to arbitrations between members and/or between members and customers.

59. This appears from the language of the first sentence of Rule 612, which purports to require that "...every party must provide every other party and the Exchange with copies of all documents that the party intends to offer into evidence...." This language plainly has reference to an arbitration that is between two parties, be it members, or a member and a customer, and provides for the exchange of documents between those parties with a copy also

[8] Thus, irrespective of the composition of the arbitration panel, a claimant may already have been substantially hamstrung and prejudiced by obstacles to discovery and information retrieval imposed by an "interested" chairman, before it is presented for determination by the panel.

being provided to the Exchange. Otherwise the language would refer to the exchange of documents between a member and the Exchange.

60. Furthermore, Rule 612 does not provide a workable mechanism and procedure for any mandatory arbitration, because the requirement of an exchange of documents and lists of witnesses in a vacuum, does not cure the problem attenuated by the absence of underlying infrastructure for all prior proceedings occurring before the period reference in Rule 612, which is expressly the period which is not later than 10 days prior to the first schedule hearing, and which can therefore be up to 11 days prior to that date.

61. This problem is highlighted by the fact that Rules of Chapter 6 do not otherwise in any aspect provide any discernable mechanisms and procedure that might cure this infrastructure deficiency, including as might be presented, by way of example, if the CME Arbitration Rules incorporated by reference the National Futures Association or the American Arbitration Association arbitration procedures and mechanisms.

62. The only potential for invoking a claim that the Arbitration Rules otherwise provide a curative provisions for all of the marked deficiencies enumerated above, could conceivably lie within the bounds of Rule 613. That rule allows the Chairman[9] to establish "...procedures not otherwise contemplated by [Chapter 6] necessary to establish a just, equitable and efficient method of resolving a particular dispute...", other than a motion to dismiss a claim which is not permitted.

63. However, Rule 613 cannot be invoked to cure the deficiencies of the Arbitration Rules, as illuminated by this Declaration, because Defendants nowhere in their moving papers suggest that any such Rules have been propagated, and Plaintiff has never heard of or seen any such curative Rules. This purpose could have been served by adopting and incorporating the arbitration rules and procedures of the FAA and/or the AAA, but neither was any such curative action undertaken.

64. The provisions of Rule 614, to the extent claimed to be applicable to a compulsory arbitration demanded by Defendants, with respect to the appointment of an Arbitration Panel, would be a further example of a Rule which invests the type of discretion in the Exchange that is unfair and one-sided and which can affect the outcome, and which is therefore inconsistent with the Core Principles.

[9] The term "chairman" is defined to be: "The Chairman of the Board of Directors, or one acting in lieu of and with the authority of the Chairman of the Board. (See, Exhibit "B" to Defendants' Memorandum, at p. 2.

65. Rule 614.A provides that "the Market Regulation Department shall select a panel of arbitrators from the Exchange's Arbitration Committee[10] to hear and decide a dispute." Further, that Rule provides that "[t]he panel shall consist of five arbitrators and one chairman." What greater prejudicial discretion could be presented than to allow the Exchange to choose not only the panel of arbitrators to hear and decide the claim against it, but to also choose the chairman who would supervise and control the proceedings, including the ultimate hearing and determination.

66. Furthermore, Rule 614A. and B., allows the Exchange, by the Department of Market Regulation to choose arbitrators at its election and in its discretion, but members can only obtain the removal of an arbitrator for "good cause shown". This is a marked difference in right, entitlement and advantage in favor of the Exchange. Further exacerbating the transgression of the Core Principles, Rule 614.B invests the Chairman to deny any such request by a member.

67. Continuing the prejudice which is in prospect from Rule 614, Rule 615, under the caption: "HEARING PROCEDURES", provides that the Chairman (see fn. "8" above) "shall preside over the proceeding and shall make such determinations on relevancy and procedure as will promote a fair and expeditious adjudication of any claim." (Sounds like "the cat deciding if the mouse gets a daily allotment of cheese.").

68. Similarly, Rule 615.A leaves it up to the panel chairman whether to request documents from the Exchange.

[10] The Arbitration Committee is appointed by the Chairman of the Board of Directors of the Exchange on an annual basis. (See Rule 627, annexed as part of Ex. "A-2" to Defendants' Memorandum.

69. A further example of impermissible advantage in favor of the Exchange that may affect the outcome of a dispute is that Rule 615.B. provides for reference of legal issues to the Exchange's counsel, rather than independent counsel.

70. Rules 616 through 618, and Rule 620 reveal themselves as not applying to member claims against the Exchange, or as relating to awards arrived at in the absence of required procedures for a mandatory arbitration, and are therefore, beside the point of this Declaration.

71. Rule 619, captioned: "Appeal" is beside the point for the same reason as recounted in the preceding paragraph, but is otherwise shown to refer to disputes among members by the first sentence of that Rule.

72. Continuing this "Alice In Wonderland-like adventure" in non sequiturs and confusing and inconsistent appellations, the Arbitration Rules are further confused and contradicted, including because of the imprecise and/or conflicting language of Rule 622.A, which states that all claims based on trade cancellation or price adjustments under Rule 588.C.3. a, b or c, as is the case with the claims asserted by Plenum Fund, shall be arbitrated in accordance with Rule 622.[11]

73. Assuming that Rules 621 and 622 can otherwise be reconciled, plainly Rule 622 when it is examined closely does not relate to a claim filed by a member against the Exchange. This appears from Rule 622.B, which states that the "Exchange shall administer the arbitration

[11] Apart from the above, the CME Rules are otherwise confusing, and it can not be discerned if the arbitration panel is to be comprised by three members to be selected from the National Futures Association roster of arbitrators (Rule 621.C), or by the co-chairman of the Arbitration Committee, plus five (5) additional arbitrators--three of whom must not be a member of the exchange, or associated or affiliated with a contract market (see, Rules 622.C and 601.A.3, defining a "mixed panel"), or by the provisions of Rule 614.

and provide notice to all parties." It could not be deemed to be within any notion of fairness required by the Core Principles that the Exchange would or could administer an arbitration in which it was claimed to be liable for damages for its own "bad faith". Thus, this Rule must be deemed to apply to claims asserted by customers and/or member/traders *vis a vis* other member/traders who caused a claim under Rule 622. If not, and it is claimed to apply to the circumstances of this case it is for the foregoing reasons contrary to the requirements imposed by the Core Principles.

74. Similar to Rule 621, Rule 622.A throws any arbitration otherwise purported to be covered by that Rule back to the application of the Rules of Chapter 6. Thus, like Rule 621, Rule 622.B states that a claim under Rule 588.C.a. 1, 2 and 3, must first be submitted to the Exchange, as per Rule 588.D.

75. Rule 588.D provides that the Exchange may reject the claim, and any decision in that regard is "final". It could also not be deemed to be within any notion of fairness and equity required by the Core Principles that a claim under 588.C., and thus pursuant to CEA, § 22(b)(4), could be dispositively and finally disposed of at the discretion of the very Exchange against which such claim is leveled, and that such decision could be final.

76. Therefore, Rules 621 and 622 to the contrary, and in light of their procedural lacuna in relation to a claim asserted by a member against the Exchange, a member seeking to assert a claim against the Exchange for arbitration is further relegated to assume the application of the general provisions of Chapter 6 of the CME Rules by virtue of the broad scope of Rule 600.C. cited above and at pg. "3" of the Defendants Memorandum; and all of the frailties and deficiencies stated above are incorporated with respect to that circle by the notions of renvoi.

77. Finally, Rules 623 through 627, under the caption, Miscellaneous, do not support Defendants' argument or position, and in fact application of Rule 627 is inimical to the notion that the Arbitration Rules are not violative of the Core Principles.

The Lack Of Efficacy And/Or Enforceability As To The Arbitration Rules Based on a Claim of Contract of Adhesion and/or Substantive and Procedural Unconscionability Should be Considered Apart From the Substantive Analysis of This Declaration, But in Conjunction With Considerations Under CEA, §22(b)(4), and Notions of "Bad Faith" Thereunder.

78. This Declaration necessarily deals with the inadequacy of the provisions of the Arbitration Rules to govern and regulate a supposed "mandatory arbitration of Plenum Fund's claims against the CME; inclusive of the claim that such rules transgress the requirements imposed on the CME by the Core Principals.

79. However, in considering the sufficiency of Plenum Fund's Opposition and its alternative request for a jury trial, it is respectfully submitted as to Plenum Fund's claims of substantive and procedural unconscionability, as detailed in the accompanying Affidavit of Steven A. LaPierre, it should be recognized and considered that in the case of members, such as Plenum Fund, there is no direct consent and approval as to the CME Arbitration Rules and such Rule are sought to be imposed indirectly and by way of implication.

80. As detailed in the LaPierre Affidavit, this is accomplished by intentional, albeit insidious and deceptive devices and mechanisms, without any effort to highlight the fact that the Arbitration Rules will be sought to be imposed against Plenum Fund and those similarly situated at a later time in a manner that will, or may be, materially adverse to such member's ability to prove "bad faith" in respect of a claim made pursuant to CEA, §22(b)(4), as that burden is imposed by that Statute. It is suggested that the indirect

process orchestrated and propagated by the CME is bound up with, and is, in large part, motivated in its continuation by, the foregoing deficiencies and inadequacies.

81. Thus, it is requested that the Court consider the analysis of this Declaration within the specific elements of the process employed by the CME to implicate a consent to arbitrate, which is summarized as follows: (1) The Membership Application (Exh. "B" to Defendants' Memorandum), at pg. "6", putatively includes a general acknowledgement and agreement "to abide by the requirements for such corporate membership...."; (2) the CME does not provide a copy of its lengthy and complicated and often convoluted Rules to a prospective applicant for review at the time of such application, but rather makes such rules available only on its website; (3) despite its status as a "quasi governmental instrumentality", charged with a fiduciary duty in the self-regulatory process imposed by the CEA, and despite its knowledge that the Arbitration Rules can and do pose substantial substantive and procedural impediments to a member's effort to make out and prove a claim of "bad faith" against the CME, pursuant to CEA, ¶22(b)(4), the CME does not make any disclosure and does not issue any warnings to a prospective applicant with respect to the import of the Arbitration Rules, specifically as they may impact the ability of a member to later carry its burden of proof under CEA, ¶22(b)(4); (4) Chapter 4, CME Rule 400, "GENERAL PROVISIONS", includes a seemingly innocent directive, at its tail end as follows: "Members are deemed to know, consent to and be bound by all Exchange Rules." (A copy of Chapter 4, and CME Rules 400-444 is annexed hereto as Exhibit "D"); then (5) even years later[12], if a member asserts a claim against the CME, including, and especially in the context of the CME's failure to enforce Rule

[12] The Plenum Fund Membership Application was executed on February 18, 2005

588.C, in pursuance of CEA, ¶22(b)(4), the CME invokes Rule 400, contending that a member has, by the submission of its membership application, agreed to be bound by the CME's putative requirements for a "mandatory arbitration".

82. From the foregoing analysis, it may be seen that a member resorting to the CME Arbitration Rules, in the circumstance of a decision to assert a claim, including by way of litigation in the Federal Courts, pursuant to CEA, ¶22(b)(4), is without any ability to understand and appreciate from a substantive or procedural stance that there are adequate, fair and workable provisions requiring and governing such a "mandatory arbitration"; and, such a member will necessarily conclude that Rule 621 does not set forth the necessary procedures for a mandatory arbitration, notwithstanding the that Defendants' Memorandum, makes assertions to the contrary. (See ¶ "A", at pg. "3")

The Filing Of The Complaint Herein Was
Not A Prohibited Act Under The CME Rules.

83. Deceptively, as if it were a precluded act, at page "3" of Defendants' Memorandum, Defendants implicitly suggest that in filing its Complaint Plenum Fund engaged in conduct which is prohibited by the Exchange. In pursuance of this attempted mischaracterization, Defendants implicate, reference and rely on Rule 440 (see Ex. "D" hereto), which provides in pertinent part, that: "a member who commences legal action against the Exchange...without first...exhausting the procedures established by Rule 110 and the mandatory arbitration provisions of Chapter 6 (including appeals to the Board)...shall be deemed to have committed an act detrimental to...the Exchange". Any contention that the filing of a complaint against the Exchange is prohibited is belied by applicable case law which holds, in substance, that "because such an action is contrary to CME policy does not mean it is prohibited".[13]

84. Such proposition is otherwise belied by any close inspection and analysis of Rule 440, and the provisions it seeks to incorporate.

85. First, Rule 110 (a copy of which is annexed hereto as Exhibit "E"), is without relevance, since it pertains pertinence only to certain claims against Membership Interests.

[13] See, *Wigod v. Chicago Mercantile Exchange,* 141 Ill.App.3d 129,132, 490 N.E.2d 39, 41, 95 Ill.Dec. 566, 568 (Ill.App. 1st Dist.,1986)

86. Second, resort to "the mandatory arbitration provisions of Chapter 6" is abjectly without any salutary benefit or assistance to Defendants' suggestion of impropriety on the part of Plaintiff. As noted above, other than the hollow and unsupported declaration of Rule 600.C regarding "mandatory arbitration in accordance with the rules of [Chapter 6]", the remaining provisions of the Chapter 6 reflect Rules which overwhelmingly reference claims by members against members, or invoke a form and nature of discretion as to advantage the Exchange in the outcome of any dispute, and which therefore may not be enforced by reason of the prescriptions and prohibitions of the Core Principles.

Plenum Fund Has Not Availed Itself Of Any Filing Under The CEA By Reason of Which It Has Invoked The Benefits Of the CME Rules In a Manner Or Way As to Embrace the Arbitration Rules.

87. Defendants' Memorandum, at pp. 4-5 claims that by "filing a CEA claim based on protections afforded by CME's rules, Plenum invoked the benefits and rights provided by [CME] rules, and thus may not avoid the obligations contained therein." This is the height of sophistry.

88. In fact, in October, 2008, my firm, on behalf of Plenum Fund, filed a Petition with the Commodity Futures Trading Commission ("CFTC") specifically to invalidate, strike and/or amend the Arbitration Rules, on many of the grounds set forth herein. That Petition contained the following express statements and clarification:

> "... Petitioner wishes to clarify that the recovery of its trading damages as described above, pursuant to §22 of the CEA, in violation of CME Rule 588, is not a subject matter and/or objective of this Petition, and such facts and circumstances concerning those damages, and the requirements of Rule 588 are set out herein merely as background information, and to demonstrate the interest of the Plenum Fund in making and filing this Petition.
>
> It will be the separate purpose and objective of a plenary action to be initiated in the Federal District Court for the Northern District of Illinois to

> recover those damages. Thus, for the absence of doubt, and as set out above in section "III", it is the purpose and objective of this Petition to invalidate the whole, or those portions and provisions of CME Rule 578, inclusive of Chapter 6 and Rules 600, 606 and 621 that is, or are, inconsistent with and which seek to denude or erode the express provisions of CEA, § 22, including as interpreted by applicable Federal Court decisions, and as may hinder or preclude the assertion of Plenum's rights, interests and entitlements, pursuant to CEA, § 22; and to thereby serve the purposes and objectives of 7 U.S.C. §§ 5(c) and 7(d)."

89. In addition, and significant for purposes of this Action, fn. "4" of Plaintiff's Petition stated as follows:

> Nothing herein contained is intended or shall be deemed to suggest that in the absence of CFTC action invalidating Rule 578, Plenum would not alternatively or otherwise be entitled to challenge the validity of CME Rule 578 in a plenary action in a Federal District Court, on the basis that it is an arbitrary and improper effort by the CME to limit its liability in contravention of Federal Law and is against public policy.

90. The original petition has since been supplemented and will again be supplemented by the filing of a copy of Plaintiff's opposition papers on this motion, making the claims herein and before the CFTC substantially similar, including with respect to the claim that such Rules violated and transgress the CFTC's Core Principles. (The October, 2008 Petition and December 8, 2008 supplement are annexed hereto as Exhibits "F" and "G".)

Summary and Conclusion.

91. The LaPierre Affidavit sufficiently demonstrates that any putative consent to arbitrate was vitiated by monopolistic coercion.

92. The LaPierre Affidavit sufficiently demonstrates that any putative consent to arbitrate was vitiated by procedural unconscionability.

93. The analysis of this Declaration sufficiently demonstrates that Rules 578, 621 and Chapter "6" do not provide understandable or fair and workable rules and procedures to support Defendants' claim of a mandatory arbitration with respect to Plaintiff's claims against the CME;

and that the Arbitration Rules, as applied to such a claim, do not meet the Core Principles and therefore can not otherwise be enforced in this action to compel arbitration.

94. To the extent that Plaintiff's Opposition Papers do not demonstrate that Defendants' motion to compel is without the requisite showing and proof, and that it should be denied, in the alternative to the foregoing, at a minimum, it is contended that this Declaration, together with the LaPierre Affidavit, demonstrate the existence of a triable question of fact, necessitating a jury trial, pursuant to Plaintiff's Demand for a Jury Trial (Ex. "A" hereto); and this court should order such a trial and should therefore not stay the Case Management Procedures of this Court.

95. In the foregoing connection, it is submitted that the relevant question is not whether the interpretation of the Arbitration Rules set forth in this Declaration is the only interpretation, but rather, whether the interpretation herein is a reasonable interpretation, and one that may be confirmed by a jury. In that context, it will be a question for decision upon a jury trial whether the Arbitration Provisions involve "procedural unconscionability", because the arbitration terms are so difficult to find, read, or understand in relation to and within the context of a claim under CEA, §22(b)(4), so that it may be found that it cannot fairly be said that Plenum Fund was aware that it was agreeing to arbitrate claims against the Exchange in the context of a CEA, §22(b)(4) claim, inclusive of the burden to demonstrate bad faith conduct, when it submitted the Plenum Fund Membership Application.

96. Pursuant to 28 U.S.C. § 1746, I declare, under the penalties of perjury, that the statements made by me herein are true. I understand that if any of these statements is willfully false, I am subject to punishment.

Dated: Old Westbury, New York
December 18, 2008

Jeffrey L. Rosenberg (JR-3597)

EXHIBIT "E"

110. CLAIMS AGAINST MEMBERSHIP, APPLICATION OF PROCEEDS

For the purposes of this rule "sale" shall include a sale made pursuant to Rule 104 or a transfer made in accordance with the provisions of Rule 106; "seller" shall include firms that have membership privileges pursuant to Rules 106. F., G., H., I., N., R. or S.; and "claim" shall be limited to claims involving incidents that occurred prior to the sale of the membership and which arose in connection with transactions on the Exchange or membership in the Exchange. Claims resulting from conduct subsequent to the sale of a membership may not be asserted against that membership or its proceeds. All claims against the seller's membership or its proceeds shall be submitted in writing to the Department within 20 days of the posting of notice of the sale of said membership. At the conclusion of the 20-day claim filing period, the Market Regulation Department and the Department shall conduct an investigation of all claims properly filed against the seller's membership or its proceeds. This investigation shall be completed within 20 days unless the investigation cannot be resolved within that period. The total proceeds of the sale, or in the case of a transfer, the value at the mid-point of the bidoffer spread as of the date of the transfer, of the membership shall be applied to the following purposes and in the following order of priority:

a. Payment of all dues, fines, contributions, charges and other indebtedness due to the Exchange, the CME Gratuity Fund or GFX Corporation;

b. Payment of any indebtedness to the clearing member who last qualified the selling member prior to the sale arising out of a pledge of: (i) such membership as collateral security on such indebtedness, or (ii) a deficit which the Exchange staff determines to have arisen directly out of transactions on the Exchange or transactions with GFX Corporation;

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c. Payment of amounts due to other clearing members on claims filed which the Exchange staff determines to have arisen directly out of transactions on the Exchange;

d. Payment of amounts due to members and member firms on claims filed which the Exchange staff determines to have arisen directly out of transactions on the Exchange;

e. Payment of amounts due to public customers of the seller based on claims filed by such customers or based on reports of the Market Regulation Department, which claims are determined by the Exchange staff to be based upon misappropriation of customer funds, improperly executed transactions, unpaid credit balances, or other similar matters, directly related to transactions on the Exchange;

No other claims against the proceeds of the sale of a membership shall be recognized and administered by the Exchange, but the creditors of the seller of a membership not falling in the foregoing categories may pursue other legal means of securing payment of their obligations. The Exchange staff shall make a final determination of all claims filed in time or reported by the Market Regulation Department and the Department against the proceeds of the sale of a membership.

Except as provided in Rule 913, the Exchange staff shall make a distribution of such proceeds within 40 days after receiving notification and confirmation of the sale of the membership, unless claims to the proceeds are not resolved within that period. If, however, at such time an Exchange disciplinary proceeding is pending against the seller or, based upon a pending investigation, is highly probable, or if a legal proceeding, in respect to which the indemnification provisions of Rule 439 would operate, is pending, has been announced or is highly probable, then the Exchange staff shall retain so much of the proceeds as determined by staff in order to satisfy such obligations until such time as the pending matter is concluded. Distribution of proceeds shall be made by the payment of claims in the categories listed in this rule to the extent the proceeds from the sale are sufficient to meet those obligations. If the proceeds of the sale of a membership are insufficient to pay all amounts determined to be due under the categories listed in this rule, the proceeds shall be applied to pay the full amounts determined to be due under subparagraphs a, b, c, d and e in the priority named. If the proceeds are insufficient to pay the amounts determined to be due under any priority, the claims due under that priority shall be paid pro rata, and the remaining priorities shall be left unpaid. In determining the amount of any claim, the Exchange staff shall first deduct the fair cash value of any collateral held by that claimant. Creditors of the seller of a membership whose obligations are not fully satisfied pursuant to this paragraph may pursue other legal means of securing payment of their obligations.

The surplus, if any, shall be paid to the person whose membership was sold or his legal representative or a 106.A.-B. grantee, as applicable, upon the execution of a satisfactory release. The Exchange staff's determination and allowance of claims hereunder shall be final. The death, incompetence, expulsion, suspension, insolvency or bankruptcy of a member shall not affect the rights of claimants under this rule.

CHAPTER 4
ENFORCEMENT OF RULES

400. GENERAL PROVISIONS
401. THE CHIEF REGULATORY OFFICER
402. BUSINESS CONDUCT COMMITTEE
- 402.A. Jurisdiction and General Provisions
- 402.B. Hearings
- 402.C. Emergency Actions
- 402.D. Actions against Non-Members

403. CLEARING HOUSE RISK COMMITTEE
- 403.A. Jurisdiction and General Provisions
- 403.B. Settlement Offers
- 403.C. Emergency Actions
- 403.D. Appeal of Administrative Fines

404. PIT COMMITTEE
405. FLOOR CONDUCT COMMITTEE
406. PROBABLE CAUSE COMMITTEE
407. INITIAL INVESTIGATION, ASSIGNMENT FOR HEARING AND NOTICE OF CHARGES
- 407.A. Investigation File
- 407.B. Notice of Charges; Opportunity for Hearing
- 407.C. Answer to Charges

408. CONDUCT OF HEARINGS
- 408.A. General
- 408.B. Pre-Hearing
- 408.C. Settlement Offers
- 408.D. Hearings
- 408.E. Decisions

409. SUMMARY PROCEEDINGS BEFORE THE FLOOR CONDUCT COMMITTEE
- 409.A. Jurisdiction
- 409.B. Selection of Panel
- 409.C. Conduct of Summary Proceedings
- 409.D. Appeals

410. HEARINGS BEFORE A HEARING PANEL OF THE BOARD OF DIRECTORS
411. APPEAL TO A HEARING PANEL OF THE BOARD OF DIRECTORS
412. SUMMARY ACTION
413. SUMMARY ACCESS DENIAL ACTIONS
- 413.A. Authority to Deny Access
- 413.B. Notice
- 413.C. Hearing
- 413.D. Duration of Access Denial

414. INVESTIGATIONS BY OTHER SELF-REGULATORY ORGANIZATIONS
415. COOPERATION WITH OTHER EXCHANGES AND CLEARING ORGANIZATIONS
416. CONFLICTS OF INTEREST
- 416.A. Abstention Requirements
- 416.B. Disclosure of Relationship

417. PROHIBITED COMMUNICATIONS
- 417.A. *Ex Parte* Communications
- 417.B. Communications with Panelists
- 417.C. Disclosure

418.-431. [RESERVED]
432. GENERAL OFFENSES
433. STRICT LIABILITY FOR THE ACTS OF AGENTS
434. [RESERVED]

435. EFFECT OF SUSPENSION OR EXPULSION
436. [RESERVED]
437. NOTICE OF DISCIPLINE
438. [RESERVED]
439. MEMBER'S INDEMNIFICATION LIABILITY
440. CLAIMS BY MEMBERS
441. COMMUNICATIONS WITH THE PUBLIC AND PROMOTIONAL MATERIAL
442. NOTIFICATION OF SIGNIFICANT EVENTS
443. POSITION LIMIT VIOLATIONS
443.A. First Violation
443.B. Subsequent Violations Following a Warning Letter
443.C. Referral to the Probable Cause Committee
443.D. Alternate Risk Factor Evaluation
444. SANCTIONS AND RESTITUTION ORDERS

Chapter 4
Enforcement of Rules

400. GENERAL PROVISIONS

The Board has adopted rules, and from time to time adopts amendments and supplements to such rules, to promote a free and open market on the Exchange, to maintain appropriate business conduct and to provide protection to the public in its dealings with the Exchange and its Members. The Board has created committees to which it has delegated responsibility for the investigation, hearing and imposition of penalties for violations of Exchange rules. The Board has also delegated responsibility for the investigation and imposition of penalties for violations of Exchange rules to Exchange staff as set forth in the rules. The delegation of such responsibility and authority shall in no way limit the authority of the Board with respect to all rule violations.

For purposes of Chapter 4, the term "Member" shall mean: 1) members and clearing members of the Exchange, including retired members with floor access privileges and individuals and entities described in Rule 106; 2) associated persons ("APs") and affiliates of clearing members and member firms of the Exchange; 3) guaranteed introducing brokers of clearing members and member firms of the Exchange and their APs, 4) Exchange permit holders and any person or entity that has been granted cross-exchange trading privileges; 5) employees, authorized representatives, contractors, and agents of any of the above persons or entities, in regard to the Exchange related activities of such employees and agents; 6) regular firms; 7) individuals and entities that have agreed in writing to comply with the rules of the Exchange; and 8) CME members and other individuals who have access to the combined CBOT and CME trading floors.[1]

Members are deemed to know, consent to and be bound by all Exchange rules. Former Members shall be subject to the continuing jurisdiction of the Exchange, including, without limitation, the application of Rule 432.L., with respect to any conduct that occurred while a Member.

401. THE CHIEF REGULATORY OFFICER

It shall be the duty of the Chief Regulatory Officer to enforce Exchange rules, and he shall have available to him at all times the resources of the Market Regulation Department and such other Exchange resources as may be necessary to conduct investigations of alleged rule violations and market conditions. The Chief Regulatory Officer shall have the authority to inspect the books and records of all Members and the authority to require any Member to appear before him and produce his or its books and records and answer questions regarding alleged violations of Exchange rules, at the time, place and in the manner he designates. The Chief Regulatory Officer may also delegate such authority to staff of the Market Regulation Department.[2]

402. BUSINESS CONDUCT COMMITTEE

402.A. Jurisdiction and General Provisions

The Business Conduct Committee ("BCC") shall have: 1) jurisdiction over Members with respect to matters relating to conduct, trading practices, sales practices, trading ethics and market manipulations or other actions that threaten the integrity of the market; 2) the authority, pursuant to Rule 402.C., to take emergency actions; 3) the authority, pursuant to Rule 402.D., to take actions against non-members; 4) the authority, pursuant to Rule 413.B., to conduct hearings on denials of access pursuant to Rule 413.A., and 5) the authority to conduct hearings on all matters over which it has jurisdiction.

The BCC shall act through a Panel composed of a chairman, three Exchange members or employees of member firms and three non-members. A quorum of a Panel shall consist of a majority of the panel, but must include at least the chairman, two members or employees of member firms and two non-members

Any Panel that conducts a hearing or proceeding shall consist of panelists who possess sufficiently diverse interests so as to ensure fairness.

No person shall serve on the BCC unless he has agreed in writing that he will not publish, divulge, or make known in any manner, any facts or information regarding the business of any person or any other information which may come to his attention in his official capacity as a member of the BCC, except when reporting to the Board or to a committee concerned with such information or to the Legal Department or Market Regulation Department, when requested by the CFTC or other governmental agency or when compelled to testify in any judicial or administrative proceeding.

[1] Revised April 2008.
[2] Revised December 2008.

All information, records, materials and documents provided to the BCC and all deliberations, testimony, information, records, materials and documents related thereto shall be treated as non-public and confidential and shall not be disclosed, except as necessary to further an Exchange investigation or as required by law.

402.B. Hearings

Hearings by the BCC shall be before a Panel, and shall be conducted by a chairman of the BCC in accordance with the provisions of Rule 408.

If a Member is found guilty, by a majority vote, the Panel may do one or more of the following:

1. Order the Member to cease and desist from the conduct found to be in violation of these rules, the rules of any other exchange owned or controlled by CME Group, or the Commodity Exchange Act;
2. Order the Clearing Member or other Member to liquidate such portion of the open contracts in the Clearing Member's or other Member's proprietary or customers' accounts, or both, as the Panel deems appropriate to ensure the integrity of Exchange contracts or to ensure an orderly and liquid market;
3. Order the Clearing Member or its customer to deposit such additional performance bonds with the Clearing House ás the Panel deems appropriate to protect the integrity of open contracts;
4. Prescribe such additional capital or other financial requirements as it deems appropriate;
5. Restrict the privilege of being affiliated with, employed by or having an interest in, a broker association or guaranteed introducing broker and/or suspend the trading floor access and/or the right to associate with a Member;
6. Restrict the Member's access to the Globex platform or any other trading or clearing platform owned or controlled by CME Group or to supervise the entry of any orders into such platforms by others;
7. Restrict the Member's access to any trading floor owned or controlled by CME Group:
8. Restrict the Member's ability to trade or enter orders in any or all products of any exchange owned or controlled by CME Group:
9. Suspend any or all of the privileges of membership;
10. Expel the member;
11. Impose a fine upon the Member not to exceed $1,000,000 per violation plus the amount of any benefit received as a result of the violation;
12. Issue a reprimand;
13. Prescribe limitations on positions of the Member as may be appropriate;
14. Impose advertising restrictions upon the Member pursuant to these rules; and/or
15. Direct the Member to make restitution, in such amount as is warranted by the evidence, to the account of any party damaged by the conduct, or to the Clearing Member who has previously made restitution to the account of such party.
16. Revoke the regularity status of a regular firm.

The Panel may also find that the evidence warrants an adjustment to the account of a party where a Member, though not in violation of an Exchange rule, has not fulfilled his or its responsibility for proper execution of such party's order.

When determining whether to impose any of the sanctions listed above, the Panel may consider any factors determined by the Panel to be relevant in the context of a particular case, including any of the factors described in the "Sanctioning Guidance to Self-Regulatory Organizations" in the CFTC Policy Statement Relating to the Commission's Authority to Impose Civil Money Penalties and Futures Self-Regulatory Organizations' Authority to Impose Sanctions: Penalty Guidelines (1994).

If the Panel shall decide by a majority vote that the matter might warrant a penalty in excess of its own authority, the chairman of the Panel shall refer the matter to the Board for further hearings and decision.

402.C. Emergency Actions

1. The BCC is authorized to determine whether an emergency exists and whether emergency action is warranted. The following events and/or conditions may constitute emergencies:
   a. Any actual, attempted, or threatened market manipulation;
   b. Any actual, attempted, or threatened corner, squeeze, congestion, or undue concentration of positions;
   c. Any action taken by the United States or any foreign government or any state or local

government body, any other contract market, board of trade, or any other exchange or trade association (foreign or domestic), which may have a direct impact on trading on the Exchange;

d. The actual or threatened bankruptcy or insolvency of any Member or the imposition of any injunction or other restraint by any government agency, self regulatory organization, court or arbitrator upon a Member which may affect the ability of that Member to perform on its contracts;

e. Any circumstance in which it appears that a Member or any other person or entity has failed to perform contracts or is in such financial or operational condition or is conducting business in such a manner that such person or entity cannot be permitted to continue in business without jeopardizing the safety of customer funds, Members, or the Exchange; and/or

f. Force majeure, which shall mean any circumstance (including but not limited to a strike, lockout, national emergency, governmental action, or act of God) which is beyond the control of the buyer or seller, and which prevents the buyer or seller from making or taking delivery of product or effecting payment when and as provided for in Exchange rules; and/or

g. Any other circumstance which may have a severe, adverse effect upon the functioning of the Exchange.

2. In the event that the BCC determines, in the good faith exercise of its sole discretion, that an emergency exists, it may take any of the following emergency actions or any other action that may be appropriate to respond to the emergency:

a. Terminate trading;

b. Limit trading to liquidation of contracts only;

c. Impose or modify position limits and/or order liquidation of all or a portion of a Member's proprietary and/or customers' accounts;

d. Order liquidation of positions as to which the holder is unable or unwilling to make or take delivery;

e. Confine trading to a specific price range;

f. Modify price limits;

g. Modify the trading days or hours;

h. Modify conditions of delivery;

i. Establish the settlement price at which contracts are to be liquidated; and/or

j. Require additional performance bond to be deposited with the Clearing House.

All actions taken pursuant to this subsection shall be by a majority vote of the Panel members present. A Member directly affected by the action taken shall be notified in writing of such action. As soon as practicable, the Board and the CFTC shall be notified of the emergency action in accordance with CFTC regulations. Nothing in this section shall in any way limit the authority of the Board, other committees, or other appropriate officials to act in an emergency situation as defined by these rules.

402.D. Actions against Non-Members

If the BCC or Market Regulation Department has reason to believe or suspect that any non-member is conducting trading activities in violation of the Commodity Exchange Act or Exchange rules or in a manner that threatens the integrity or liquidity of any contract, the committee or Market Regulation Department may request such non-member and require any Members to appear, produce documents and testify at a Market Regulation Department interview or investigation, or hearing to be conducted by the BCC.

If, after the hearing, the BCC determines that the actions of such non-member threaten the integrity or liquidity of any contract or threaten to violate or violate the Commodity Exchange Act or Exchange rules, the BCC may:

1. Order any Clearing Member to liquidate all or any portion of such non-member's position;
2. Order that no Clearing Member accept new positions on behalf of any such non-member;
3. Deny, limit or terminate access of such non-member to the Globex platform or any other trading or clearing platform owned or controlled by CME Group; and/or
4. Order such action as is necessary to prevent a threat to the contract or violation of the Commodity Exchange Act or Exchange rules.[1]

403. CLEARING HOUSE RISK COMMITTEE

[1] Revised December 2008.

403.A. Jurisdiction and General Provisions

The Clearing House Risk Committee (or any subcommittee thereof) (collectively, "CHRC"), shall determine whether an applicant satisfies the qualifications for status as a Clearing Member. The CHRC decision shall be subject to appeal to the Board by an applicant. The CHRC may adopt regulations regarding qualifications for admission to membership in the Clearing House, which regulations, when approved by the Board, shall have the same effect as rules of the Exchange. The CHRC shall act upon applications for clearing membership and applications for assignment of Class A Shares and Series B trading rights for clearing purposes. Applications for clearing membership and for assignment of Class A Shares and Series B trading rights for clearing purposes, when approved by the CHRC, shall be effective and thereafter ratified by the Board.

The CHRC shall have at least two co-chairmen, who shall be members of the Board, and at least seven additional individuals, five who shall be Clearing Member representatives and at least one who shall be a non-member.

The CHRC may conduct investigations, issue charges and consider settlement offers on its own initiative or by referral from Exchange staff, the PCC, or the BCC. Hearings on charges issued by the CHRC will be conducted by the BCC pursuant to the provisions of Rule 408.

If the CHRC determines that a Clearing Member is in a financial condition which jeopardizes or may jeopardize the integrity of the Exchange, the CHRC may, by majority vote:

1. Order the Clearing Member or its customers to deposit such additional performance bond with the Clearing House as deemed appropriate to protect the integrity of open contracts;
2. Prescribe such additional capital or other financial requirements as it deems appropriate;
3. Impose position limits on Clearing Members based on their regulatory capital and such other criteria as it deems appropriate;
4. Suspend a Clearing Member, subject to approval of any two of the following individuals: the Chief Executive Officer, the President, the President of the Clearing House, the Chairman of the Board, the Chairman of the CHRC or the Chief Operating Officer; and/or
5. Order the Clearing Member to cease and desist from the conduct found to be contrary to the best interests of the Exchange.

No person shall serve on the CHRC unless he has agreed in writing that he will not publish, divulge, or make known in any manner, any facts or information regarding the business of any person or entity or any other information which may come to his attention in his official capacity as a member of the CHRC, except when reporting to the Board or to a committee concerned with such information or to the Legal Department, Audit Department or Market Regulation Department, when requested by the CFTC or other governmental agency or when compelled to testify in any judicial or administrative proceeding.

All information and documents provided to the CHRC and all deliberations and documents related thereto shall be treated as non-public and confidential and shall not be disclosed, except as necessary to further an Exchange investigation or as required by law.

The CHRC shall have jurisdiction to enforce rules pertaining to the following:

1. Financial integrity of Clearing Members; and
2. Business conduct of and compliance with Exchange rules by Clearing Members and by any Member who is an officer or a principal or who has assigned his membership on behalf of a Clearing Member, in connection with such Clearing Member's activities, except insofar as jurisdiction over matters relating to conduct, trading practices, trading ethics and certain sales practices of Members, and market manipulations or other actions that threaten the integrity of the market are within the purview of the BCC.

403.B. Settlement Offers

A respondent that is the subject of an investigation or charges may submit for consideration by the CHRC a written offer of settlement in disposition of such investigation or charges. A respondent may submit a settlement offer without admitting or denying the rule violations upon which the penalty is based; provided, however, that an offer must include a consent to entry of findings by the CHRC regarding the conduct and rule violations at issue and to the penalty to be imposed.

If the Audit or Market Regulation Department does not oppose the respondent's offer of settlement, the respondent's written offer of settlement and the Audit or Market Regulation Department's supporting statement shall be submitted to the CHRC for consideration.

If the Audit or Market Regulation Department opposes an offer of settlement, the Respondent's written offer and the Audit or Market Regulation Department's written opposition shall be submitted to the CHRC. The CHRC's consideration of the offer of settlement shall be based upon the written offer and opposition filings, as well as the evidence presented to the CHRC in determining to issue the charges.

The respondent may withdraw his offer at any time prior to final acceptance of the offer by the CHRC. If the CHRC accepts the offer, a written decision setting forth the CHRC's findings and sanction shall be issued, and written notice of the decision shall be given to the respondent.

If the CHRC rejects the offer, the respondent will be notified of the rejection and the offer will be deemed withdrawn. If an offer is withdrawn or rejected by the CHRC, the respondent shall not be deemed to have made any admissions by reason of the offer and shall not otherwise be prejudiced by having submitted the offer. The CHRC chairman may decline to convene the CHRC to consider a settlement offer.

In submitting a settlement offer, the respondent waives his right to a hearing and to appeal the CHRC's decision if the offer is accepted; the respondent also waives any claim of bias or prejudgment on the part of the CHRC. If a respondent submits an offer within 14 days of a scheduled BCC hearing on the charges, or after the BCC hearing has begun, the offer shall not stay the BCC hearing unless otherwise determined by the chairman of the BCC. Any settlement offer submitted within 14 days of a scheduled BCC hearing will be directed to the BCC in the first instance. The BCC may determine to accept or reject the settlement offer, or the BCC may refer the settlement offer to the CHRC, in which case the CHRC will determine whether to accept or reject the offer.

403.C. Emergency Actions

1. The CHRC is authorized to determine whether an emergency exists and whether emergency action is warranted. The following events and/or conditions may constitute emergencies:
   a. Any circumstances which may materially affect the performance of contracts traded on the Exchange, including failure of the payment system;
   b. Any action taken by the United States or any foreign government or any state or local government body, any other contract market, board of trade, or any other exchange or trade association (foreign or domestic), which may have a direct impact on trading on the Exchange;
   c. The actual or threatened bankruptcy or insolvency of any Member or the imposition of any injunction or other restraint by any government agency, court or arbitrator upon a Member of the Exchange which may affect the ability of that Member to perform on its contracts;
   d. Any circumstance in which it appears that a Member or any other person or entity has failed to perform contracts, is insolvent, or is in such financial or operational condition or is conducting business in such a manner that such person or entity cannot be permitted to continue in business without jeopardizing the safety of customer funds, Members, and/or the Exchange; and/or
   e. Any other circumstances which may have a severe, adverse effect upon the functioning of the Exchange.
2. In the event that the CHRC determines, in the good faith exercise of its sole discretion, that an emergency exists, it may take any of the following emergency actions or any other action that may be appropriate to respond to the emergency:
   a. Order the Clearing Member or his customer to deposit such additional performance bond with the Clearing House as deemed appropriate to protect the integrity of open contracts;
   b. Prescribe such additional capital requirements as it deems appropriate;
   c. Prescribe such position limitations as it deems appropriate;
   d. Order special or advance performance bond or funds to be deposited with the Clearing House from Members or from longs, shorts or both; and/or
   e. Order such performance bond changes as it deems appropriate.

All actions taken pursuant to this subsection shall be by majority vote of the committee members present. A Member affected by the action taken shall be notified in writing of such action. As soon as practicable, the Board and the CFTC shall be promptly notified of the emergency action in accordance with CFTC regulations. Nothing in this section shall in any way limit the authority of the Board, other committees, or other appropriate officials to act in an emergency situation as defined by these rules.

403.D. Appeal of Administrative Fines

Appeals of administrative fines in excess of $25,000, imposed pursuant to Rule 852, shall be heard by a panel comprised of a co-chairman and three members of the CHRC. The panel's decision shall be final. The appellant shall be advised of its right to appear at the hearing and of its right to be represented by legal counsel or a member of the Exchange, other than a member of the CHRC, a member of the Board or an employee of the Exchange. The appellant may present evidence in support of its appeal. The panel shall not set aside, modify or amend the decision appealed from unless the panel determines by a majority vote that the decision was:

1. Arbitrary, capricious, or an abuse of Exchange staff's discretion;
2. In excess of Exchange staff's authority or jurisdiction; or
3. Based on a clearly erroneous application or interpretation of Exchange rules.

404. PIT COMMITTEE

The Pit Committee shall have the authority to: 1) participate in the determination of opening and closing ranges in accordance with Rule 546; 2) oversee and enforce changes in prices in accordance with Rule 528; 3) resolve pit space disputes; 4) remove unauthorized persons from the pit; 5) resolve, by immediate action, all grievances arising from price infractions pursuant to Rule 514 during pit trading; and 6) issue charges for alleged violations of Rule 514.

To the extent that Pit Committee members participate in the creation of settlement prices, they agree to assign and transfer to the Exchange any and all right, title and interest in and to the settlement prices, including, but not limited to, all copyrights in the settlement prices.

A Pit Committee member shall not exercise his authority if he or any person, firm, or broker association with which he is affiliated has a personal, financial, or other direct interest in the matter under consideration. A Pit Committee member shall be deemed to have a financial interest if the decision is likely to have an immediate financial impact on a transaction for his account or an account in which he has an interest or if the decision is likely to impact on liability for filling an order for which he or a person with whom he has a financial or business relationship was responsible.

405. FLOOR CONDUCT COMMITTEE

The Floor Conduct Committee shall be responsible for resolving pit space disputes that are not resolved by the Pit Committee. The committee shall conduct summary proceedings for alleged violations of Rule 514. Floor Conduct Committee members shall participate in the resolution of quotation change requests pursuant to the Quotation Change Procedures set forth in the Appendix to Chapter 5. The Floor Conduct Committee shall have jurisdiction to conduct summary proceedings for violations of, and assess penalties in accordance with, Exchange rules. The procedures contained in Rule 409 shall govern summary proceedings.

406. PROBABLE CAUSE COMMITTEE

The Probable Cause Committee ("PCC") shall receive and review investigation reports from the Market Regulation Department. The PCC shall act through a Panel comprised of a chairman, three Exchange members or employees of member firms and three non-members. A quorum of a Panel shall consist of a majority of the Panel, but must include at least the chairman, two members or employees of member firms and two non-members. The Market Regulation Department is not required to provide notice of its intent to appear before the PCC to request charges.

Each Panel shall consist of panelists who possess sufficiently diverse interests so as to ensure fairness.

The PCC shall have the power to compel any Member to appear before it and to produce all books and records relevant to the subject matter under investigation. No Member or subject of an investigation shall have the right to appear before the PCC or make any written submission on his behalf.

A Panel shall endeavor to review an investigation report prepared by the Market Regulation Department within 30 days of receipt of a report the Panel deems to be complete. The Panel shall, by majority vote, take one of the following actions: If the Panel determines that disciplinary action is unwarranted it shall direct that no further action be taken or that a warning letter be issued. If the Panel determines that a reasonable basis exists for finding that a violation of an Exchange rule may have occurred which may warrant disciplinary action, it shall issue appropriate charges. The Panel shall direct the Market Regulation Department to give notice of the charges to the respondent in accordance with Rule 407.B. and to the appropriate BCC Panel chairman.

The Market Regulation Department may appeal to the Board any refusal by a Panel to issue those charges requested by the Market Regulation Department. If such an appeal is requested, the Board shall conduct a hearing on the matter in accordance with the procedures in Rule 411.

No person shall serve on the PCC unless he has agreed in writing that he will not publish, divulge or make known in any manner, any facts or information regarding the business of any person or entity or any other information which may come to his attention in his official capacity as a member of the PCC, except when reporting to the Board or to a committee concerned with such information or to the Legal Department or Market Regulation Department, when requested by the CFTC or other governmental agency or when compelled to testify in any judicial or administrative proceeding.

All information, records, materials and documents provided to the PCC and all deliberations, testimony, information, records, materials and documents related thereto shall be treated as non-public and confidential and shall not be disclosed, except as necessary to further an Exchange investigation or as required by law.[1]

407. INITIAL INVESTIGATION, ASSIGNMENT FOR HEARING AND NOTICE OF CHARGES

The Market Regulation Department shall investigate alleged rule violations. Investigations and all information and documents obtained during the course of an investigation shall be treated as non-public and confidential and shall not be disclosed, except as necessary to further an Exchange investigation or as required by law. The Market Regulation Department is authorized to take recorded interviews of Members pursuant to an Exchange investigation.

The Market Regulation Department may take oral depositions of witnesses during an investigation. The Member under investigation shall be given at least five days written notice of the time of the deposition and place where the witness will be deposed, which may be at any location within the United States. The Member under investigation shall have the right to be present in person or by representative at the oral deposition, with right of cross-examination. All oral depositions of witnesses shall be taken under oath, before an officer qualified in the place of the deposition to administer oaths, and the complete testimony of the witnesses shall be transcribed by such officer or by a person under his supervision. Oral depositions taken in accordance with this rule shall be admissible in evidence at any hearing of the Board of Directors or a committee, reserving to the Member under investigation the right to object at the hearing to the relevancy or materiality of the testimony contained therein.

Upon conclusion of an investigation, the Market Regulation Department may issue a warning letter to the Member under investigation. Such letter shall not constitute either the finding of a rule violation or a penalty.

If the Market Regulation Department has reasonable cause to believe an offense has occurred which should be dealt with by a panel of the BCC ("BCC Panel"), it shall request a panel of the PCC ("PCC Panel") to convene to consider its recommendation for charges. The Market Regulation Department's presentation to the PCC Panel shall not constitute an ex parte communication as described in Rule 417.

407.A. Investigation File

The Market Regulation Department shall maintain a file once an investigation is initiated. The file shall include any materials in the possession of the Market Regulation Department that may be relevant to the conduct being investigated. In any matter in which a PCC Panel issues charges, the investigation file shall include an investigation report prepared by the Market Regulation Department. A member charged with a violation of the rules shall have the right to review the evidence in the investigation file relevant to the issued charges, provided, however, that protected attorney work product, attorney-client communications and investigative work product, including, but not limited to, the investigation report and any exception reports, are neither discoverable by a respondent in disciplinary proceedings nor subject to review by a respondent as part of the investigation file. Production of the investigation report to a PCC Panel shall not constitute a waiver of the protected and/or privileged nature of such report.

407.B. Notice of Charges; Opportunity for Hearing

The notice of charges shall set forth the alleged misconduct and the rule(s) alleged to have been violated, and shall advise the respondent regarding the submission of a responsive answer to each charge in accordance with Rule 407.C. Further, the notice shall advise the respondent that the matter will be heard by a BCC Panel and of the time and place for the hearing, if known. The respondent shall also be advised of his right to appear personally at the hearing and of his right to be represented by legal counsel or a member of the Exchange, other than a member of the charging or hearing committee, a member of the Board or an employee of the Exchange. A respondent may waive his right to a hearing within 10 days of receipt of the notice of charges.

A respondent who elects to waive his right to a hearing on the charges will be notified of the date on which the BCC Panel will render its decision. Upon a finding of guilt on any charge, the BCC Panel will promptly determine what penalties, if any, are to be imposed and their effective date. A respondent who has waived his right to a hearing and/or admitted the charges against him will be advised of his right to participate in the hearing solely with respect to the penalty.

407.C. Answer to Charges

The respondent shall have 21 days after notice to submit a written answer to the charges. Upon a showing of good cause, the BCC Panel chairman may extend the period of time in which the respondent is required to submit his answer. The answer must state that the respondent admits,

[1] Revised December 2008.

denies, or lacks sufficient knowledge to admit or deny each charge. A statement of lack of sufficient knowledge shall be deemed a denial. Any charge not denied in whole or in part shall be deemed admitted, and the failure to file a timely answer may be deemed an admission to the charges. If all the charges are admitted, the respondent shall be deemed to waive his right to a hearing on the charges and the BCC Panel shall find that the violations alleged in the notice have been committed. The BCC Panel will determine the penalty, if any, to be imposed at a hearing, due notice of which will be provided to the respondent. The respondent shall be advised of his right to appear personally at the penalty hearing and advised of his right to be represented by legal counsel or another member of the Exchange, other than a member of the charging or hearing committee, a member of the Board or an employee of the Exchange.

If an answer contains both an admission to one or more charges and a denial of one or more charges, the BCC Panel will consider the penalties which may be imposed for the admitted charges at the same time as the charges denied by the respondent are considered.[1]

408. CONDUCT OF HEARINGS

408.A. General

All disciplinary proceedings conducted before a panel of the BCC or before a hearing panel of the Board of Directors (collectively, "Panel") shall be conducted in accordance with the following procedures. Hearings shall be fair. The respondent shall have the right to appear personally at the hearing and to be represented by legal counsel or a member of the Exchange, other than a member of the charging or hearing committee, a member of the Board, a potential respondent or witness, or an employee of the Exchange. The Panel or its chairman shall have the power to compel any Member to attend, testify and/or produce evidence in connection with the hearing.

The BCC's counsel shall, in writing, notify the respondent of the names of the persons on the Panel at least seven days in advance of the originally scheduled hearing date. Parties to the hearing may request the Panel chairman to strike any panelist for good cause shown. The Panel chairman may then excuse such panelist and direct that an alternate panelist be appointed.

408.B. Pre-Hearing

1. Procedural and Evidentiary Matters

The Panel chairman may require a pre-hearing conference.

The Panel chairman shall have the authority to decide all procedural and evidentiary matters and all pre-hearing motions, and the chairman's decision shall be final. Notwithstanding the preceding sentence, a motion to dismiss any or all of the charges may be granted only by the Panel. The Market Regulation Department may appeal to the Board any decision of the Panel to grant such a motion. If such an appeal is requested, the Board shall conduct a hearing on the matter in accordance with the procedures in Rule 411.

Pre-hearing motions must be submitted in writing to the BCC's counsel and a copy shall also be provided to the Market Regulation Department. Motions to dismiss any or all of the charges must be submitted at least 21 days in advance of the originally scheduled hearing date and a copy shall also be provided to the Market Regulation Department. Upon receipt, the Market Regulation Department shall have seven days to submit a written response to the BCC's counsel, and shall provide a copy to the respondent.

Any pre-hearing motions not specifically covered by these rules must be filed at least five business days in advance of the hearing.

Prior to the hearing, the respondent may examine all evidence which is to be relied upon by the Market Regulation Department during the hearing, or which is relevant to the charges. However, the respondent shall not be entitled to examine protected attorney work product, attorney-client communications or investigative work product, including, but not limited to, the investigation report and any exception reports. The respondent may obtain a copy of all such evidence, and any copying costs shall be the sole responsibility of the respondent. A respondent who seeks documents that are not in the possession of the Market Regulation Department may request the documents from their custodian. The Market Regulation Department is not required to produce or obtain any documents that are not in its possession. Upon a showing of good cause, the respondent may petition the Panel chairman to compel the production of documents by a custodian, provided that the custodian is subject to the jurisdiction of the Exchange, the custodian has refused voluntarily to provide the documents, and the documents are relevant to the charges. The Market Regulation Department may object, in whole or in part, to any such petition.

[1] Revised December 2008.

The issuance of charges shall not restrict the Market Regulation Department from further investigating the activity underlying the charges or investigating other potential violations by the respondent.

2. Submission of Documents and Identification of Witnesses by Respondent

At least 10 days in advance of the hearing, the respondent shall submit to the Market Regulation Department copies of all documents and records upon which the respondent plans to rely at the hearing, and provide a list of, and make available for inspection by the Market Regulation Department, all books, records, names of witnesses and other tangible evidence upon which the respondent plans to rely at the hearing. The Panel may refuse to consider any books, records, documents or other tangible evidence which was not made available to, or witnesses whose names were not submitted to, the Market Regulation Department pursuant to this section.

408.C. Settlement Offers

A respondent that is the subject of an investigation or charges may submit for consideration by the Panel a written offer of settlement in disposition of such investigation or charges. However, the CHRC will determine whether to accept or reject any settlement offer with respect to charges issued by the CHRC submitted more than 14 days before a scheduled BCC hearing, pursuant to Rule 403.B.

A respondent may submit a settlement offer without admitting or denying the rule violations upon which the penalty is based; provided, however, that an offer must include a consent to entry of findings by the Panel regarding the conduct and rule violations at issue and to the penalty to be imposed.

If the Market Regulation Department does not oppose the respondent's offer of settlement, the respondent's written offer of settlement and the Market Regulation Department's supporting statement shall be submitted to the Panel for consideration.

If the Market Regulation Department opposes the respondent's offer of settlement, then following the issuance of any charges by the PCC, the respondent may submit a written offer of settlement for consideration by the Panel no less than 14 days in advance of the originally scheduled hearing date. If a respondent submits an offer less than 14 days before a scheduled hearing date, or after the hearing has commenced, the offer shall not be considered unless agreed by the parties. In considering whether to accept the respondent's offer, the Panel shall examine the respondent's written offer of settlement and the Market Regulation Department's written opposition thereto.

The respondent may withdraw his offer at any time prior to final acceptance of the offer by the Panel. If the Panel accepts the offer, a written decision setting forth the Panel's findings and sanction shall be issued, and written notice of the decision shall be given to the respondent.

If the Panel rejects the offer, the respondent will be notified of the rejection and the offer will be deemed withdrawn. If an offer is withdrawn or rejected by the Panel, the respondent shall not be deemed to have made any admissions by reason of the offer and shall not otherwise be prejudiced by having submitted the offer.

The Panel chairman may decline to convene the Panel to consider a settlement offer. Upon consent by the respondent, any hearing that follows a rejected settlement offer will be heard by the same Panel.

In submitting a settlement offer, the respondent waives his right to a hearing and to appeal the Panel's decision if the offer is accepted; the respondent also waives any claim of bias or prejudgment on the part of the Panel.

408.D. Hearings

The Market Regulation Department shall be a party to the hearing and shall present evidence on the charges. The Market Regulation Department and the members of the Panel may question any witness and examine all the evidence stipulated to or presented at the hearing. The respondent shall be entitled to appear personally, testify, produce evidence, call witnesses on his own behalf and cross-examine any witness. The Market Regulation Department bears the burden of establishing the basis for a finding of guilt on any charge by a preponderance of the evidence. Formal rules of evidence shall not apply.

All testimony and documents produced in connection with a disciplinary hearing shall be deemed non-public and confidential and shall not be disclosed except in connection with proceedings resulting from that hearing or as required by law. A recording or other substantially verbatim record of the hearing shall be made and become part of the record of the proceeding. If a respondent requests a transcript, he shall be solely responsible for the cost of producing the transcript.

A majority vote of the Panel is required for a finding of guilt. A respondent that is found not guilty shall not again be charged with or tried for the same underlying conduct. In the event of a finding of guilt, the Panel may request additional information or argument from the parties as to the appropriate nature and amount of a sanction prior to determining such sanction. In the absence of exceptional circumstances, as determined by the Panel chairman, such argument shall proceed immediately upon the conclusion of the evidence and determination of the committee.

408.E. Decisions

Promptly following a hearing, the respondent shall be issued a written decision of the Panel's findings, which shall include: the notice of charges (or a summary thereof); the answer to the charges, if any (or a summary thereof); a brief summary of the evidence produced at the hearing; a statement of findings and conclusions with respect to each charge, including the specific rules which the respondent is found to have violated; a declaration of any penalty imposed and the effective date of such penalty; and the availability, if any, of an appeal of the decision within the Exchange or to the Commodity Futures Trading Commission.[1]

409. SUMMARY PROCEEDINGS BEFORE THE FLOOR CONDUCT COMMITTEE

409.A. Jurisdiction

A member of the Pit Committee, a member of the Floor Conduct Committee, or a designated representative of the Market Regulation Department shall have the authority to issue charges against an individual with respect to trading infractions as set forth in Rule 514. A panel of the Floor Conduct Committee shall have authority to conduct summary proceedings with respect to charges under Rule 514.

Charges against an individual shall be issued by filing the appropriate forms with the Market Regulation Department and by giving a copy to the respondent.

409.B. Selection of the Panel

For proceedings before the Floor Conduct Committee, the Chief Regulatory Officer or his designee, in consultation with a Floor Conduct Committee Co-Chairman, shall select a panel consisting of three additional members of the Floor Conduct Committee, which may include other Co-Chairmen of the committee. The Chief Regulatory Officer shall endeavor to rotate the members serving on the panels.

No panelist may serve on the particular panel if he or any person, firm, or broker association with which he is affiliated has a personal, financial, or other direct interest in the matter under consideration.

409.C. Conduct of Summary Proceedings

A summary proceeding before the Floor Conduct Committee shall be conducted in a fair and impartial manner.

A summary proceeding before the Floor Conduct Committee shall take place as soon as practicable after the issuance of charges. The proceeding will not be recorded. The respondent shall be entitled to appear personally and answer the charges issued. Respondents and witnesses may not be represented by counsel at a summary proceeding. However, an employee without membership privileges who is a respondent may be represented by a single representative of his employer. A panel shall decide by a majority vote whether the individual is guilty of the violation or offense charged. If the accused individual is found guilty, a panel may impose fines in accordance with Exchange rules. A witness who fails to appear at a summary proceeding after being directed to do so by the Chairman of the panel or by staff may be charged with a violation of Rule 432.

If a panel of the Floor Conduct Committee, by a majority vote, decides that the matter is of major importance or might warrant a penalty in excess of its own authority, the Chairman of the Panel shall refer the matter to the PCC and shall inform the individual of this referral in writing.

409.D. Appeals

An individual found guilty of an offense who receives a fine greater than $1,000 may, within 10 days of the decision, file a written appeal of the decision with the Market Regulation Department. A written appeal that fails to specify the grounds for the appeal and the specific error or impropriety of the original decision shall be dismissed by the Chief Regulatory Officer. The appeal shall be heard by a Panel of the BCC ("BCC Panel") whose decision shall be final. The appellant shall be entitled to be represented by counsel, appear personally before the BCC Panel and present evidence that he may have in support of his appeal. The BCC Panel shall not set aside, modify or amend the appealed decision unless it determines, by majority vote, that the decision was:

1. Arbitrary, capricious, or an abuse of the committee's discretion;
2. In excess of the committee's authority or jurisdiction; or
3. Based on a clearly erroneous application or interpretation of Exchange rules.

410. HEARINGS BEFORE A HEARING PANEL OF THE BOARD OF DIRECTORS

Whenever a hearing is scheduled to be held before a hearing panel of the Board ("Panel"), the

[1] Revised December 2008.

Chairman of the Board shall appoint a director to serve as the Panel chairman, who shall conduct the hearing, and two additional directors to serve on the Panel. One of these directors shall be a non-member. A majority decision by the Panel shall be considered the action of the Board as a whole.

This rule shall not create any right to a hearing before a Panel that is not otherwise provided for in other rules of the Exchange. The Chairman of the Board shall determine, in his sole discretion, whether sufficient grounds exist to hold a hearing with respect to any matter that is not addressed by other Exchange rules.

Each Panel that conducts a hearing or proceeding shall consist of directors that possess sufficiently diverse interests so as to ensure fairness. In a disciplinary matter, the hearing shall be conducted in accordance with the provisions of Rule 408.

No member of the Board may serve on a particular Panel if he participated on the charging committee or has a personal, financial or other direct interest in the matter under consideration or is a member of the same broker association as the respondent.[1]

411. APPEAL TO A HEARING PANEL OF THE BOARD OF DIRECTORS

The Market Regulation Department may request an appeal to a hearing panel of the Board ("Appellate Panel") regarding a final decision of or sanction imposed by the BCC, or any refusal by the PCC to issue those charges requested by the Market Regulation Department, by filing a request for an appeal with the Exchange Legal Department within 10 business days after receiving notice of such decision, sanction or refusal. Filing of a request for an appeal by the Market Regulation Department shall stay any decision that is appealed unless the Chairman of the Board or the chairman of the BCC Panel from which the appeal is taken specifically directs that the decision is not stayed pending appeal.

A Member found guilty of an offense or otherwise aggrieved by a final decision of the BCC, may, within 10 business days of being provided notice of any such decision, unless specifically prohibited, request an appeal to an Appellate Panel provided that the decision assesses a monetary sanction greater than $10,000 and/or an access denial or suspension of any membership privileges for greater than five business days against the Member. Filing of a request for an appeal by a Member shall stay the decision appealed unless the Market Regulation Department objects to such a stay and the Chairman of the Board or the chairman of the BCC Panel from which the appeal is taken specifically directs that the decision is not stayed pending appeal.

Upon receiving the written request for an appeal, the Appellate Panel, by a majority vote, shall determine whether sufficient grounds exist to hold a hearing on the appeal. The Appellate Panel may only determine that sufficient grounds exist if there is a reasonable basis to conclude that the appellant might be able to meet one of the standards identified below that would permit the Appellate Panel to set aside, modify or amend the appealed decision or the refusal to issue charges. The Appellate Panel's determination shall be based solely upon the written request and, in the case of an appeal of a BCC decision, any written response by the opposing party. The Appellate Panel's determination of whether to hold a hearing on an appeal shall be final.

If the Appellate Panel grants the appellant's request for a hearing, the appeal shall be heard within 60 days of the filing of the request for an appeal, unless the chairman of the Appellate Panel determines that good cause for an extension has been shown.

The appellate hearing shall be limited to the record from the appealed proceeding. The Appellate Panel shall not entertain any new evidence or new legal theory not raised in the prior proceeding except upon a clear showing by the appellant that such new evidence or new legal theory did not exist or was not ascertainable by due diligence at the time of the proceeding, and that there was insufficient time within the intervening period prior to the hearing of the Appellate Panel for the appellant to bring such new evidence or legal theory to the attention of the BCC or the PCC, as applicable. The chairman of the Appellate Panel shall allow the filing of briefs in connection with the appeal of a decision of the BCC. The Appellate Panel shall review the investigation report in connection with the appeal of a refusal by the PCC to issue those charges requested by the Market Regulation Department.

No member of the Board may serve on a particular Appellate Panel if he participated on the PCC Panel that issued, or considered issuing, the charges, or on the BCC Panel that issued the decision, or if he has a personal, financial, or other direct interest in the matter under consideration or is a member of the same broker association as the respondent or potential respondent.

The Chairman of the Board shall appoint a director to serve as the Appellate Panel chairman, who shall conduct the hearing, and two additional directors to serve on the Appellate Panel. One of these directors shall be a non-member. Any party to the appeal may request the Chairman of the Board to

[1] Revised December 2008.

strike any director for good cause shown. The Chairman of the Board may then excuse such director and shall then select an alternate director from the Board. An Appellate Panel shall consist of directors that possess sufficiently diverse interests so as to ensure fairness.

The Appellate Panel shall not set aside, modify or amend the appealed decision or the refusal to issue charges unless it determines, by a majority vote, that the decision or the refusal to issue charges was:

A. Arbitrary, capricious, or an abuse of the committee's discretion;

B. In excess of the committee's authority or jurisdiction; or

C. Based on a clearly erroneous application or interpretation of Exchange rules.

In the case of an appeal of a disciplinary decision, the Appellate Panel shall issue a written decision which shall include a statement of findings with respect to the decision from which the appeal was taken and the Appellate Panel's determination that such initial decision is affirmed, set aside, modified or amended in whole or in part and, with respect to any initial decision that is not affirmed in whole, the Appellate Panel's determination of the order or penalty to be imposed, if any, and the effective date. The decision of the Appellate Panel shall be deemed a decision of the Board and shall be a final decision of the Exchange.

In the case of an appeal by the Market Regulation Department of a decision by the PCC not to issue those charges requested by the Market Regulation Department, the Appellate Panel shall either affirm or set aside the decision of the PCC. If the decision is set aside, the Appellate Panel shall remand the matter to the PCC for the issuance of charges. If the decision is affirmed, the Appellate Panel shall direct that no further action be taken and such decision shall be deemed a decision of the Board and shall be a final decision of the Exchange.

In the case of an appeal by the Market Regulation Department of a decision by the BCC to grant a respondent's motion to dismiss any or all of the charges, the Appellate Panel shall either affirm or set aside the decision of the BCC with respect to each dismissed charge. If the decision is set aside with respect to any dismissed charge, such charge shall be deemed to be reinstated and disciplinary proceedings with respect to all of the charges shall be conducted before a different panel of the BCC pursuant to the procedures in Rule 408. If the decision is affirmed with respect to any dismissed charge, the Panel shall direct that no further action be taken with respect to such dismissed charge and such decision shall be deemed a decision of the Board and shall be a final decision of the Exchange.

This rule shall not apply to appeals of Arbitration Committee decisions, which shall be governed by the rules contained in Chapter 6.[1]

412. SUMMARY ACTION

In cases of action taken against a Member pursuant to Rules 976 or 977, the Member affected shall be notified in writing of such action. The notice shall state: the action taken; the reason for action; and the effective time, date and duration thereof.

The Member may, within two business days following receipt of notice of action taken, request a hearing before a hearing panel of the Board ("Panel") pursuant to Rule 410. The hearing shall be conducted within 60 days of such request, in accordance with the requirements of Rule 408, unless the chairman of the Panel determines that good cause for an extension has been shown, but shall not stay any action taken pursuant to Rules 976 or 977.

Following the hearing, if any, the Panel shall cause to be prepared a written decision containing: a description of the summary action; the reasons for such action; a description of the evidence produced at the hearing; findings and conclusions; a determination that the summary action should be affirmed, set aside, modified or amended and the reasons therefor; and the effective date and duration, if any, of subsequent or continuing actions. The Panel shall not set aside, modify or amend the summary action taken against a Member unless it determines, by a majority vote, that the summary action taken was:

A. Arbitrary, capricious, or an abuse of the committee's discretion; or

B. In excess of the committee's authority or jurisdiction.[2]

413. SUMMARY ACCESS DENIAL ACTIONS

413.A. Authority to Deny Access

Members may be: (1) denied access to any or all CME Group markets; (2) denied access to the Globex platform; (3) denied access to any other electronic trading or clearing platform owned or controlled by CME Group; or (4) immediately removed from any trading floor owned or controlled by CME Group by

[1] Revised December 2008.

[2] Revised December 2008.

the Chief Regulatory Officer or his delegate upon a good faith determination that there are substantial reasons to believe that such immediate action is necessary to protect the best interests of the Exchange.

Non-members may be denied access to any or all CME Group markets or be denied access to the Globex platform or any other electronic trading or clearing platform owned or controlled by CME Group by the Chief Regulatory Officer or his delegate upon a good faith determination that there are substantial reasons to believe that such immediate action is necessary to protect the best interests of the Exchange.

413.B. Notice

Promptly after an action is taken pursuant to Rule 413.A., the Member shall be informed of the action taken, the reasons for the action, and the effective date, time and the duration of the action taken. The Member shall be advised of his right to a hearing before a panel of the BCC ("Panel") by filing notice of intent with the Market Regulation Department within 10 business days of the Notice date.

413.C. Hearing

The Member shall have the right to be represented by legal counsel or a member of the Exchange, other than a member of the BCC, a member of the PCC, a member of the Board or an employee of the Exchange. The Panel shall conduct a de novo hearing solely on the issue of the denial of access in accordance with the procedures in Rule 408. Filing of a notice of intent pursuant to Rule 413.B. shall not stay the Chief Regulatory Officer's decision to deny access.

413.D. Duration of Access Denial

Any decision to deny access pursuant to Rule 413.A. or Rule 413.C. shall not remain in effect for more than 60 days unless the Chief Regulatory Officer or his delegate, upon further consideration of the circumstances that resulted in a prior access denial action, provides written Notice to the Member advising that the Member's access will be denied for an additional period of time not to exceed 60 days. Such Notice shall comport with the provisions of Rule 413.B. At any time, a Member may petition the BCC to reconsider the access denial based upon materially changed circumstances.[1]

414. INVESTIGATIONS BY OTHER SELF-REGULATORY ORGANIZATIONS

If a self-regulatory organization that is a party to an information sharing agreement with the Exchange requests assistance in connection with an investigation, the Chief Regulatory Officer may direct a Member to submit to an examination by the requesting self-regulatory organization and to produce information pertinent to that investigation. The request for assistance shall describe the investigation, explain why Exchange assistance is necessary and describe the scope of assistance sought. An order directing a Member to submit to an examination shall be issued unless the Chief Regulatory Officer determines that such order would not be in the best interests of the Exchange. An examination pursuant to such order shall be conducted according to Exchange rules and shall be conducted on Exchange premises under the direction of Exchange staff. At the discretion of the Chief Regulatory Officer, representatives of the requesting self-regulatory organization may observe and participate in the examination. Failure to comply with an order issued under this rule shall be an offense against the Exchange.

415. COOPERATION WITH OTHER EXCHANGES AND CLEARING ORGANIZATIONS

The Chief Executive Officer or the President, or their delegates, are authorized to provide information to an exchange or clearing organization that is a party to an information sharing agreement with the Exchange, in accordance with the terms and conditions of such agreement.

416. CONFLICTS OF INTEREST

416.A. Abstention Requirements

A member of a charging, adjudicating, or appeal committee or panel must abstain from participating in any matter where such member:

1. Is a witness, potential witness, or a party;
2. Is an employer, employee, or co-worker of a witness, potential witness, or a party;
3. Is associated with a witness, potential witness, or a party through a broker association as defined in Exchange rules;
4. Has any significant personal or business relationship with a witness, potential witness, or a party, not including relationships limited to (a) executing futures or options transactions opposite each

[1] Revised December 2008.

other, or (b) clearing futures or option transactions through the same clearing member; or

5. Has a familial relationship to a witness, potential witness, or a party.

416.B. Disclosure of Relationship

1. Prior to the consideration of any matter involving a subject, each member of a charging, adjudicating, or appeal committee or panel must disclose to the appropriate Exchange staff whether he or she has one of the relationships listed in Rule 416.A. above with the subject.
2. In its sole discretion, Exchange staff shall determine whether any member of the committee or panel is required to abstain in any matter.

417. PROHIBITED COMMUNICATIONS

417.A. *Ex Parte* Communications

Unless on notice and opportunity for all parties to participate:

1. No subject or respondent (or any counsel to or representative of a subject or respondent) or the Market Regulation Department (or any counsel to or representative of the Market Regulation Department) shall knowingly make or cause to be made an ex parte communication relevant to the merits (which shall not include scheduling and procedural matters) of an investigation or a proceeding to a member of a charging, adjudicatory, or appeal committee or panel with respect to that matter or proceeding.
2. No member of a charging, adjudicating, or appeal committee or panel that is participating in a decision with respect to an investigation or a proceeding shall knowingly make or cause to be made to a subject or respondent (or any counsel to or representative of a subject or respondent) or the Market Regulation Department (or any counsel to or representative of the Market Regulation Department) an ex parte communication relevant to the merits (which shall not include scheduling and procedural matters) of that matter or proceeding.

417.B. Communications with Panelists

No member shall attempt to influence disciplinary matters pending before a charging, adjudicatory, or appeal committee by discussing, or attempting to discuss, such pending matters with a member of such committee or any member of the Board.

417.C. Disclosure

Any person who receives, makes or learns of any communication which is prohibited by this rule shall promptly give notice of such communication and any response thereto to the Market Regulation Department and all parties to the proceeding to which the communication relates. A person shall not be deemed to have violated this rule if the person refuses an attempted communication concerning the merits of an investigation or proceeding as soon as it becomes apparent that the communication concerns the merits.

418.-431. [RESERVED]

432. GENERAL OFFENSES

It shall be an offense:

A. to have an interest in, operate or knowingly act on behalf of a bucket-shop, or knowingly make any transaction with a bucket-shop;

B. to engage in fraud, bad faith or in conduct or proceedings inconsistent with just and equitable principles of trade;

C. to engage in dishonest conduct;

D. to create or report a false or fictitious trade;

E. to extort or attempt extortion;

F. to buy or sell any Exchange futures or options contract with the intent to default on such purchase or sale;

G. to act as both buyer and seller in the same transaction;

H. to engage in, or attempt to engage in, the manipulation of prices of Exchange futures or options contracts; to corner or squeeze, or attempt to corner or squeeze, the underlying cash market; or to purchase or sell, or offer to purchase or sell Exchange futures or options contracts, or any underlying commodities or securities, for the purpose of upsetting the equilibrium of the market or creating a condition in which prices do not or will not reflect fair market values;

I. to make a verbal or written material misstatement to the Board, a committee, or Exchange employees;

J. to knowingly disseminate false, misleading or inaccurate information concerning crop or market information or conditions that affect or may affect the price of any Exchange futures or options contract or spot transaction in the underlying commodity;

K. to trade or accept performance bonds after insolvency;

L. 1. to fail to appear before the Board, Exchange staff or any investigative or hearing committee at a duly convened hearing or in connection with any investigation;

   2. to fail to fully answer all questions and produce all books and records at such hearing or in connection with any investigation, or to make false statements;

   3. to fail to produce any books or records requested by Exchange staff in connection with an investigation within 10 days after such request is made or such shorter period of time as determined by the Market Regulation Department in exigent circumstances or to fail to appear at a scheduled staff interview;

M. to use or disclose, for any purpose other than the performance of an individual's official duties as a member of any committee or the Board of Directors, any non-public information obtained by reason of participating in any Board of Directors or committee meeting or hearing;

N. to knowingly accept, directly or indirectly, a trade on the Exchange for the account of a non-member employed on the floor of the Exchange;

O. for a Member to permit the use of its facilities or membership privileges in a manner that is detrimental to the interest or welfare of the Exchange or results in a violation of Exchange Rules or the Commodity Exchange Act;

P. for a Clearing Member to fail to maintain minimum financial requirements;

Q. to commit an act which is detrimental to the interest or welfare of the Exchange or to engage in any conduct which tends to impair the dignity or good name of the Exchange;

R. to fail to submit to arbitration any dispute which Exchange staff, an arbitration panel or the Board decides should be arbitrated pursuant to Chapter 6; or to fail to comply with a final arbitration award;

S. to fail, after hearing, to comply with an order of the Board, Exchange staff or any hearing committee;

T. to engage in dishonorable or uncommercial conduct;

U. except where a power of attorney or similar document has been executed pursuant to Rule 956, for a Member to accept or transmit a customer order which has not been specifically authorized, i.e., the customer has not specified commodity, contract month, quantity, time and price;

V. to be expelled from a U.S. or foreign designated commodities or securities exchange;

W. for a Member to fail to diligently supervise its employees and agents in the conduct of their business relating to the Exchange;

X. for a Member to aid or abet the commission of any offense against the Exchange;

Y. to improperly use the Globex platform or any electronic trading or clearing platform owned or controlled by CME Group or permit the unauthorized use of such platforms; and/or

Z. for a Member to fail to disclose to the Exchange and his qualifying Clearing Member that an involuntary bankruptcy petition has been filed against him or, in the case of a voluntary bankruptcy proceeding, that he has filed or has formed a definite intention to file for bankruptcy.[1]

433. STRICT LIABILITY FOR THE ACTS OF AGENTS

Pursuant to Section 2(a)(1)(B) of the Commodity Exchange Act, and nothwithstanding Rule 432.W., the act, omission, or failure of any official, agent, or other person acting for any Member within the scope of his employment or office shall be deemed the act, omission or failure of the Member, as well as of the official, agent or other person who committed the act.[2]

434. [RESERVED]

435. EFFECT OF SUSPENSION OR EXPULSION

The effects of a suspension or expulsion from membership shall apply to all CME Group markets in which the suspended or expelled member has membership privileges.

[1] Revised December 2008.

[2] Adopted December 2008.

Unless otherwise determined by the committee with jurisdiction over such matters, a suspended or expelled Member shall not be entitled to any of the privileges of membership during the period of such suspension or expulsion, including, but not limited to, the right to:

A. access any trading floor owned or controlled by CME Group;

B. access the Globex platform or any other electronic trading or clearing platform owned or controlled by CME Group;

C. obtain member rates;

D. any applicable cross-exchange trading privileges; and

E. lease out an owned membership.[1]

436. [RESERVED]

437. NOTICE OF DISCIPLINE

Notice, in accordance with Section 8c(a)(2) of the Commodity Exchange Act, shall be made available to an internet accessible computer database at the National Futures Association and shall be provided to any Member who is suspended, expelled, disciplined or denied access to the Exchange within 30 days after the decision becomes final. Additionally, a written notice shall be posted on the floor of the Exchange for five business days promptly after the disciplinary action becomes effective. The notice shall include the Member's name, the rule(s) violated, the reason for the Exchange's action, and the action taken or penalty imposed.

438. [RESERVED]

439. MEMBER'S INDEMNIFICATION LIABILITY

A Member or former Member shall indemnify and hold harmless the Exchange and CME Group, Inc., including each of their respective subsidiaries and affiliates (collectively, the indemnified parties) and their officers, directors, employees, and agents, for any and all losses, damages, costs and expenses (including attorneys' fees) incurred by the indemnified parties as a result (directly or indirectly) of such Member's violation or alleged violation of Exchange rules or state or federal law.

Any charges arising out of this rule shall be subject to liens as provided in Rule 110(a).

440. CLAIMS BY MEMBERS

A Member who commences a legal action against the Exchange, its directors, officers, employees, or agents, or another Member of the Exchange without first resorting to and exhausting the procedures established by Rule 110 and the mandatory arbitration provisions of Chapter 6 (including appeals to the Board), or any other rules relating to settlement of disputes arising out of transactions or matters pertaining to the Exchange shall be deemed to have committed an act detrimental to the interest or welfare of the Exchange. This rule shall not abrogate an individual's right to reparations pursuant to Section 14 of the Commodity Exchange Act.

A Member who commences a legal action against the Exchange, its directors, officers, employees, or agents, after he has exhausted all of the procedures established by the Exchange, may be found to have committed an act detrimental to the interest or welfare of the Exchange in the event that at hearing the Board or the BCC determines that the Member's action was not meritorious or warranted.

441. COMMUNICATIONS WITH THE PUBLIC AND PROMOTIONAL MATERIAL

Promotional material and similar information issued by Members shall comply with the requirements of National Futures Association Rule 2-29, as amended.

442. NOTIFICATION OF SIGNIFICANT EVENTS

Each Member shall immediately notify the Market Regulation Department in writing upon becoming aware of any of the following events relating to such Member:

1. any suspension, expulsion, revocation or restriction of such Member's trading privileges or any fine in excess of $25,000, through an adverse determination, voluntary settlement or otherwise, by any court, commodity or securities exchange or related clearing organization, the Securities and Exchange Commission, the Commodity Futures Trading Commission or the securities commission or equivalent authority of any state, territory, the District of Columbia or foreign country, the National Futures Association, the National Association of Securities Dealers, Inc., or any self-regulatory or regulatory organization;

[1] Revised December 2009.

2. any indictment of the Member or any of its officers for, any conviction of the Member or any of its officers of, or any confession of guilt or plea of guilty or nolo contendere by the Member or any of its officers to 1) any felony or 2) any misdemeanor involving, arising from, or related to the purchase or sale of any commodity, security, futures contract, option or other financial instrument or involving or arising from fraud or moral turpitude; and/or

3. any involuntary bankruptcy petition that has been filed against such Member, or in the case of a voluntary bankruptcy proceeding, when such Member has filed or has formed a definite intention to file for bankruptcy.

Nothing in this rule shall limit or negate any other reporting obligations that any member may have to the Exchange or any other regulator or person.

443. POSITION LIMIT VIOLATIONS

The Market Regulation Department and the BCC shall have the authority to enforce the position limit rules of the Exchange. For purposes of this rule, any positions in excess of those permitted under the rules of the Exchange shall be deemed position limit violations. Additionally, any person making a bid or offer that would, if accepted, cause such person to exceed the applicable position limits shall be in violation of this rule.

A customer who exceeds the position limits as a result of maintaining positions at more than one clearing member shall be deemed to have waived confidentiality regarding his position and the identity of the clearing members at which they are maintained.

A clearing member will not be in violation of this rule if it carries positions for its customers in excess of the applicable position limits for such reasonable period of time as the firm may require to discover and liquidate the excess positions or, if applicable, to file the appropriate hedge or exemption statements for the customer accounts in question. For the purposes of this rule, a reasonable period of time shall generally not exceed one business day.

In addition to any other sanctions imposed pursuant to this rule, the failure to reduce any positions as instructed by the Market Regulation Department shall result in the imposition of automatic fines in accordance with the fine schedule maintained by the Market Regulation Department. Sanctions issued pursuant to this rule may be appealed to the BCC which may modify or overturn the sanction for good cause shown.

443.A. First Violation

The first violation of a position limit may result in a warning letter to be issued by the Market Regulation Department to the customers and Members, including the associated persons and/or clearing firms involved.

443.B. Subsequent Violations Following a Warning Letter

A subsequent position limit violation within 12 months of the issuance of a warning letter may result in the issuance of a cease and desist order by the Market Regulation Department to the Members, including the associated persons and/or clearing members involved. A notice of such cease and desist order shall be posted.

If a customer exceeds the position limits after having received a warning letter for a previous violation of this rule, the customer will be issued a second warning letter, with copies sent to the appropriate parties.

443.C. Referral to the Probable Cause Committee

Any third, subsequent and/or egregious position limit violation may be referred by the Market Regulation Department to the PCC for consideration of the issuance of charges.

443.D. Alternate Risk Factor Evaluation

If a position that includes options exceeds position limits for passive reasons such as a market move or exercise assignment, the person who owns or controls such position shall be allowed one business day to liquidate the excess position without being considered in violation of the limits. In addition, if at the close of trading, a position that includes options exceeds position limits when evaluated using the previous day's delta factors, but does not exceed the limits when evaluated using the delta factors of that day's close of trading, then the position shall not constitute a position limit violation.

444. SANCTIONS AND RESTITUTION ORDERS

Members and Member Firms may, subject to a determination by the sanctioning entity, be liable for unpaid fines or unpaid restitution orders imposed upon their employees.[1]

[1] Adopted December 2008.

(End Chapter 4)

Exchange, it is the duty of the clearing member to ensure that registration is current and accurate at all times. Each individual must use a unique user ID to access Globex. In no event may a person enter an order or permit the entry of an order by an individual using a user ID other than the individual's own unique user ID.

577. [RESERVED]

578. LIMITATION OF LIABILITY, NO WARRANTIES

A. EXCEPT AS PROVIDED BELOW, THE EXCHANGE, THE BOARD OF TRADE OF THE CITY OF CHICAGO, INC. ("CBOT"), THE NEW YORK MERCANTILE EXCHANGE INC. ("NYMEX") AND CME ALTERNATIVE MARKETPLACE INC., (INCLUDING EACH OF THEIR RESPECTIVE SUBSIDIARIES AND AFFILIATES), THEIR OFFICERS, DIRECTORS, EMPLOYEES, AGENTS, CONSULTANTS, LICENSORS, MEMBERS, AND CLEARING MEMBERS, SHALL NOT BE LIABLE TO ANY PERSON FOR ANY LOSSES, DAMAGES, COSTS OR EXPENSES (INCLUDING, BUT NOT LIMITED TO, LOSS OF PROFITS, LOSS OF USE, AND DIRECT, INDIRECT, INCIDENTAL, CONSEQUENTIAL OR PUNITIVE DAMAGES), ARISING FROM:

(i) ANY FAILURE, MALFUNCTION, FAULT IN DELIVERY, DELAY, OMISSION, SUSPENSION, INACCURACY, INTERRUPTION, TERMINATION, OR ANY OTHER CAUSE, IN CONNECTION WITH THE FURNISHING, PERFORMANCE, OPERATION, MAINTENANCE, USE OF OR INABILITY TO USE ALL OR ANY PART OF ANY OF THE SYSTEMS AND SERVICES OF THE EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC., OR SERVICES, EQUIPMENT OR FACILITIES USED TO SUPPORT SUCH SYSTEMS AND SERVICES, INCLUDING WITHOUT LIMITATION ELECTRONIC ORDER ENTRY/DELIVERY, TRADING THROUGH ANY ELECTRONIC MEANS, ELECTRONIC COMMUNICATION OF MARKET DATA OR INFORMATION, WORKSTATIONS USED BY MEMBERS AND AUTHORIZED EMPLOYEES OF MEMBERS, PRICE REPORTING SYSTEMS AND ANY AND ALL TERMINALS, COMMUNICATIONS NETWORKS, CENTRAL COMPUTERS, SOFTWARE, HARDWARE, FIRMWARE AND PRINTERS RELATING THERETO; OR

(ii) ANY FAILURE OR MALFUNCTION, FAULT IN DELIVERY, DELAY, OMISSION, SUSPENSION, INACCURACY, INTERRUPTION OR TERMINATION, OR ANY OTHER CAUSE, OF ANY SYSTEM OR SERVICE OF THE EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC., OR SERVICES, EQUIPMENT OR FACILITIES USED TO SUPPORT SUCH SYSTEMS OR SERVICES, CAUSED BY ANY THIRD PARTIES INCLUDING, BUT NOT LIMITED TO, INDEPENDENT SOFTWARE VENDORS AND NETWORK PROVIDERS; OR

(iii) ANY ERRORS OR INACCURACIES IN INFORMATION PROVIDED BY THE EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC. OR ANY EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC. SYSTEM, SERVICE OR FACILITY; EXCEPT FOR INCORRECT ORDER STATUSING INFORMATION AS PROVIDED IN RULE 579 (GLOBEX CONTROL CENTER AND ORDER STATUSING); OR

(iv) ANY UNAUTHORIZED ACCESS TO OR UNAUTHORIZED USE OF ANY EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC. SYSTEM, SERVICE OR FACILITY BY ANY PERSON.

THE FOREGOING LIMITATION OF LIABILITY SHALL APPLY WHETHER A CLAIM ARISES IN CONTRACT, TORT, NEGLIGENCE, STRICT LIABILITY, CONTRIBUTION OR OTHERWISE AND WHETHER THE CLAIM IS BROUGHT DIRECTLY OR AS A THIRD PARTY CLAIM.

THE FOREGOING LIMITATION OF LIABILITY SHALL BE SUBJECT TO THE COMMODITY EXCHANGE ACT AND REGULATIONS THEREUNDER. A PARTY WHO HAS BEEN FINALLY ADJUDICATED TO HAVE ENGAGED IN WILLFUL OR WANTON MISCONDUCT MAY NOT AVAIL ITSELF OF THE PROTECTIONS IN THIS RULE.

B. THERE ARE NO EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS (INCLUDING BUT NOT LIMITED TO WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE OR USE) PROVIDED BY THE EXCHANGE, CBOT, NYMEX OR CME ALTERNATIVE MARKETPLACE INC. (INCLUDING THEIR RESPECTIVE SUBSIDIARIES AND AFFILIATES), THEIR OFFICERS, DIRECTORS, EMPLOYEES, AGENTS, CONSULTANTS, AND LICENSORS RELATING TO ANY SYSTEMS OR SERVICES OF THE EXCHANGE, CBOT OR CME ALTERNATIVE MARKETPLACE INC. OR SERVICES, EQUIPMENT OR FACILITIES USED

TO SUPPORT SUCH SYSTEMS OR SERVICES, INCLUDING THE GLOBEX SYSTEM.

C. ANY DISPUTE ARISING OUT OF THE USE OF SYSTEMS OR SERVICES OF THE EXCHANGE OR CME ALTERNATIVE MARKETPLACE INC. OR SERVICES, EQUIPMENT OR FACILITIES USED TO SUPPORT SUCH SYSTEMS OR SERVICES IN WHICH THE EXCHANGE, OR CME AUCTION MARKETS (INCLUDING EITHER OF THEIR SUBSIDIARIES AND AFFILIATES), OR ANY OF THEIR OFFICERS, DIRECTORS, EMPLOYEES, AGENTS, CONSULTANTS OR LICENSORS IS A PARTY SHALL BE ARBITRATED PURSUANT TO RULE 621. ANY ARBITRATION SHALL BE BROUGHT WITHIN THE PERIOD PRESCRIBED BY EXCHANGE RULES. ANY OTHER ACTIONS, SUITS OR PROCEEDINGS AGAINST ANY OF THE ABOVE MUST BE BROUGHT WITHIN TWO YEARS FROM THE TIME THAT A CAUSE OF ACTION HAS ACCRUED. THIS PARAGRAPH C SHALL IN NO WAY BE CONSTRUED TO LIMIT A PARTY'S OBLIGATION TO ARBITRATE ITS CLAIM OR TO CREATE A CAUSE OF ACTION AND SHALL NOT AUTHORIZE AN ACTION THAT WOULD OTHERWISE BE PROHIBITED BY CME RULES. IF FOR ANY REASON, A COURT OF COMPETENT JURISDICTION FINDS THAT SUCH DISPUTE IS NOT ARBITRABLE, SUCH DISPUTE MAY ONLY BE LITIGATED IN THE COUNTY OF COOK IN THE STATE OF ILLINOIS AND WILL BE GOVERNED BY THE LAWS OF THE STATE OF ILLINOIS WITHOUT REGARD TO ANY PROVISIONS OF ILLINOIS LAW THAT WOULD APPLY THE SUBSTANTIVE LAW OF A DIFFERENT JURISDICTION.

D. THE EXCHANGE, AND WITH RESPECT TO "AUCTIONS," CME ALTERNATIVE MARKETPLACE INC., MAY, IN THEIR RESPECTIVE SOLE DISCRETION, ASSUME RESPONSIBILITY FOR DIRECT, OUT-OF-POCKET LOSSES DIRECTLY CAUSED BY THE NEGLIGENCE OF GLOBEX CONTROL CENTER OR OTHER EXCHANGE STAFF AND/OR ORDER STATUS ERRORS PROVIDED BY THE GLOBEX CONTROL CENTER OR AN EXCHANGE SYSTEM, SERVICE OR FACILITY. NOTWITHSTANDING THE ABOVE, i) THE EXCHANGE'S ii) CBOT's (EXCEPT WITH RESPECT TO ANY PRODUCTS TRADED ON e-cbot, WHICH ARE GOVERNED BY CBOT RULE 5B.19); AND iii) WITH RESPECT TO AUCTIONS, CME ALTERNATIVE MARKETPLACE INC.'S TOTAL COMBINED AGGREGATE OBLIGATIONS SHALL NOT EXCEED $100,000 FOR ALL LOSSES FROM ALL CAUSES SUFFERED ON A SINGLE DAY; $200,000 FOR ALL LOSSES SUFFERED FROM ALL CAUSES IN A SINGLE CALENDAR MONTH; AND $2,400,000 FOR ALL LOSSES FROM ALL CAUSES SUFFERED IN A SINGLE CALENDAR YEAR. ANY DISPUTED CLAIM PURSUANT TO THIS PARAGRAPH D MUST BE ARBITRATED PURSUANT TO EXCHANGE RULES.

E. IN NO EVENT SHALL THE EXCHANGE'S, CBOT'S, AND WITH RESPECT TO AUCTIONS, CME ALTERNATIVE MARKETPLACE INC.'S, TOTAL COMBINED AGGREGATE LIABILITY FOR ALL CLAIMS ARISING OUT OF ANY NEGLIGENCE, FAILURES, MALFUNCTIONS, FAULTS IN DELIVERY, DELAYS, OMISSIONS, SUSPENSIONS, INACCURACIES, INTERRUPTIONS, TERMINATIONS, ORDER STATUSING ERRORS OR ANY OTHER CAUSES, IN CONNECTION WITH THE FURNISHING, PERFORMANCE, OPERATION, MAINTENANCE, USE OF OR INABILITY TO USE ALL OR ANY PART OF ANY OF THE EXCHANGE'S, CBOT'S, OR CME ALTERNATIVE MARKETPLACE INC.'S SYSTEMS OR SERVICES, OR SERVICES, EQUIPMENT OR FACILITIES USED TO SUPPORT SUCH SYSTEMS AND SERVICES, OR THE NEGLIGENCE OF EXCHANGE OR CBOT STAFF, EXCEED $2,400,000 IN ANY GIVEN CALENDAR YEAR.

IF THE NUMBER OF ALLOWED CLAIMS ARISING OUT OF ANY FAILURES OR MALFUNCTIONS ON A SINGLE DAY OR SINGLE MONTH CANNOT BE FULLY SATISFIED BECAUSE OF THE ABOVE DOLLAR LIMITATIONS, ALL SUCH CLAIMS SHALL BE LIMITED TO A PRO RATA SHARE OF THE MAXIMUM AMOUNT FOR THE RESPECTIVE PERIOD.

A CLAIM AGAINST THE EXCHANGE, CBOT, OR WITH RESPECT TO AUCTIONS, CME ALTERNATIVE MARKETPLACE INC., ARISING OUT OF ANY FAILURE OR MALFUNCTION SHALL ONLY BE ALLOWED IF SUCH CLAIM IS BROUGHT IN ACCORDANCE WITH THIS RULE.

579. GLOBEX CONTROL CENTER

579.A. Customer Support

The Globex Control Center ("GCC") provides Globex customer support and problem management only to members, clearing members and customers designated by clearing members. In addition, designated NYMEX members and clearing members may also receive customer support and problem management from GCC with respect to contracts traded on Globex. In order to be eligible for GCC support, such persons must register with the GCC ("Registered Contacts"). The GCC provides customer support via a specified telephone number and during specified hours. GCC employees may not always be available to assist Registered Contacts. Persons other than Registered Contacts,

Chapter 6
Arbitration

JURISDICTION

600. DISPUTES SUBJECT TO CME ARBITRATION

600.A. Disputes Among Members

It is contrary to the objectives and policy of the Exchange for members to litigate certain Exchange-related disputes. Disputes between and among members that are described below and that are based upon facts and circumstances that occurred at a time when the parties were members shall be subject to mandatory arbitration in accordance with the rules of this Chapter:

1. claims between members that relate to or arise out of any transaction on or subject to the rules of the Exchange;
2. claims between or among members relating to ownership of, or interests in, trading rights on the Exchange; and
3. claims between members relating to the enforceability of:
   a. non-compete clauses to the extent they relate to the Exchange,
   b. terms of employment on the trading floor, and
   c. financial arrangements relating to the resolution of error trades in Exchange products that are included in any employment agreement entered into on or after August 1, 1998.

Nothing in this rule, however, shall require a member employee to submit to arbitration any claim that includes allegations of a violation of federal, state or local employment discrimination, wage payment or benefits laws.

600.B. Disputes Between Members and Certain Non-Member Employees

The enforceability of the following provisions of an employment agreement entered into on or after August 1, 1998, between a member and a non-member employee registered pursuant to Rule 501 shall be subject to mandatory arbitration in accordance with the rules of this Chapter:

1. non-compete clauses to the extent that they relate to the Exchange; and
2. terms of employment on the trading floor.

Nothing in this rule, however, shall require a non-member employee to submit to arbitration any claim that includes allegations of a violation of federal, state or local employment discrimination, wage payment or benefits laws. A non-member employee shall mean a member's bona fide employee who has been registered by the Exchange to work on the trading floor.

600.C. Claims Against the Exchange

Claims against the Exchange pursuant to the provisions of Rule 578.C., Rule 578.D., Rule 579.C., and/or Rule 587.C. shall be subject to mandatory arbitration in accordance with the rules of this Chapter, provided the claimant has complied with all pre-filing requirements under the applicable rule(s).

600.D. Permissive Arbitrations

The following may be submitted for arbitration at the Exchange and, in the event such a claim is submitted against a member, that member is required to arbitrate the dispute under these rules, unless otherwise provided:

1. claims of a customer against a member that relate to or arise out of any transaction on or subject to the rules of the Exchange;
2. claims against an Exchange clearing member and its Globex user pursuant to Rule 588.C.3.a. and b., where the claimant has complied with the provisions of Rule 588.D., and pursuant to Rule 588.C.3.d., provided that any non-member Globex user has consented to arbitration of the dispute at the Exchange within 20 days of receipt of a claim;
3. claims of a customer against a clearing member responsible for the spot-call delivery performance of a transaction on or subject to the rules of the Exchange and/or against a member in connection with such a transaction;
4. claims of an SGX member against a member that relate to or arise out of transactions subject to or relating to the Mutual Offset System;
5. claims of a non-member (other than those claims required to be arbitrated under Rule 600.B)

against a member that relate to or arise out of employment on the trading floor;

6. claims by or against an entity whose majority ownership is held by Exchange members and whose principal business relates to activity on or at the Exchange, where the dispute has a material connection to the business or purpose of the Exchange, provided such entity has consented to arbitration of the dispute at the Exchange within 20 days of receipt of a claim; and
7. at the discretion of the Chief Regulatory Officer, any claim involving the interests of the Exchange, its members, their business relations or commodity futures trading in general not otherwise arbitrable under these rules, provided the parties have consented to such arbitration.

600.E. Waiver of Any Objection to Jurisdiction

Any member or non-member who submits a claim or grievance to arbitration or any member who appeals to a hearing committee of the Board from any panel decision, or who takes any steps therein, shall be conclusively presumed to have voluntarily recognized and agreed to the jurisdiction of the panel or hearing committee of the Board to hear and determine the claim or appeal.

600.F. Hearing Panel

Any claim involving only members shall be heard by a Member panel and its decision shall be rendered in accordance with the rules of this Chapter. A Member panel shall mean an arbitration panel consisting of a co-chairman of the Arbitration Committee and five Members as defined in Rule 400.

601. CUSTOMER CLAIMS AGAINST MEMBERS

601.A. Definitions

1. Customer. Customer shall mean any person, not a member of the Exchange, who places an order or for whose account an order is placed for execution on the Exchange or who otherwise executes a transaction on or subject to the rules of the Exchange.
2. Claim. Claim shall mean any dispute arising out of any transaction on or subject to the rules of the Exchange, including mutual offset rules.
3. Mixed Panel. Mixed Panel shall mean an arbitration panel consisting of a co-chairman of the Arbitration Committee and five Arbitration Committee members, three of whom shall be persons who are non-members and who are not associated with any member of a contract market, or employee thereof, and are not otherwise associated with a contract market.
4. Member. Member as used in this Chapter shall mean 1) members and clearing members of the Exchange, including retired members with floor access privileges and individuals and entities described in Rule 106; 2) associated persons ("APs") and affiliates of clearing members of the Exchange; 3) guaranteed introducing brokers of clearing members of the Exchange and their APs; 4) Exchange permit holders; and 5) individuals and entities that have agreed in writing to comply with the rules of the Exchange.
5. Punitive Damages. Punitive damages shall mean an award in excess of actual damages suffered. Punitive damages shall be limited to twice the amount of actual damages and may be awarded only to a customer after a determination that there has been willful and wanton misconduct in the execution or handling of an order by a member or an employee acting on behalf of a member.

601.B. Refusal to Hear Certain Disputes

A chairman may, but shall not be required to, order that a dispute that is otherwise arbitrable under these rules not be arbitrated hereunder if the dispute requires for adjudication the presence of essential witnesses or third parties over whom the Exchange has no jurisdiction or who are not otherwise available, or if the dispute requires the application of the rules of another exchange.

601.C. Initiation of Arbitration

In the event that a complaint is received by the Exchange from a customer, it shall be referred to the Market Regulation Department, which shall inform the customer of alternative dispute settlement forums and, when appropriate, forward to the customer a Consent Form for arbitration at the Exchange. Such form shall inform the customer, by attachment of all pertinent rules, of the customer's rights and liabilities, including costs associated with arbitration, and the option of selecting an arbitration panel consisting of Exchange members or a Mixed Panel to decide the claim and any counterclaims, cross-claims or third-party claims.

A customer who submits a claim for arbitration in accordance with these rules consents thereby to the jurisdiction of the arbitrators and agrees to the arbitration of any counterclaims, cross-claims or third-party claims by any respondent which arise out of the transaction that is the subject of the customer's claim. The claim shall comply with the requirements of Rule 602, and in the case of a request for punitive damages, the claim shall set forth the facts the customer intends to present in support of the claim that the misconduct was willful and wanton.

The customer shall file a completed Consent Form and deposit the arbitration fee with the Market Regulation Department. Notice shall then be given to the member against whom the claim is asserted, who shall respond to the claim in accordance with Rule 603.

601.D. Referral to Arbitration Panel or Mixed Panel

A Customer claim against a member shall be heard by the type of panel selected by the customer and its decision shall be rendered in accordance with the rules of this Chapter. Customer claims (and any counterclaims, cross-claims or third-party claims applicable thereto) that do not exceed $5,000 and do not include any claim for punitive damages may, in the interests of efficiency and economy, be resolved without hearing. The panel shall render its decision based upon the parties' written submissions and any other relevant information obtained and provided to the panel and the parties at the direction of the chairman and/or the panel.

FILING PROCEDURES

602. INITIATING AN ARBITRATION CLAIM

A claimant may initiate a claim by submitting a written description of the dispute, a completed Arbitration Cover Sheet and depositing the appropriate arbitration fee with the Market Regulation Department within the period of eligibility for arbitration claims. The written claim shall include a clear description of the facts and circumstances involved in the dispute, including the transaction(s) or agreement(s) complained of, the names of the persons and firms alleged to be responsible for any loss to the claimant, the dates of all acts or omissions relevant to the claim, a detailed calculation of the amount claimed and any other information necessary to fully describe the dispute.

The Market Regulation Department shall reject for filing any claim that does not fully describe the dispute, is clearly filed after the period of eligibility has expired or is clearly not arbitrable at the Exchange. Such a claim will be promptly returned to the filing party with a notice describing the deficiency. A claimant seeking to correct the deficiency and file an amended claim may do so within 30 days of receiving notice describing the deficiency despite any expiration of the period of eligibility prescribed by Rule 609 during that 30-day period. The acceptance for filing by the Market Regulation Department shall not preclude a challenge to the arbitrability of the claim nor create a presumption that the claim is arbitrable.

603. ANSWERING AN ARBITRATION CLAIM

Each respondent shall file a written response within 21 days after receipt of the written claim. However, if a party has timely filed a challenge to the arbitrability of the dispute, its response shall be due 21 days after receipt of the written decision confirming the arbitrability of the dispute.

The written answer must admit the claim or describe the respondent's basis for denying liability to the claimant(s). The answer may include an admission or denial of each specific allegation contained in the claim and/or the respondent's narrative description of the facts and circumstances involved in the dispute. A respondent may assert in an answer any defense that would be available in a court of law or equity, including any affirmative defense.

604. FAILURE TO ANSWER

A respondent's unexcused failure to file a timely answer shall constitute an admission of the facts alleged in a claim.

605. COUNTERCLAIMS, CROSS-CLAIMS AND THIRD-PARTY CLAIMS

A respondent may assert any counterclaim, cross-claim and/or third-party claim to the extent such claim would be allowable as an original claim under these rules and, in response to claims by a customer against a member, the member may assert any counterclaim, cross-claim and/or third-party claim arising out of the same transaction or incident that is the subject of the customer's claim. Each respondent must file any counterclaim, cross-claim or third-party claim at the same time an answer to a claim is due. Initiating counterclaims, cross-claims, third-party claims and answers thereto shall conform to the requirements for initiating and answering original claims.

A respondent who believes that another member may have a claim to any money or property which is the subject of a dispute in arbitration and that the failure of that other member to assert a claim in the pending arbitration could prejudice the interests of the respondent may submit a request to the chairman to compel the participation of the other member. If a member fails to file such claim after being ordered to assert that claim in the pending arbitration, then notwithstanding any other rule, that member shall be barred from asserting in the future any claim against the respondent that is based on the same transaction, occurrence or subject.

606. REVIEW OF ARBITRABILITY

Any party may file a challenge to the arbitrability of a dispute submitted for arbitration at the Exchange. A party's failure to file a timely challenge to arbitrability shall waive any right to object thereafter to the arbitrability of the dispute.

A challenge to arbitrability by a claimant must be filed no later than 5 days after the claim is submitted for arbitration. A challenge to arbitrability by a respondent must be filed no later than 10 days after the respondent has received notice of the claim. The request must be in writing and state the reasons why the dispute is not arbitrable at the Exchange. Any other party may file a written response in support of or opposition to the challenge no later than 10 days after receiving notice of the challenge to arbitrability.

The chairman may decide the arbitrability of a dispute based on his consideration of the written submissions of the parties. The chairman's decision shall be final and is not appealable.

607. CONSOLIDATION OF ARBITRATION DISPUTES

If a chairman receives notice that two or more arbitration disputes pending at the Exchange are related, the chairman may order that any or all of the disputes be consolidated for purposes of conducting a hearing on the disputes. In determining whether to consolidate the disputes the chairman may consider the efficiencies of consolidation as well as the burdens and benefits to the parties in consolidating the disputes.

608. WITHDRAWAL OF CLAIMS

A. A party may voluntarily withdraw its claim, counterclaim, cross-claim or third-party claim without prejudice at any time before an answer thereto has been filed by notifying the Market Regulation Department in writing of such withdrawal.

B. After an answer to any claim, counterclaim, cross-claim or third-party claim has been filed, the claimant seeking to withdraw the claim, counterclaim, cross-claim or third-party claim must submit to the chairman a written request to withdraw with prejudice or upon such terms and conditions as may be imposed by the chairman.

C. A withdrawal with prejudice under this rule shall bar the claimant from re-filing any claim based on the same acts, transactions or omissions as the dismissed claim.

609. PERIOD OF ELIGIBILITY FOR ARBITRATION

An arbitration must be initiated within two years of the date the claimant knew or should have known of the dispute on which the claim is based, except that claims filed pursuant to Rule 600.C. must be submitted within 10 days of receiving notice that the Exchange has refused to compensate the claimant for the claimed loss.

Counterclaims, cross-claims and third-party claims must be submitted no later than the date on which the answer is due.

610. PARALLEL PROCEEDINGS

No claim will be accepted for arbitration at the Exchange if the Market Regulation Department receives notice that another arbitration, reparations action or civil court proceeding based on the same act, transaction or omission as the arbitration claim is pending at the time of filing.

No claim, counterclaim, cross-claim or third party-claim will be accepted for arbitration against a respondent if the Market Regulation Department has received notice that a stay exists due to the pendency of any bankruptcy proceeding against that respondent. If such a stay arises after a claim is accepted for arbitration or if the Market Regulation Department subsequently learns that such a stay is pending, the claim shall be dismissed without prejudice as to each respondent who is the subject of the stay. Nothing in this rule shall prevent a claim in arbitration from proceeding against any remaining respondent.

PRE-HEARING PROCEDURES

611. REQUESTS FOR DOCUMENTS, INFORMATION OR TESTIMONY

A. The initial schedule for document requests by parties and responses will be set by the Market Regulation Department. The chairman may require any member, or any person employed by or associated with a member to produce relevant documents in his possession or control at any time after a claim has been filed.

Upon the failure of a party or member to voluntarily produce relevant documents in its possession or control upon request by a party, the party seeking the documents may submit a written request to the chairman for an order compelling the production of such documents.

1. Any request for an order compelling production of documents must:
   a. identify each document or type of document sought with as much specificity as possible;
   b. explain the relevance of each document or type of document sought; and
   c. include a representation that the requesting party has attempted to obtain the documents from the responding party before resorting to a request to the chairman.
2. The party or member against whom an order compelling production is sought shall:
   a. produce copies of the requested documents to the requesting party and the Exchange; or
   b. represent in writing that the documents are not in his possession or control and explain the basis for such representation, and, if applicable, identify who is in possession or control of the requested documents; or
   c. object in writing to a request and provide the basis for each objection.

B. In connection with any claim, counterclaim, cross-claim or third-party claim that seeks relief in excess of $50,000, any party may seek leave from the chairman to serve written requests for information on any other party. The chairman shall have discretion to determine whether and under what circumstances such requests may be permitted.

C. The chairman may require any member, or any person employed by or associated with a member, to appear and to testify at a hearing.

D. Whenever such production or appearance results from the request of a party, all reasonable costs and expenses incurred shall be borne by the party making the request, unless directed otherwise by the panel. A party who incurs costs and expenses recoverable under this rule may, no later than the close of the last hearing date in the matter, submit an application to the panel for such costs and expenses. Such application shall contain a detailed explanation of amounts claimed. The panel may grant or deny all or any portion of the application.

E. Any member or employee thereof failing to appear, testify, produce documents or provide information in accordance with this rule may be charged with a violation of Rule 432.

612. DOCUMNTS AND WITNESSES TO BE PRESENTED AT HEARING

No later than 10 business days prior to the first scheduled hearing, each party must provide every other party and the Exchange with copies of all documents that the party intends to offer into evidence and a list of the names of all witnesses, including party-witnesses, who the party intends to call at the hearing in support of a claim or defense. Parties are not required under this rule to provide copies of those documents that they may use, or to identify any witnesses whom they may call, only in cross-examination or rebuttal.

613. ADDITIONAL PROCEDURES

The chairman may establish any procedures not otherwise contemplated by these rules necessary to establish a just, equitable and efficient method of resolving a particular dispute, except that the chairman may not decide a motion to dismiss a claim, as motions to dismiss are not permitted under these rules.

HEARINGS

614. ARBITRATION PANEL

614.A. Appointment of Arbitration Panel

The Market Regulation Department shall select a panel of arbitrators from the Exchange's Arbitration Committee to hear and decide a dispute. The panel shall consist of five arbitrators and one chairman.

614.B. Requests to Remove an Arbitrator

1. Each party may request the removal of any arbitrator(s) from a panel for good cause shown. Such request must be made no later than the start of testimony at the first scheduled hearing. Failure of a party to timely request the removal of any arbitrator(s) will be deemed a waiver of that party's right to any further objection to the arbitrator's participation in the hearing and decision of the dispute.
2. The chairman, after considering a request to remove an arbitrator, another party's objections

thereto and/or the statements of an arbitrator whose removal is sought, may deny the request or excuse the arbitrator. The chairman's decision shall be final and may not be appealed.

3. If an arbitrator is excused prior to the date of the first scheduled hearing, the Market Regulation Department shall select another Arbitration Committee member to replace the excused arbitrator at the hearing. Parties may make any appropriate request for the removal of the replacement arbitrator under this rule.
4. If an arbitrator is excused on or after the date of the first scheduled hearing, the dispute may, at the election of the non-requesting party and with the consent of the chairman be heard and decided by the remaining arbitrators.

615. HEARING PROCEDURES

615.A. Chairman

The panel chairman shall preside over the proceeding and shall make such determinations on relevancy and procedure as will promote a fair and expeditious adjudication of any claim. The chairman may administer oaths or affirmations by witnesses. Upon request of the panel chairman, the Market Regulation Department shall submit any documents to the panel and parties in the Exchange's possession that are relevant and readily available.

615.B. Arbitrators

The arbitration panel shall consider all relevant, probative testimony and documents submitted by the parties. The panel shall be the sole judge of the law and the facts, but if the panel is in doubt as to any questions of law, it may refer the question to Exchange legal counsel for an opinion. The panel shall not be bound by the formal rules of evidence. The final decision of the panel shall be by majority vote of the arbitrators, and the chairman shall vote only to resolve a tie.

615.C. Parties and their Representatives

Each party and his representative has the right to examine all relevant documents prior to and during the hearing, to present all relevant evidence in support of a claim or defense or as rebuttal to a claim or defense, and to question during the hearing witnesses presented in connection with a claim or defense. An entity may have one corporate representative of the entity, in addition to any counsel of record, attend the arbitration hearing. Such corporate representative will not be precluded from testifying in the matter.

615.D. Witnesses

All testimony offered to the panel will be under oath or affirmation. Witnesses will be permitted in the hearing room only while providing testimony to the panel. Witnesses shall testify in person at the hearing, except that for good cause shown and in the discretion of the chairman, a witness may be allowed to testify by telephone or other appropriate means.

615.E. Hearing Record

An audio recording of the proceeding shall be made and maintained until the decision becomes final. A verbatim record of such recording shall not be transcribed unless requested by a party, who shall bear the cost of transcription.

DECISIONS

616. AWARDS

616.A. Decision by Panel

After a hearing, or, on customer claims that do not exceed $5,000 upon consideration of the pleadings and other relevant information, the arbitration panel shall issue a written decision signed by the panel chairman and at least a majority of the panel. The panel may decide any matter in controversy and issue any order the panel deems necessary to fully resolve the dispute. The Market Regulation Department shall promptly serve copies on all parties. A monetary award made by the panel may include the following:

1. actual damages;
2. interest thereon;
3. punitive damages of no more than two times the amount of actual damages in accordance with Rule 601.A.5.;
4. the arbitration fee incurred by a prevailing party, or a portion thereof; and
5. all or any portion of the administrative costs of the proceeding and any other reasonable and necessary expenses, including, but not limited to, attorneys' fees (a) incurred by a party by reason

of another party's frivolous or bad faith claim, defense, or conduct during the arbitration or (b) where a statutory or contractual basis exists for awarding such fees. Requests for attorneys' fees and costs incurred in the arbitration proceeding must be raised in the proceeding or they are waived.

616.B. Decision by the Chairman

The chairman may order a party who fails to prosecute or defend a claim to pay to the Exchange all or a portion of its administrative costs incurred in connection with the arbitration claim.

616.C. Limitations on Monetary Awards

Monetary awards in claims filed pursuant to Rule 621 shall be limited as set forth in Rule 578.

617. CORRECTION OF AWARD

Any party may, within three days after receipt of the notice of decision, request the arbitration panel to modify or correct its decision where there has been an obvious material miscalculation or misdescription or where the notice is imperfect in a matter of form not affecting the merits of the dispute or decision.

618. SATISFACTION OF AWARD

In the absence of any request to correct an award, the award must be satisfied within three days of receipt of the notice of decision. Any party directed to pay an award shall submit payment of any amounts due directly to the person receiving the award and shall also submit evidence of such payment to the Market Regulation Department.

APPEALS

619. APPEAL

Any decision rendered in a dispute among members resulting in a non-cash award or involving a claim, counterclaim, cross-claim or third-party claim that sought a recovery over $10,000 may be appealed to a hearing committee of the Board. All other decisions rendered by an arbitration panel are final and may not be appealed. In order to appeal a decision, a party must, within three business days after receiving a copy of the decision:

A. File with the Market Regulation Department a written notice stating the grounds for appeal based upon the standards set forth in Rule 620, and

B. Deposit with the Market Regulation Department the applicable fee established by the Exchange, together with a cashier's or certified check payable to CME in the amount of any monetary award against the appellant.

Failure to timely comply with these requirements for appeal, when applicable, shall constitute a waiver of any right to appeal and render the arbitrators' decision final and binding.

Within 14 days after filing a notice of appeal, the appellant shall file with the Market Regulation Department any argument and any documents or information that the appellant intends to use in support of the appeal. The appellee shall have 14 days thereafter to file whatever documents or information he intends to rely upon in opposition to the appeal. An extension beyond the 14-day filing period may be granted by the Market Regulation Department upon a showing of good cause. In the case of a non-cash award, the filing of the notice of appeal shall not stay the decision appealed from unless the panel from which the appeal is taken or the Chief Regulatory Officer specifically directs that the decision be stayed.

The appeal shall be heard by a hearing committee of the Board, and the matter shall be heard within 60 days of the end of the appellee's filing period, unless the Market Regulation Department or the chairman of the hearing committee determines that good cause for an extension has been shown. The hearing committee shall consist of three directors appointed by the Chairman of the Board, one of whom the Chairman of the Board shall designate as chairman of the hearing committee. No director may serve on a hearing committee if he has a personal or financial interest in the matter under consideration. A party may strike any member of the hearing committee for good cause shown as determined by the Chief Regulatory Officer, in which event that director shall be excused from hearing the matter. The Chairman of the Board shall then select an alternate participant from the Board. Any meeting of the hearing committee shall require the presence of each director appointed to the committee and shall be conducted by the chairman of the hearing committee. The parties may, upon unanimous consent, waive the right to hearing, and the hearing committee may consider the matter based solely on the parties' written submissions.

620. STANDARDS AND PROCEDURES FOR REVIEW UPON APPEAL

In the following cases, the hearing committee may enter an order amending or vacating the award of the arbitration panel:

A. Where the award was procured by corruption, fraud or undue means;

B. Where there was evident partiality or corruption on the part of any of the arbitrators or the chairman;

C. Where the arbitrators were guilty of misconduct in refusing to hear relevant evidence; or of any other behavior by which the rights of any party have been prejudiced;

D. Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the dispute submitted was not made; or

E. Where the arbitrators acted in manifest disregard of the applicable law, including Exchange rules.

The hearing committee shall consider only the record made before the panel and any other evidence submitted by the parties relevant to A. through E. above. In the event that the hearing committee determines to vacate the award, the matter shall be resubmitted to a new panel of arbitrators for a rehearing. In the event that the hearing committee amends the award or denies the appeal, such decision of the hearing committee shall be final and binding.

ADDITIONAL CLAIMS

621. CERTAIN CLAIMS AGAINST THE EXCHANGE INVOLVING TRADING SYSTEMS OR SERVICES

621.A. General

All claims arising out of or relating to the following matters shall be arbitrated in accordance with the specific requirements of this Rule 621 and, to the extent not inconsistent with such requirements, the rules of this Chapter:

1. receipt of an incorrect order status or the failure to have received an appropriate order status;
2. the negligence of GCC personnel or any other Exchange staff; or
3. Phantom Orders, as defined in Rule 587.

Nothing in Rules 621 or 622 shall be construed to create a claim against the Exchange, to limit a defense available to the Exchange, or to obviate or modify any limitation of Exchange liability imposed by any other rule.

621.B. Initial Liability Claim and Demand for Arbitration

The initial claim of loss, including a detailed description of any loss suffered, must be made to the Exchange within ten business days of the date of the incident that caused the loss. The Exchange shall have 30 business days to pay or deny the claim in whole or in part. If the Exchange denies the claim in whole or in part, the claimant must file a written demand for arbitration with the Market Regulation Department within ten business days after the Exchange has notified the claimant of such denial. A claimant's failure to pursue its claim within these time limits shall bar any recovery on such claim.

621.C. Selection of Arbitration Panel

The arbitration panel shall consist of three arbitrators selected from a list of arbitrators maintained by the National Futures Association ("NFA"). The Exchange and the claimant shall each select one arbitrator. If the Exchange and the claimant are unable to agree on the third arbitrator, the President of the NFA or his delegate shall choose the third arbitrator.

621.C & 621.E
[illegible]

621.D. Related Claims

All claims arising out of the same system failure, event or alleged negligent act shall, to the extent practicable in the determination of the chairman, be consolidated for a single hearing.

621.E. Award

Within 30 days of completion of the hearing, the panel shall issue a written decision. The award shall be limited to the lesser of the actual loss or the loss that would have been incurred if the claimant had used its best efforts to mitigate the loss. Punitive damages, loss of profits, loss of use, and indirect, incidental or consequential damages shall not be awarded. The decision of a majority of the panel shall be final and binding, and there shall be no appeal to the Board of Directors. A party may move, within three business days of the award, that the award be corrected to remedy any miscalculation or misdescription or where the award is otherwise imperfect in a matter of form not affecting the merits of the award.

621.F. Satisfaction of Award by Exchange

The Exchange shall satisfy any award against it subject to its limitation of liability rules and the rules respecting proration among claimants where damages allowed for a defined period of time exceed any limit imposed by Exchange rules. The Exchange may delay paying any award until such time as any applicable proration or limitation can be finally calculated.

622. CLAIMS RELATING TO TRADE CANCELLATIONS OR PRICE ADJUSTMENTS

622.A. General

All claims relating to certain price adjustments or trade busts pursuant to Rule 588.C.3.a., b. and c. shall be arbitrated in accordance with the specific requirements of this Rule 622 and, to the extent not inconsistent with such requirements, the rules of this Chapter. All claims pursuant to Rule 588.C.3.d. shall be arbitrated in accordance with the rules of this Chapter.

622.B. Initiation of Claim

Any claim for loss under Rule 588.C.3.a., b. or c. must first be submitted to the Exchange as described in Rule 588.D. Following a denial of liability by a party responsible for a trade bust or price adjustment and by the clearing firm through which the trade was placed as described in Rule 588.D., the dispute shall be referred to arbitration. The Exchange shall administer the arbitration and provide notice to all parties.

The party alleged to have made the trade that caused the trade bust or price adjustment and the clearing firm through which that trade was placed both may be respondents in such arbitration. Any party responsible for a trade bust or price adjustment who is not otherwise subject to arbitration under these rules may voluntarily submit to such arbitration by filing a submission agreement with the Exchange within 21 days of that party's receipt of notice of the referral to arbitration. In the absence of the voluntary submission to arbitration by such party, the arbitration shall proceed solely against the clearing firm through which the trade was placed, and that firm shall be liable for any damages awarded by the panel.

622.C. Selection of Arbitration Panel

All claims under Rule 588.C.3.a., b. and c. shall be heard by a Mixed Panel as defined in Rule 601.A.3.

622.D. Related Claims

All claims arbitrable under this rule that arise out of a trade bust or price adjustment that was caused by the same incident shall, to the extent practicable in the determination of the chairman, be consolidated in a single arbitration.

622.E. Award

Within 30 days of completion of the hearing, the panel shall issue a written decision signed by a majority of the arbitrators.

The total award for a single incident shall not exceed $500,000. Except as provided below, the claims shall be limited to out-of-pocket losses. If the claimants' allowable losses exceed $500,000, the amount awarded to each claimant shall be reduced pro rata so that the total award does not exceed $500,000. Any award shall be made jointly and severally against the respondents. In the event the panel finds the respondent(s) liable for the full amount of the claim (or the capped amount of $500,000), the panel shall also award the claimants their costs and attorneys fees incurred in connection with arbitrating the claim. Punitive damages, loss of profits, loss of use, and indirect, incidental or consequential damages shall not be awarded. The decision of a majority of the panel shall be final and may not be appealed.

A party may move, within three business days of the award, for an order correcting or modifying the award to remedy any miscalculation or misdescription or where the award is otherwise imperfect in a matter of form not affecting the merits of the award.

MISCELLANEOUS

623. RIGHT TO COUNSEL

Every person is entitled to represent his own interests, be represented by an attorney at law of his choosing and at his own expense who is admitted to practice before the highest court in any State, or be represented by any other non-compensated representative at any stage of an arbitration proceeding at the Exchange. An entity must be represented by an officer or owner of the entity or by an attorney at law.

624. COMPUTATION OF TIME

For the purposes of this Chapter, when a period of time is prescribed by a number of days, and not a specific date, the first day counted for the time prescribed is the day after notice is received or other event giving rise to the period of time occurs. Any submission is due or the time to take action shall lapse by the close of business on the last day counted, unless the last day is a weekend or Exchange holiday, in which case the due date shall be the next following day the Exchange is open for business.

For time periods of five days or less only days the Exchange is open for business will be counted. For all other time periods calendar days will be counted.

625. SUBMISSIONS TO OR COMMUNICATIONS WITH THE PANEL

Any submission for consideration by a chairman or panel must be submitted to the Market Regulation Department with copies simultaneously served on each other party or designated representative of a party.

After a dispute has been submitted for arbitration, a person filing the claim or required to respond to the claim and any person asked to provide documents, information or testimony in connection with such claim shall not contact any member of a panel appointed to hear the claim for any purpose related to the dispute described by the claim.

626. ARBITRATION FEES

Any person submitting an arbitration claim or appealing a decision of an arbitration panel shall remit the applicable fees as may be determined by the Exchange at the time of submission or appeal, in order for such action to be effective.

ARBITRATION COMMITTEE

627. ARBITRATION COMMITTEE

Each member of the Arbitration Committee shall:

A. be appointed by the Board Chairman on an annual basis;

B. pledge to the Exchange that he will not publish, divulge, or make known in any manner any facts or information which may come to his attention while performing his duties as a member of the Arbitration Committee, except when reporting to the Board, or to a committee concerned with such information, or when called upon to respond in any judicial or administrative proceeding;

C. comply with the standards of the American Bar Association-American Arbitration Association's "Code of Ethics for Arbitrators in Commercial Disputes" which the Exchange hereby adopts as its own code of ethics for arbitrators;

D. pledge to immediately disclose any matter, relationship or interest with any party or the subject of a dispute which may affect the arbitrator's ability to be, or create the appearance that the arbitrator is not, impartial in deliberating and deciding a dispute; and

E. promptly give notice to the Market Regulation Department of any ex parte communication directed to such Arbitration Committee member which is prohibited by Rule 625.

(End of Chapter 6)

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS,
EASTERN DIVISION

THE PLENUM FUND, LP	)	
	)	Case No. 08 CV 6091
Plaintiff	)	
	)	(EEB) (ECF)
-against-	)	
	)	AFFIDAVIT OF STEVEN LAPIERRE
CHICAGO MERCANTILE EXCHANGE, INC.,	)	IN OPPOSITION TO DEFENDANTS'
CME GLOBEX CONTROL CENTER, AND	)	MOTION TO COMPEL ARBITRATION,
CME GROUP, INC. and JOHN DOES 1-20	)	AND STAY PROCEEDINGS, AND
	)	IN SUPPORT OF JURY TRIAL.
Defendants.	)	

STATE OF PENNSYLVANIA)
:
COUNTY OF Bucks)

Steven A. LaPierre, being duly sworn, deposes and says:

1. I am the President of Plenum Management, LLC, which is the General Partner of Plenum Investment Partners, LP, which is the general partner of Plenum Fund, LP ("Plenum Fund"), the "Plaintiff" herein, and I am otherwise authorized to act for and on behalf of Plenum Fund, including with respect to all aspects of its operation, management and control; I have personal knowledge of all of the facts and circumstances set forth herein, and I submit this affidavit in opposition to Defendants' motions: (1) to stay the Case Management Procedures of this action; and (2) to compel arbitration of the dispute set out in Plaintiff's Complaint herein. I also submit this affidavit in support of (3) Plaintiff's Demand for a Jury Trial, seeking a jury trial on the issue of whether the arbitration provisions between the parties to this action are unenforceable, including for the reason that such provisions are the product of a contract of adhesion, are otherwise substantively

and/or procedurally unconscionable under Illinois Law, and/or such arbitration rules and procedures do not, and can not be deemed to pertain to claims asserted by a member (Plenum) against an exchange (the CME).

Background And Special Significance Of This Action.

2. On January 14, 2008, Plenum Fund suffered losses in connection with the purchase and sale of E-Mini S&P 500 futures contracts (contract code "ESH8") traded on the Chicago Mercantile Exchange (the "CME"). These losses initially resulted from computer software glitches and anomalies occurring in Plenum's Automated Trading System ("ATS"), which utilizes the Plenum "S&P 500 Momentum Strategy"--a software module consisting of algorithms which automatically generate trade orders for the CME E-Mini S&P 500 futures contracts.

3. As a result of this malfunction, commencing at 2:01:10am on January 14, 2008, and which continued for only 6.5 seconds, the Plenum ATS erroneously generated trades for more than 46,000 ESH8 contracts (the "Erroneous Trades"). The programs and systems put in place by Plenum thereafter closed down the ATS and terminated all further trading; and such trading pattern in the market for ESH8 contracts returned to normalcy in an orderly manner 6.5 seconds after the event began.

4. As more fully detailed in the Complaint (paragraphs "33" to "42"), this action involves the "bad faith" failure of the CME to enforce and apply CME Rule 588, and to apply the "Trade Cancellation and Price Adjustment" policy set out in that Rule to the Erroneous Trades of the ESH8 futures contracts on January 14, 2008.

5. The bad faith is alleged to be comprised by complicity between the CME and one or more of its large member/traders in connection with decisions made by the CME regarding the implementation of CME Rule 588. More specifically, it is alleged

that the CME wrongfully consulted with its large member/traders to ascertain their profit and loss position in the ESH8 contracts traded after and in connection with Plenum Fund's Erroneous Trades, before making and as impacting on its decision in respect of the manner in which it would apply its "no bust rules" to Plenum Funds' Erroneous Trades, with a view to making a decision and taking action that would result in windfall profits for such large traders and customers. The action thereafter taken, net of the complicity between the CME and its large member/traders, is alleged to have been in derogation of the CME's obligation to protect the public interest.

6. In support of Plaintiff's allegations of "bad faith", in substance, it is alleged at paragraph "39" of the Complaint, that it should have been apparent to any objective and impartial observer, unfettered by improper purpose (including an intent to benefit certain of the CME's large member/traders), that the Erroneous Trades were the result of a malfunction in Plenum's ATS, and that such trades were aberrations in an otherwise flat and tranquil market, and therefore were not the outcome of any "legitimate price discovery".

7. In support of this contention it is submitted that the Global Control Center ("GCC"), an agent and instrumentality of the CME, has and maintains on-line systems which provide it with graphic presentations of actual trading in real time. Therefore, on January 14, 2008, such systems provided the GCC with information which informed CME/GCC that the Erroneous Trades were a singular event, which did not rise to the level of "excessive volatility", as could justify any decision to double the No Bust Range, as was otherwise wrongfully implemented to benefit the foregoing large member/traders.

8. As more fully detailed below, it is Plenum Fund's supposition that the CME's counsel has pursued a motion to compel arbitration in circumstances where the arbitration rules proffered plainly do not apply in this case and do not provide any understandable and discernible procedures with respect to a claim by a member against the Exchange, as opposed to a claim by a member against a member, for the express purpose and objective of keeping Plaintiff from availing itself of the more liberal and expanded discovery afforded by the Federal Rules of Civil Procedure, in the hope and expectation that the more limited discovery available in an arbitration will make it more difficult for Plaintiff to demonstrate its burden to prove bad faith under Commodity Exchange Act ("CEA") §22(b)(4). As demonstrated by the accompanying Declaration of Jeffrey L. Rosenberg, dated December 19, 2008 (the "Rosenberg Declaration"), Defendants' contentions regarding the applicability of the proffered arbitration rules is without proper and required substantive basis, and is borne of the ulterior purpose of delay and an attempt to obtain the foregoing procedural advantage and defense.

9. Furthermore, with respect to the importance of this motion as it relates to the trial of the action presented by the Complaint, it is suggested that the incident underlying this action (the Erroneous Trades resulting from a computer glitch in Plenum Fund's automated trading system) has a very great significance to and upon the current and evolving trend of computerized trading of futures contracts and other automated commodity transactions present in the market; and the result in this controversy will be of great importance with respect to the automated trading of such futures contracts and commodities currently, and in ensuing years, including for the reason that such automated trading has dramatically increased in recent years, and is anticipated to increase at an even greater rate in the ensuing several years.

10. It is therefore respectfully submitted that the incidence of other and similar "erroneous trades" on designated contract exchanges, unrelated to "legitimate price discovery", resulting from the implementation of automated trading systems featuring algorithmic formulations will concomitantly increase over the next several years.

11. As a result, it may be anticipated that the frequency with which the CME and other Contract Markets and Exchanges will be called upon to apply rules similar to the CME's "Trade Cancellation and Price Adjustment" policy, as contained in CME Rule 588, will continue to increase. It is thus imperative for this Court to ensure that there are fair and predictable rules and procedures in place to deal with this anticipated greater incidence of aberrations in the trading of futures contracts and other commodities; and that any arbitration rules sought to be imposed by the CME are not unfair and intentionally infected with a lack of clarity and precision and undue and unregulated discretion, as is presented by the application of the CME "Arbitration Rules" in relation to the claim of a member (Plenum Fund) against an exchange (CME).

12. As indicated below, and elsewhere in Plaintiff's Opposition papers, CME Rules 578 and Chapter 6, Rules 600-627 are ill-equipped, and not formulated for claims asserted by members against an Exchange, but rather are plainly intended by their wording and application to claims asserted by a member against a member. Those Rules if applied to member/exchange disputes would purport to invest such unchecked discretion to the Exchange as to adversely impact a member's ability to prosecute its claim against the Exchange, including by advantaging the Exchange; and as to abrogate any notion of fairness or propriety, and as to preclude the requisite requirements of justicability. It is the supposition of the accompanying Rosenberg Declaration that such discretion and

imprecision makes the CME Arbitration Rules violative of the "Core Principles of 7 U.S.C. § 7(d), and for that reason also the Arbitration Rules are unenforceable as to this action.

Summary and Overview of this Opposition.

13. I am advised by Plenum Fund's counsel that Defendants' motion papers assert and insist that the Rules of the CME "provide for mandatory arbitration of claims against the CME", and for that reason this action should be stayed pending the outcome of such arbitration. *Au contraire*, Plenum Fund never did or could have volitionally and/or cognitively agreed to arbitrate any claim it might assert against the CME; including because such arbitration provisions were "procedurally unconscionable".

14. More pervasively, it is contended that any such putative agreement to arbitrate is vitiated and abrogated because such consent was sought and obtained indirectly and surreptitiously, and by way of implication, but not directly and openly.

15. It is an essential and material element of Plaintiff's Opposition that although Defendants' claim that any such arbitration "SHALL BE ARBITRATED PURSUANT TO RULE 621" [1], analysis of the text of CME Rule 621 does not demonstrate sufficient procedures and mechanisms demarking the methodology of any such supposedly compulsory arbitration; and the abbreviated and dogmatic, but procedurally incomplete dictates that claims against the Exchange must be submitted to mandatory arbitration appear as afterthoughts and knee-jerk responses to the provisions of CEA, §22(b)(4).

16. At best, Rule 621 has reference to the procedures provided by CME Rules 600 through 627, which, upon any close analysis, demonstrate that they were

[1] Capitalization used in Defendants' Memorandum of Law.

intended to apply to claims between and among customers and members of the CME, but not to claims by members against the Exchange.

17. Moreover, it is submitted that such Rules, if applied in the instance of the within controversy, would and do provide unfair and procedurally unconscionable mechanisms and procedures which unduly and materially advantage the CME over any member, and which, more specifically disadvantage Plenum Fund in respect of proving that the CME acted with "bad faith", as required by CEA §22(b)(4), including by virtue of provisions which allow representatives of the CME (e.g., the "Chairman of Market Regulation Department) to control discovery, and which allow the CME to finally reject and dispose of any claims against itself. [2]

Personal Knowledge of Facts;
Plenum Fund Not Represented By Counsel.

18. I was one of the people directly responsible for the completion and submission of Plenum Fund's Application for Corporate Membership to the CME (the "Membership Application"), a copy of which is Exhibit "B" to Defendants' Memorandum of Law in Support of the Motion to Compel Arbitration ("Defendants' Memorandum").

19. Plenum Fund was not represented by counsel in and with respect to the preparation and filing of the Membership Application; except on the narrow issue regarding whether Plenum's organizational structure allowed it to qualify for a CME corporate membership, and thus discounted fees. No counsel reviewed the sufficiency or other content of the Membership Application, nor provided Plenum Fund with any legal or

[2] When I was presented with Defendants' motions, and when I saw the claim that claims against the CME were to arbitrated pursuant to Rule 621, I attempted to work through that Rule and understand the procedure established, but I could not in any meaningful manner, and I came to the conclusions stated above regarding unfairness and a lack of workability. Accordingly, I requested that Plenum Fund's counsel, Jeffrey L. Rosenberg, engage in a legal analysis, conducing his own review. That review and analysis is set out in Mr. Rosenberg's accompanying Declaration, which, it is suggested, confirms my layman's analysis.

other advice regarding the implications of the approval of the Membership Application in relation to any agreement to arbitrate.

20. Additionally, neither the CME, nor its counsel made any disclosures to Plenum Fund in relation to the CME Rules, including the arbitration provisions thereof, or in any way urged or recommended that Plenum Fund obtain the advice of counsel in connection with its application for membership to the CME, and/or the implied enforceability of the CME Arbitration Rules, currently, or in prospect.

21. At no time prior to the preparation and filing of the Membership Application did the CME provide a copy of its Rules to Plenum Fund, or, to my knowledge, representative of Plenum Fund; and it is my information and belief that the CME provides access to its Rules only on internet, by accessing its website.

22. While I was generally familiar with the CME Rules that applied to and governed the trading of futures contracts and other commodities, and such things as margin requirements in that connection, at no time prior to the preparation and filing of the Membership Application did I, or any representative of Plenum Fund review that portion of the CME Rules constituting the "Arbitration Rules" or "Arbitration Provisions" referred to in Defendants' Memorandum; nor did the CME, or any CME representative urge or advise Plenum Fund to make or conduct such a review, or take or make any special note of any rules therein contained, or as to the importance and effect of such Arbitration Rules to any claims that Plenum Fund might, in the future, seek to assert against the CME.

23. It is respectfully submitted that the CME, being a quasi-governmental entity and instrumentality, charged by Federal Statute (the CEA) with the protection of the public interest, and because the CME's Rules, in their application, may have such a

material economic impact on its members, this Court should find that the CME may not impute knowledge, consent and approval as to the Arbitration Rules by reason of an applicant, such as Plenum Fund, making application for membership to the CME, and upon the acceptance of such application, unless the CME provides to such applicant a copy of such Rules, while concurrently making express disclosure with regard to the application of the Arbitration Rules as they may inhibit the ability of a member to assert and prosecute a claim against the CME, in circumstance where the member must prove a level of culpability equal to or greater than "bad faith". (E.g., as required by CEA §22(b)(4))

**Plenum Fund's Commencement of Trading;
Investment Strategies and Decisions; and
CME's Monopoly Position as to the Trading
of E-Mini S&P 500 Futures Contracts.**

24. Upon approval of its Membership Application, Plenum Fund, LP began trading on the CME in April, 2005, using a proprietary, algorithmic, automated high-frequency futures trading strategy and system ("ATS") that performed most effectively only if and to the extent that the futures contracts which were traded by Plenum Fund had very high levels of order liquidity, trading frequency, and trading volume.

25. Plenum Fund's investment managers and advisors had previously conducted months' of extensive research in order to determine, as a business decision and trading strategy, which futures contracts could and would meet these requirements.

26. After this prolonged business consideration and investigation, it was the conclusion of Plenum Funds' managers and advisors that the optimal contract to trade in conjunction with Plenum Fund's ATS was the E-Mini S&P 500 futures contract.

27. It was concluded the E-Mini S&P 500 futures contract was possessed of the highest trading volume of any futures contract in the world. However, it was

concurrently observed that E-Mini S&P 500 futures contracts were traded only on the CME, and no other place in the world!

28. In the 33 months from the start of trading by Plenum until the system malfunction that occurred in January, 2008, Plenum Fund primarily, trading in or with respect to the E-Mini S&P 500 futures contract, and utilizing the Plenum ATS, did not have a single losing month, and averaged an annualized net return of almost 20% for its investors over that period—thus providing imprimatur to Plenum Fund's management decisions in choosing to trade that contract.

Lack of Volitional and Cognitive Consent as to CME Arbitration Provisions.

a.) Consent Voided By Monopolistic Coercion As to Arbitration.

29. Apart from any claim that an agreement to arbitrate is vitiated by a lack of cognitive ability on the part of Plenum Fund to understand, appreciate and therefore knowingly consent to the CME's Arbitration Rules, in applying for Corporate Membership to the CME Plenum Fund was without any effective or realistic choice or alternative other than to capitulate to all CME Rules to the extent they encompassed a putative consent to arbitrate claims, including those asserted against the CME.[3]

30. This virtual coercion resulted from the fact that Plenum Fund's managers and advisors made the business decision that it was most efficacious to trade E-Mini S&P 500 futures contracts in conjunction with the operation of the Plenum Fund's ATS. Thus, it was an unavoidable business reality that if the Plenum Fund wished to engage in that economic activity, it had no choice other than to accept the Arbitration

[3] As more fully demonstrated in the accompanying Rosenberg Declaration the CME's Arbitration Rules purportedly pertaining and regulating a claim by a member against the CME are so one-sided, unfair and invoke so much discretion in favor the CME as to be a sham, and so unfair as to evidence that agreement with respect to such Rules could only be the result of the CME's position of monopoly as related to Plenum Fund.

Provisions included within the CME Rules, whether or not it did, or could, otherwise cognitively appreciate the implications of any implied agreement to be bound thereby.

31. On this basis, the indirect and imputed agreement to arbitrate all claims against the CME, supposedly effected by the acceptance of Plenum Fund's Membership Application, was not just a "take or leave It' situation, where there were other alternatives which could be pursued, even if with less advantageous terms, utilities or facilities; but rather, this was an unavoidable capitulation, borne of monopolistic coercion which the CME was able to impose on the Plenum Fund because CME was the only contract market in the world where Plenum Fund could trade E-Mini S&P 500 contracts.

32. Admittedly, Plenum Fund was better able to understand and appreciate the general rules pertaining to day-to-day trading activities, margin requirements and the like; and therefore it does not make any claim of unenforceability and invalidity as to the more pervasive aspects of the overall agreement between Plenum Fund and the CME; but rather seeks to strip out and sever only the Arbitration Rules for an attack as to their enforceability in the context of claims made under CEA §22(b)(4).

b.) Consent Voided as to Arbitration Rules by Virtue of Lack of Cognitive Ability to Appreciate and Understand the Arbitration Rules, and the "Procedural Unconscionability" of Such Rules.

33. Apart from the coercion to capitulate to the Arbitration Rules borne of the CME's monopoly, Plenum Fund also asserts that any appearance of consent to the Arbitration Provisions is abrogated by the "procedural unconscionability" of those Rules. In support, neither I, nor any other representative of Plenum Fund did, or could have, cognitively appreciated the substance of the Arbitration Rules, including as to their scope, ambit and application, presently, or prospectively; and especially, as they pertained to a

prospective claim which Plenum Fund was not then contemplating or thinking about, and as that claim might be materially prejudiced in Plenum Fund being required to prove the bad faith of the CME in failing to enforce its Rules, resulting from any agreement to arbitrate in the future.

34. In this connection, I have recently been advised by counsel, that in prosecuting any claim that the CME failed to enforce its Rules, specifically Rule 588, Plenum Fund is required to demonstrate and prove "bad faith" conduct on the part of the CME, pursuant CEA, § 22(b)(4).

35. I am advised that it is commonly acknowledged that proof of "bad faith" is, by its nature, hidden and secrete, and it does not lie in the open for public view and scrutiny.

36. With proof of bad faith, fraud, and similar culpable conduct being the most difficult type of proof to unveil and present to a court or tribunal, I am advised that the myriad of discovery mechanisms, including electronic data and depositions provided by the Federal Rules, as administered in the Federal Courts, but not generally available in arbitration proceedings[4], are a necessary and essential part of any arsenal of weapons required to achieve the level of culpability as to demonstrate "bad faith".

37. Similarly, it was only in connection with this action, that I was instructed by Plenum Fund's counsel and came to understand that discovery and disclosure in an arbitration proceeding is far more limited and circumspect as compared to that which is available under the Federal Rules, thus making proof of "bad faith" in an arbitration context vastly more difficult, if not, impractical.[5]

[4] unless by agreement or specific rules not present here.

[5] It is the supposition of Plenum Fund that it is this procedural disadvantage and disability that motivates

38. It is submitted that the accompanying Rosenberg Declaration demonstrates that the CME Arbitration Rules do not support the CME's claim that they adequately and sufficiently provide a workable and fair procedural matrix for a mandatory arbitration of Plenum Fund's claims against the Exchange, and that such Arbitration Rules are otherwise unenforceable because they contravene the Core Principles imposed on the CME by Federal Statute. However, I suggest that it is a separate reason that the Arbitration Rules are not enforceable, because neither I nor other Plenum Fund representatives could or did reasonably understand and appreciate that the Arbitration Rules were intended to inhibit a member's ability to meet the proof requirements of CEA §22(b)(4) in a later, as yet immature claim against the Exchange; and most certainly, I could not at the early stage of the filing of a Membership Application, understand and appreciate the interrelationship between those Arbitration Rules and the requirements of CEA §22(b)(4).

39. It is submitted that the CME knew and intended to take advantage of this inability; and intended by its terse and otherwise unsupported assertions in the CME Rules to circumscribe the scope and ambit of CEA §22(b)(4), in an attempt to stultify any claims that might be asserted against the CME by members such as Plenum Fund.

40. In fact, even after this action was commenced, and I received a copy of Defendants' Memorandum, I was only able to appreciate these distinctions and niceties when Plenum Fund's counsel elucidated Plenum Fund's managers, operators and advisors, including me, on this complex and subterranean issue. But for that tutorial I could not have been expected, and I would not have been able to identify the fact that any

the CME to pursue its erroneous claim that the CME Arbitration Rules provide for the mandatory arbitration of the claims of the Complaint herein.

agreement to arbitrate a claim that required proof of bad faith could only be reasonably pursued to the extent that the tools for the unmasking of such bad faith were available, which they would not be if Plenum Fund agreed to arbitrate a CEA §22(b)(4) claim.

41. Although Plenum Fund's managers and advisors were experienced in commodity transactions, they, and thus Plenum Fund, were without any effective capacity to know or understand that there were material disabilities that would be visited and imposed upon Plenum Fund by virtue of an implied and imputed agreement to arbitrate any claim Plenum Fund might later, at some undetermined and unanticipated time, assert against the CME, in circumstances where it would have to prove "bad faith' in order to prevail on such a claim; but could not reasonably do so in the context of the limited disclosure and discovery generally afforded by arbitration.

42. In retrospect, even if I had read the CME Arbitration Rules (as compared to the CME Rules of broader application to trading contracts and margin requirements), and although I might have perceived a comprehension of those Rules, it is clear that I and other management personnel acting for Plenum Fund would have been misperceived in any such assessment; and, in fact, we could not have actually and effectively appreciated the distinctions and fine points necessary to have achieved and made a voluntary and cognitive decision on a very complex, but materially important issue relating to substantial economic interests of Plenum Fund.

43. It is thus asserted that the CME, being a "quasi governmental" instrumentality, charged under the CEA with what I understand to be an affirmative program and obligation of "self-regulation"[6], in pursuance and in protection of the "public

[6] As a contract market, the CME's activities are regulated by the Commodity Futures Trading Commission, pursuant to CEA, 7 U.S.C. § 1, et seq. The CME's status as a contract market imposes upon it a duty of self-regulation, subject to oversight by the CFTC. (See, Complaint, paragraphs "29" and "30"

interest", the CME should have made, but did not make, affirmative disclosures, warnings and admonitions with respect to Plenum Fund's consideration, and as to its adoption of and/or consent to the CME "Arbitration Rules". This is all the more compelling because the CME must be deemed to know, and it should have known, about this systemic disability and prejudicial effect that it achieved indirectly, but not openly upon any kind of full or appropriate disclosure.

44. I am advised that it is the surmise of the Rosenberg Declaration that it was the CME's purpose in amending its Rules to require mandatory arbitration of a member's claims against it, and to require that any arbitration claim be filed within ten days, or be barred, to limit the recovery of damages by members under and pursuant to CEA §22(b); and I understand that it will be necessary for Plenum Fund to conduct discovery to demonstrate that point in connection with Plenum Fund's request that this Court order a Jury Trial.

45. Having read the Rosenberg Declaration, and having been imbued with the unavoidable notion that the CME must have inserted just a few terse provisions in the CME Arbitration Rules in response to the adoption of CEA §22(b)(4), and as part of an effort to protect the CME from such claims by invoking an arbitration requirement, without taking the time to more fully amend those rules, which might catch the eye of the CFTC and unmask it nefarious purpose to inhibit the application of CEA §22(b)(4), it is suggested that this circumstance alone, and apart from the other bases herein set forth, supports Plenum Fund's demand for a jury trial on the issues related to the efficacy of the Arbitration Rules; and that a trial should be ordered—to the extent that Defendants' motion is not denied outright. (See, Ex. "A" to Rosenberg Declaration)

46. Thus, for the absence of doubt and for purposes of clarity, it is postulated that the CME's abstinence and refrain from disclosure regarding the risks and disadvantages of a member agreeing to be bound by the Arbitration Rules, is part of an overall intentional and preconceived approach and stratagem, intended to discourage and make it more difficult for members to bring and sustain claims against the CME, pursuant to CEA, § 22(b)(4); and that such Rules and procedures are therefore antagonistic and contrary to the purposes, intent and effect of that statute and also with respect to the Core Principles.

47. It is equally suggested that the refrain from such disclosures and warnings is an essential and constituent part of the "procedural unconscionability" which must be deemed to vitiate Plenum's purported consent to arbitration, since absent some remedial effort by the CME to counteract this informational and practical disparity of position and knowledge, it was not reasonably practical for Plenum Fund to "locate, appreciate and comprehend the scope and import" of its implied, but not actual, agreement to submit to the CME's Rules relating to Arbitration in the context of having to prove "bad faith" on the part of the CME in failing and refusing to enforce its Rule 588.

48. This disability and intended advantage is not passive on the part of the CME. Rather, it is pursued and achieved by the CME's intentional and "practiced practice" of not seeking separate and distinct confirmation, approval and agreement regarding its Arbitration Rules. This results because such separate consideration might or would lead to a more isolated review, and thus to insistence on alternative provisions—including broader facilities for discovery and cross examination of witnesses and documents.

49. Thus, it is suggested that based on an apparent intent to subvert a full understanding and appreciation of the potential dilemma and disadvantage for a member,

the CME implements a process and procedure pursuant to which it seeks implicate an agreement as to the Arbitration Provisions by the act of an applicant signing and submitting a membership application, and by asserting an agreement to arbitrate when that application is accepted, including by the mechanism of CME Rule 400 (see, Ex. "D" to Rosenberg Declaration), pursuant to which the member is "***deemed*** to know, consent to and to be bound by all Exchange rules." This is hardly the type of open and full disclosure that should be provided by a quasi governmental instrumentality, charged with protecting the public interest.

50. Directly related to the issue of "procedural unconscionability" and as suggested by the accompanying Rosenberg Declaration, the Court should consider the fact that Plenum Fund did not otherwise have the ability to follow and comply with the CME arbitration rules even if it understood and wished to comply with them. This results because of the inherent unfairness and/or abject inappropriateness of such Rules, and the insipid inconsistencies and variations between provisions of those Rules, which would preclude any notion of justicability as to any claims which might be asserted by a member against the CME. This point is made with greater clarity and resolve in the Rosenberg Declaration.

51. Therefore, it is submitted that even if Plenum had acted pursuant to the express language of the CME Arbitration Rules, with an intent and purpose of timely filing a claim against the Exchange and prosecuting such claim, those rules would have, if taken literally, placed Plenum Fund in a situation of procedural inequity, unfairness and disadvantage, as would constitute an abject sham of any type of adversarial proceeding; including because those Rules so heavily and one-sidedly impart broad discretion in favor

of the CME, as to make any claim that such Rules provide a procedure for compulsory arbitration a mere pretense; and violative of the Core Principles imposed on the CME.

52. Since this position is more fully set out and analyzed in the Rosenberg Declaration, I will not burden the Court with my own, current views; but having read, reviewed and considered the analysis presented by the Rosenberg Declaration I embrace it and join in it on behalf of Plenum Fund.

53. Nonetheless, I do feel compelled to provide a limited personal observation to illuminate that portion of the Rosenberg Declaration that suggests that it was otherwise impractical for Plenum Fund to have timely filed a detailed claim form, even if it otherwise endeavored to do so.

54. Any attempt at such compliance would have been precluded by, among other things, the following circumstances: (i) In the hours after the January 14, 2008 incident, Plenum Fund's management was necessarily engaged in a dedicated program of trading intended to, and which did, mitigate its damages by millions of dollars with respect to the January 14, 2008 incident; (ii) thereafter the Plenum Fund management team halted all Plenum Fund trading until in or about April, 2008, including in pursuance of an intensive course of identifying, correcting and preventing any recurrence of any glitches in its automatic trading system; (iii) in the days and weeks following the January 14, 2008 incident, Plenum Fund management was heavily involved and concerned with investor relations problems, relating to its $6 million trading loss, and was repeatedly and continually required to respond to the concerns and inquiries of its investors; (iv) the task of identifying the nature and extent of the CME's "bad faith' (recently admitted by CME employees in a telephone conversation with me and present counsel, had in August, 2008), was extremely time consuming and difficult, including for the reasons related to the

difficulties of obtaining proof of such "bad faith"; (v) separately, Plenum Fund experienced great difficulty in identifying and retaining appropriate counsel, meeting with such counsel and conveying to them the underlying issues in sufficient time and manner to file any requisite claim forms. Many of the counsel with which and with whom we met, took substantial time in conducting a "conflicts check", and/or after hearing about the circumstances of Plenum Fund's claims, indicated that having represented either parties against the CME, or the CME, they could and did not accept an engagement on behalf of Plenum Fund.

55. For the foregoing reasons, it would have been impractical to file a formal claim in sufficient detail within the ten business day requirement; and there does not appear to be any any provision providing for any extension of time. Rather the CME Arbitration Rules cut off any claim not timely filed within such ten day period—as Plenum Fund believes they were designed to do. In addition, I have not been able to find any reference to and/or source of the required and approved claim form, other than the form of consent referenced in the Rosenberg Declaration.

56. The circumstance of a claim by a member against an exchange implicates substantial and important economic rights, Intended to be preserved and served by CEA §22(b)(4); and it is nothing less than unseemly that the CME would and does purport to seek to cut off and/or curtail its own liability on such a short notice and time as ten days, in circumstances that will most likely be analogous for other members similarly situated to Plenum Fund in respect to its Erroneous Trades. It would seem inescapable that such a truncated time period is inconsistent with the intent and purposes of CME, § 22(b).[7]

[7] In any event, it is worthy of note that when I and other Plenum Fund managers were able to

Unmasking CME's Hidden Agenda
Regarding Its Pursuit of Arbitration.

57. Neither the CME executives, nor its counsel, the Skadden Arps firm may be considered to be anything less than highly intelligent, experienced and accomplished in their respective fields. Therefore, it may be assumed that they can read and interpret the CME Rules as well as Plenum Fund and its counsel.

58. From this it may be discerned that they are not unmindful that the contention set forth in Defendants' Memorandum to the effect that CME Rule 621 sets forth the procedures for mandatory arbitration is not supported by actual or literal resort to the text of Rule 621, and/or the other Rules contained in Chapter 6, incorporated thereby.

59. Nonetheless, the CME unabashedly seeks to promote a motion that is not supported by the documentary evidence; and which, more perniciously, seems contrary to the plain language of the CME's own rules. To take such a risk in this context must be seen to suggest some hidden agenda of great and important purpose and magnitude, including that absent this mercurial application, it is likely that Plenum Fund's claims will get the public airing they deserve, or even worse for the CME, Plenum Fund will be able to prove and demonstrate its claims of "bad faith".

60. In this context there is great need and reason on the part of the CME to pursue and attempt to bring about an arbitration, with two primary reasons for this, among others:

(1) The first of course is that once the CME is able to move this matter to arbitration it will seek to preclude the hearing of any claim by Plenum Fund, and will seek the

consult with counsel, long prior to the commencement of the Complaint herein, we were advised by counsel that there was a $100,000.00 damage limitation, and that it would be a useless act, since Plenum Fund could incur that amount or more in proving its claims. For this reason also, Plenum Fund did not file a claim in pursuance of arbitration.

dismissal of the Arbitration by claiming that Plenum Fund did not timely file a claim form detailing its claims against the CME within the short and circumscribed time period putatively imposed by the CME Arbitration Rues; and

(2) Second, and paramount if the first tactic fails, is the perception that the far more limited discovery available in and disclosure required by arbitration will greatly inhibit or preclude Plenum's ability to prove "bad faith" on the part of the CME. Exacerbating this need and fear is the fact that the CME has already admitted that in the minutes immediately following the January 14 Event it was actively engaged in telephone calls with some of its member/traders (intimated to be some of the larger trader/members), and perhaps thereby inattentive to its otherwise existing obligations to conclude a decision in regard to the implementation of its "no bust rules and policy." By reason of the more limited discovery available in arbitration, it appears that the CME and its counsel are hopeful of avoiding depositions and electronic discovery that might reveal which customers were engaged in these telephone calls, at what time, and for what length of time, and to prevent Plenum Fund from demonstrating that the CME was more interested in protecting and enriching its large trader/members than it was in protecting the integrity of the market and the public interest.

61. This admission came in the course of an attempt by the CME to dissuade Plenum Fund from initiating the Complaint herein. For this purpose a conference call was agreed to and conducted on August 21, 2008, participated in by Plenum Fund's counsel, Jeffrey L. Rosenberg and me on behalf of Plenum Fund and Steven Szarmack, in-house counsel for the CME and Paul Milhoff and Michael McDonald, CME operations and trading personnel.

62. In response to Mr. Rosenberg's observation during that conference call that it was Plenum Fund's contention that CME personnel were engaged in telephone discussions with some its larger trader/customers, discussing their profit and loss situation in respect to Plenum Fund's Erroneous Trades, and for that reason Plenum Fund could not get through to the CME to inform and advise them of the circumstances then known with respect to such Erroneous Trades, the CME admitted this; and admitted that its phones were completely inundated and tied up with those calls.

63. I am aware that Defendants' counsel was furious when they observed that this admission was referenced in the Complaint, and they have claimed to Plenum Fund's counsel, including local Illinois counsel, James McGurk, that evidence of this admission was the subject of a prior confidentiality agreement and it was improper to set it forth.

64. Whatever may be the effectiveness of any prior confidentiality agreement, including a claim that it is invalid because it encompasses an effort by counsel to cover up the violation of a Federal Statute, the conversations had on August 21, 2008 in the context of the foregoing conference call were not confidential. CME's in-house attorney, Steven Szarmack was participating in that call at all times, and there was not any mention or claim of confidentiality as related to those discussions.

65. Thus, despite the lack of substantive support for the motion to compel to be discerned from the text of the CME Arbitration Rules, and the other failings resulting from direct or indirect coercion in regard to those Rules, the CME, at the behest and upon the orchestration of its counsel, has pursued its motion to compel arbitration, in effect, as a defense to this potentially damaging admission.

66. It is suggested that this hidden agenda, borne of desperation and fear of public dissemination regarding the CME's bad faith, which, in turn, may lead to a CFTC investigation of this impropriety, has encompassed direct and not so subtle attempts to coerce Plenum Fund to either give up its claims, including by reason of economic browbeating predicated on the CME's ability to out-spend Plenum Fund on unwarranted motion practice, and by other, more direct coercion--including Skadden Arps' threats made against each counsel that has thus far sought to represent Plenum Fund, at each stage of the pending controversy, in the form of threatening Plenum Fund and such counsel with a Rule 11 Motion for sanctions.

67. A form of that motion was recently sent to current counsel and will be the subject of a separate response on or about December 21, 2008. Without further amplification, it is sufficient to note this coercion was sought to be applied in conjunction with the pending motion to compel arbitration, and intended to bolster an otherwise unavailing attempt to preclude this Court from hearing and trying the matters asserted by the Complaint. It may yet eventuate if Defendants' counsel do not withdraw that threat of a Rule 11 motion, that Plenum Fund may suggest to the Court that the form of Rule 11 motion for sanctions, and the threat to interpose such a motion, were themselves indicia and constituent elements of frivolous conduct precluded by Rule 11, and therefore sanctionable.

68. Nonetheless, and notwithstanding my disdain for such unmitigated and uncloaked coercion, and in order to avoid the protraction of motion practice and the costs and fees associated therewith, and to move this matter to a determination as soon as practical, I authorized and urged Plenum Fund's counsel to agree with the CME's counsel to submit this matter to arbitration and to withdraw from this litigation, predicated

on two primary conditions, among others: (1) that the CME would not seek to claim that the arbitration should be dismissed by reason of the failure of Plenum Fund to timely file any prescribed claim form, detailing and initiating that proceeding; and (2) that any arbitration would necessarily have to encompass the expanded facilities of the Federal Rules as to discovery and disclosure. Implicitly, if such an agreement to arbitrate was to be reached, there would also have to be adoption and/or incorporation of some set of external arbitration rules, such as those of the National Futures Association or the American Arbitration Association, since, as demonstrated by the Rosenberg Declaration, the CME Arbitration Rules do not provide a sufficient infrastructure and are unfair and unworkable and violate the impositions and obligations of the Core Principles.

69. This importunity was made by the instrumentality of Plenum Fund's counsel's letter to Jerrold Salzman, Esq., dated December 2, 2008, a copy of which is annexed as Exhibit "B" to the Rosenberg Declaration.

70. I am advised that Mr. Salzman wasted no time in eschewing that importunity, and by e-mail transmitted at about 9:05pm on Friday evening, December 5, 2008, Mr. Salzman responded: "We are not prepared to waive any substantive or procedural defenses."

71. That may have been a matter of good fortune for Plenum Fund, since "our backs" were thereafter steeled for battle, inclusive of the machination of an unsupported motion to arbitrate and the Rule 11 threats, which individually and collectively, all the more appear to be part of a desperate attempt to hide from public scrutiny the CME's "bad faith" conduct.

The Court Should Not Stay the Case Management Rules
or Any Preliminary Discovery and Disclosure in this Action.

72. To the extent that Defendants' Motion to Compel Arbitration is denied outright, no stay of the "Case Management Rules" is appropriate. Furthermore, if, in the alternative, this Court determines that the issue of the validity of the CME Arbitration Rules should be submitted for determination by a jury trial, in that circumstance also the "Case Management Rules' should not be stayed or suspended, since Plaintiff will be entitled to discovery in that connection, and the discovery in that circumstance and the discovery in connection with the underlying action are not so different and would not be significantly more costly in comparison to one another, such that it would be a duplication and inefficient to have two disparate flights of discovery and disclosure, and one should proceed now without abatement since it will be required in connection with a jury trial in any event.

Conclusion.

73. For the foregoing reasons, and based on the accompanying Declaration of Jeffrey L. Rosenberg, and as set forth Plaintiff's accompanying Memorandum of Law, it is respectfully submitted that Plenum Fund has established, at minimum, the existence of one or more material facts with respect to whether its consent or approval in connection with any agreement to arbitrate its claims against the CME was volitional and/or effective, including whether such consent was voluntary or cognitively appreciated, and whether any such agreement to arbitrate, as a distinct and servable agreement, is unenforceable, including by reason of substantive and/or procedural unconscionability; and therefore, at a minimum, this Court should direct that a jury trial should be held on such issues, including by reason of the filing of Plaintiff's Demand for a Jury Trial.

74. More optimistically and expansively, it is contended that by reason of the facts and circumstances set forth herein and in Plaintiff's accompanying opposition papers, Plaintiff has established that any agreement to arbitrate was not voluntary and/or enforceable, and/or that in these circumstances the CME Arbitration Rules are inconsistent with and antagonistic to and precluded by CEA. § 22(b), and may not therefore be enforced in the circumstances of this action.

WHEREFORE, for all of the foregoing reasons, Defendants' motion to stay and motion to compel arbitration should both be denied, and in the alternative, a jury trial should be directed as specified above.

Steven A. LaPierre

Sworn to before me
on the 19 day of December, 2008

NOTARY PUBLIC

COMMONWEALTH OF PENNSYLVANIA
Notarial Seal
Albert A. Scales, Notary Public
Middletown Twp., Bucks County
My Commission Expires Dec. 18, 2012
Member, Pennsylvania Association of Notaries

PAC 7-1/3

CME Group
A CME/Chicago Board of Trade/NYMEX Company

C.F.T.C.
OFFICE OF THE SECRETARIAT
2009 JUN 9 PM 4 30

June 8, 2009

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

RE: Request for Repeal of Regulation 7.201

Dear Mr. Stawick:

Pursuant to Commodity Futures Trading Commission ("Commission") Regulation 13.2, CME Group Inc. hereby petitions the Commission to repeal Regulation 7.201 (Customers' claims and grievances) which refers to The Board of Trade of the City of Chicago's ("CBOT") legacy Regulation 620.01(B). This request for repeal is based on the grounds that Regulation 7.201 is no longer necessary, having been superseded by a CBOT rule that fully conforms to the Commission's intent in originally imposing Regulation 7.201.

In 1981, the Commission disapproved proposed CBOT Regulation 620.01(B), dealing with the arbitration of customer claims, on the grounds that the Regulation, as originally proposed, did not compel CBOT members to participate in customer-initiated arbitrations. The Commission determined that the Regulation violated Section 5a(11) of the Commodity Exchange Act ("Act"), which required each contract market to "provide a fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof..."

Pursuant to the authority of Section 8a(7) of the Act, the Commission altered and supplemented the CBOT's regulation to implement a Commission-drafted version of CBOT Regulation 620.01(B). The revised regulation was also incorporated into the Commission's rules as Regulation 7.201. The revised Regulation compelled CBOT members to submit to arbitration claims initiated by customers. Subsequently, in 1984, CBOT amended Regulation 620.01(B) to conform to the 1982 amendments to the Act which repealed a statutory limit of $15,000 on the size of claims that could be arbitrated.

In connection with the merger of Chicago Mercantile Exchange Holdings Inc. with CBOT Holdings, Inc. in 2007, CBOT eliminated Regulation 620.01(B) on November 25, 2007, as part of the harmonization of CBOT rules with those of Chicago Mercantile Exchange Inc. ("CME"). On that date, CBOT adopted Rule 600.D., which is, in every respect, identical to CME Rule 600.D. The new rule provides that a CBOT member is "... required to arbitrate ... claims of a customer against a member that relate to or arise out of any transaction on or subject to the rules of the Exchange." A copy of CBOT Rule 600.D. appears on the next page.

Given that CBOT Rule 600.D. has, since November 25, 2007, compelled members to submit to arbitration claims initiated by customers, and the rule fully conforms to the Commission's intent in originally imposing Regulation 7.201, CME Group Inc. respectfully requests that Regulation 7.201 be deleted as it is duplicative, unnecessary and inaccurate in its reference to a legacy CBOT Regulation.

If you have any questions regarding this request, please contact me at 312.341.5991.

Sincerely,

Robert A. Sniegowski
Associate Director, Market Regulation Department

CBOT Rule 600.D.

600.D. Permissive Arbitrations

The following may be submitted for arbitration at the Exchange and, in the event such a claim is submitted against a member, that member is required to arbitrate the dispute under these rules, unless otherwise provided:

1. claims of a customer against a member that relate to or arise out of any transaction on or subject to the rules of the Exchange;
2. claims against an Exchange clearing member and its Globex user pursuant to Rule 588.C.3.a., b. or c., where the claimant has complied with the provisions of Rule 588.D., and pursuant to Rule 588.C.3.d., provided that any non-member Globex user has consented to arbitration of the dispute at the Exchange within 21 days of receipt of a claim;
3. [Reserved];
4. [Reserved];
5. claims of a non-member (other than those claims required to be arbitrated under Rule 600.B) against a member that relate to or arise out of employment on the trading floor;
6. claims by or against an entity whose majority ownership is held by Exchange members and whose principal business relates to activity on or at the Exchange, where the dispute has a material connection to the business or purpose of the Exchange, provided such entity has consented to arbitration of the dispute at the Exchange within 20 days of receipt of a claim; and
7. at the discretion of the Chief Regulatory Officer, any claim involving the interests of the Exchange, its members, their business relations or commodity futures trading in general not otherwise arbitrable under these rules, provided the parties have consented to such arbitration.

MSA 7/7/6

CME Group
A CME/Chicago Board of Trade/NYMEX Company

C.F.T.C.
OFFICE OF THE SECRETARIAT
2010 APR 7 PM 2 32

April 6, 2010

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition for Amendment of Commodity Futures Trading Commission Regulation 150 2

The Board of Trade of the City of Chicago, Inc. ("CBOT®" or "Exchange") hereby petitions, pursuant to Commodity Futures Trading Commission ("Commission" or "CFTC") Regulation 13.2, that the Commission amend its Regulation 150.2 (Position Limits). Open interest in Corn, Wheat, Soybean, and Soybean Oil futures and options contracts has increased significantly since speculative position limits were last updated for these contracts. Speculative position limits were last updated for these commodities in June and December 2005 (a phased implementation) based on 2004 open interest.

Increased open interest supports higher speculative position limits (for single-month and all-month limits) for these contracts based on a formula used by the Commission in the past to determine approved speculative limits for enumerated commodities. The CBOT is not seeking any amendments at this time in the spot month limits for these products or in any of the limits for Oats or Soybean Meal.

Currently, the single-month and all-month speculative limits for Corn stand at 13,500 and 22,000 contracts, for Wheat at 5,000 and 6,500 contracts, for Soybeans at 6,500 and 10,000 contracts, and for Soybean Oil at 5,000 and 6,500 contracts, respectively. Based on open interest data, we are proposing that Regulation 150.2 be amended to provide for new limits as follows: single-month and all-month speculative limits for Corn at 20,500 and 33,000 contracts; for Wheat at 9,000 and 12,000 contracts; for Soybeans at 10,000 and 15,000 contracts; for Soybean Oil at 6,500 and 8,000 contracts; respectively.

A. Current Regulation 150.2

Regulation 150.2 establishes speculative position limits for named agricultural contracts that are traded on specifically identified designated contract markets. For Chicago Board of Trade products, those limits are currently set forth as follows:

Speculative Position Limits
[By contract with regular and min-sized contracts aggregated pursuant to the regulation]

Limits by number of contracts

Contract Spot month Single month All months

Chicago Board of Trade

Contract	Spot month	Single month	All months
Corn (and Mini-Corn)	600	13,500	22, 000
Oats	600	1,400	2,000
Soybeans (and Mini-Soybeans)	600	6,500	10,000
Wheat (and Mini-Wheat)	600	5,000	6,500
Soybean Oil	540	5,000	6,500
Soybean Meal	720	5,000	6,500

B. Single-month and all-months speculative position limits for CBOT Corn, Soybeans, Wheat, Soybean Oil and Soybean Meal should be increased.

The Exchange requests that the Commission raise such limits for CBOT contracts as follows:

Deletions [~~bracketed~~] and ~~struck-through~~; Additions **bolded** and **underlined.**

Contract	Spot month	Single month	All months
Corn (and Mini-Corn)	600	**[~~13,500~~] 20,500**	**[~~22,000~~] 33,000**
Oats	600	1,400	2,000
Soybeans (and Mini-Soybeans)	600	**[~~6,500~~] 10,000**	**[~~10,000~~] 15,000**
Wheat (and Mini-Wheat)	600	**[~~5,000~~] 9,000**	**[~~6,500~~] 12,000**
Soybean Oil	540	**[~~5,000~~] 6,500**	**[~~6,500~~] 8,000**
Soybean Meal	540	5,000	6,500

As noted, trading volume and open interest in Corn, Soybean, Wheat and Soybean Oil futures and options contracts has increased significantly since the Commission last revised its single-month and all-month position limits for these products. Therefore, the Exchange determined to examine the efficacy of the existing single-month and all-months-combined speculative position limits in light of the increased participation in these markets.

1. Market participants historically have supported increased speculative position limits.

Over the years, the Federal position limits for the enumerated commodities listed for trading on the CBOT have been raised on numerous occasions. Our market users have consistently supported increases in those limits, and we are not aware of any information that indicates any change has occurred in those longstanding views. In addition, most supporters of increased limits historically have preferred that the ratio of single-month to all-months limits remain in roughly the same proportions as they exist today. Thus, the CBOT has generally maintained these proportions in the levels that it has proposed for single-month and all-months-combined speculative position limits.

2. The proposed increases are justified by the application of the percentage of open interest formula that has been adopted by the Commission as the appropriate method for determining the levels of single-month and all-months speculative position limits.

Since 1992, the Commission has consistently taken the position that the levels of single-month and all-months speculative position limits are appropriately based upon a percentage of average open interest in the relevant contracts. The applicable formula is clearly stated in Regulation 150.5(c)(2), as follows:

> Individual nonspot or all-months-combined levels must be no greater than 10% of the average combined futures and delta-adjusted option month-end open interest for the most recent calendar year up to 25,000 contracts with a marginal increase of 2.5% thereafter...

Regulation 150.5(c)(2) specifically addresses exchange-set speculative position limits for physical delivery contracts that are not enumerated in Regulation 150.2. However, the Commission applied the same open interest criterion and numeric formula when it proposed to raise the single-month and all-months limits for CBOT agricultural commodities to their current levels, beginning in 1992. Revision of Federal Speculative Position Limits, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,268 (57 F.R. 12766, April 13, 1992).

When increases in single-month and all-months position limits previously were finally adopted in May 1999, the Commission indicated that it would consider future increases to the speculative position limit levels for all [Regulation 150.2] contracts as open interest or large traders' positions increased. Furthermore, the Commission invited petitions such as the instant one, by explicitly stating that ". . . an exchange may petition the Commission for rulemaking any time that a contract meets the criteria supporting an increase in the levels." Revision of Federal Speculative Position Limits and Associated Rules, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,608, at 47,883-47,884 (64 F.R. 24038, May 5, 1999).

The application of the Commission's percentage of open interest formula to CBOT Corn, Soybeans, Wheat and Soybean Oil contracts clearly supports the Exchange's proposed increases in the single-month and all-months speculative position limits. It should be noted that, consistent with the CBOT's historical practice, the new limits that we are proposing have been rounded down by several hundred lots from the maximum levels suggested by the open interest data.

The 2009 average month-end futures and futures equivalent option open interest in Corn was 1,263,064 contracts. CFTC Regulation 150.5 criteria, when applied to Corn, suggests that appropriate speculative limits would be up to 33,452 single-month and all-month contracts. Therefore, the Exchange proposes that Regulation 150.2 be amended to roughly maintain the current ratio between single-month and all-months-combined limits, with a 20,500 single-month speculative position limit and a 33,000 all-months speculative position limit for Corn.

The 2009 average month-end futures and futures equivalent open interest in Soybeans was 536,133 contracts. CFTC Regulation 150.5 criteria, when applied to Soybeans, suggests that appropriate speculative limits would be up to 15,278 single-month and all-month contracts. Therefore, the Exchange proposes that Regulation 150.2 be amended to roughly maintain the current ratio between single-month and all-months-combined limits, with a 10,000 single-month speculative position limit and a 15,000 all-months speculative position limit for Soybeans.

The 2009 average month-end futures and futures equivalent open interest in Wheat was 405,098 contracts. CFTC Regulation 150.5 criteria, when applied to Wheat, suggests that appropriate speculative limits would be up to 12,002 single-month and all-month contracts. Therefore, the Exchange proposes that Regulation 150.2 be amended to roughly maintain the current ratio between single-month and all-months-combined limits, with a 9,000 single-month speculative position limit and a 12,000 all-months speculative position limit for Wheat.

The 2009 average month-end futures and futures equivalent open interest in Soybean Oil was 262,932 contracts. CFTC Regulation 150.5 criteria, when applied to Soybean Oil, suggests that appropriate speculative limits would be up to 8,448 single-month and all-month contracts. Therefore, the Exchange proposes that Regulation 150.2 be amended to roughly maintain the current ratio between single-month and all-months-combined limits, with a 6,500 single-month speculative position limit and a 8,000 all-months speculative position limit for Soybean Oil.

Spreadsheets reflecting the data used to make the calculations described in the preceding paragraphs are attached as Appendix A.

3. The proposed increases are also supported by the distribution of large trader positions in the relevant markets.

As discussed above, when the Commission proposed to raise the single-month and all-months position limits for CBOT agricultural products to their current levels in 1992, it did so with reference to the percentage of open interest formula that is described in Regulation 150.5(c)(2). However, the Commission determined that the distribution of speculative traders in the markets continued to be a relevant criterion, and even concluded that higher limits than those suggested by the open interest formula may be appropriate where it appears that such levels ". . . would constrain the normal pattern of speculative trading." Revision of Federal Speculative Position Limits, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,268, at 38,862, and fn. 18 and 19 (57 F.R. 12766, April 13, 1992).

Accordingly, when the Commission re-proposed the current levels of single-month and all-months limits for CBOT products on July 17, 1998, it indicated that increases in the relevant numbers of large traders and the size of their positions, as well as increased open interest, justified the proposed increases. Revision of Federal Speculative Position Limits and Associated Rules, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,354, at 46,612-46,613 (63 F.R. 38525, July 17, 1998).

Appendix B contains charts and graphs that Exchange staff has compiled from the Commission's Commitment of Traders Reports. In particular, these charts and graphs reveal significant increases in the numbers of large traders; however, the percentage of open interest held by any category of large trader has remained relatively constant despite increases in the speculative position limits in late 2005 and significant increases in open interest. This suggests any additional speculative activity attracted through increased speculative position limits also attracts corresponding activity from other categories of traders.

Between the first CFTC Commitment of Trader (COT) report in 2006 (immediately following the last increase in speculative position limits and when the CFTC began isolating Index Funds in the COT Report) and the first COT report in 2010, open interest has increased 30, 29, 47, and 23 percent in Corn, Wheat, Soybeans, and Soybean Oil, respectively. Likewise, the number of large reportable traders has increased 20, 35, 32, and 42 percent in Corn, Wheat, Soybeans, and Soybean Oil, respectively. These markets have grown significantly since the last speculative position limit increase. Looking more closely at outright speculators in the market, the number of outright reportable speculators in Corn has increased 13 percent while the percentage of outright open interest held by these reportable speculators has decreased 0.69 percent. The number of outright reportable speculators in Wheat has increased 27 percent while the percentage of outright open interest held by these reportable speculators has decreased 0.01 percent. The number of outright reportable speculators in Soybeans has increased 41 percent while the percentage of outright open interest held by these reportable speculators has increased only 2.88 percent. The number of outright reportable speculators in Soybean Oil has increased 73 percent while the percentage of outright open interest held by these reportable speculators has decreased 0.72 percent.

In short, the data reflected in Appendix B shows a relationship between increased speculative activity and increased commercial activity. Increasing the single-month and all-months speculative limits would facilitate increased speculative trading in these markets. More speculative trading, within appropriate limits, would provide greater liquidity, which, in turn, would allow commercial market participants to hedge their risks more effectively.

C. Conclusion

The Exchange requests that the Commission amend Regulation 150.2 to raise the single-month and all-months limits applicable to CBOT Corn, Soybeans, Wheat and Soybean Oil to the levels specified above and for the reasons discussed therein.

The Exchange is also submitting a request to the Commission for approval of amendments to Position Limit, Position Accountability and Reportable Level table in the Interpretations & Special Notices section at the end of Chapter 5 of the CBOT's rulebook, which reflect increases to the Exchange's single-month and all-months-combined speculative position limits that are identical to those described above. A copy of the proposed amendments is included as an attachment to this petition.

If you have any questions about this Petition, please contact Dave Lehman, Managing Director, Commodity Research and Products, at (312) 930-1875; Fred Seamon, Associate Director, Commodity Research and Development, at (312) 634-1587; or Brian Regan, Managing Director, Regulatory Counsel, at (212) 299–2207.

Sincerely,

Brian Regan

Brian Regan

cc: Steve Sherrod
David Van Wagner

Att.

Soybean

	Fut OI	Mini OI	Tot Fut OI	Opt OI	Delta Adj	Total OI
Jan-09	316,740	12,720	319,284	490,995	135,856	455,140
Feb-09	287,291	7,955	288,882	378,240	113,890	402,772
Mar-09	316,690	13,864	319,463	459,057	130,056	449,519
Apr-09	379,123	14,169	381,957	457,858	143,182	525,138
May-09	449,219	22,593	453,738	612,801	189,971	643,709
Jun-09	437,046	21,241	441,294	498,892	140,957	582,252
Jul-09	391,411	22,417	395,894	539,533	150,450	546,344
Aug-09	406,047	23,915	410,830	588,846	153,895	564,725
Sep-09	449,622	22,345	454,091	635,742	151,345	605,436
Oct-09	422,117	11,404	424,398	358,033	101,816	526,214
Nov-09	472,376	18,873	476,151	437,889	126,958	603,109
Dec-09	418,247	12,589	420,765	403,391	108,471	529,236
						536,133

Appendix A

CFTC LIMIT	15,278

Soyoil

	Fut OI	Mini OI	Tot Fut OI	Opt OI	Delta Adj	Total OI
Jan-09	208,505	0	208,505	116,183	41,615	250,120
Feb-09	212,449	0	212,449	81,372	31,170	243,619
Mar-09	208,168	0	208,168	103,876	33,642	241,810
Apr-09	201,919	0	201,919	109,605	37,312	239,231
May-09	230,938	0	230,938	153,049	47,645	278,583
Jun-09	241,338	0	241,338	128,783	41,800	283,138
Jul-09	250,411	0	250,411	148,766	42,335	292,746
Aug-09	228,994	0	228,994	145,134	39,434	268,428
Sep-09	209,535	0	209,535	142,807	36,135	245,670
Oct-09	235,620	0	235,620	177,330	43,917	279,537
Nov-09	256,432	0	256,432	98,051	34,542	290,974
Dec-09	208,809	0	208,809	97,832	32,520	241,329
						262,932

CFTC LIMIT	**8,448**

Corn

	Fut OI	Mini OI	Tot Fut OI	Opt OI	Delta Adj	Total OI
Jan-09	819,228	7,153	820,659	1,299,392	424,685	1,245,343
Feb-09	738,231	5,429	739,317	958,190	341,266	1,080,583
Mar-09	811,140	8,326	812,805	1,186,758	413,061	1,225,867
Apr-09	780,468	7,375	781,943	1,083,579	375,062	1,157,005
May-09	946,579	10,277	948,634	1,230,683	418,636	1,367,270
Jun-09	922,119	9,678	924,055	1,079,719	354,854	1,278,909
Jul-09	882,162	10,051	884,172	1,243,845	435,585	1,319,757
Aug-09	834,091	9,221	835,935	1,177,031	412,614	1,248,549
Sep-09	854,372	10,306	856,433	1,349,731	458,742	1,315,175
Oct-09	958,573	11,164	960,806	1,419,419	476,266	1,437,071
Nov-09	973,178	7,534	974,685	688,071	243,980	1,218,665
Dec-09	1,001,511	9,349	1,003,381	760,509	259,187	1,262,567
					Average OI	1,263,064

CFTC LIMIT	33,452

Wheat

	Fut OI	Mini OI	Tot Fut OI	Opt OI	Delta Adj	Total OI
Jan-09	285,967	1,667	286,300	292,619	86,054	372,354
Feb-09	282,313	1,648	282,643	227,839	75,063	357,705
Mar-09	314,959	1,832	315,325	306,486	97,388	412,714
Apr-09	288,413	1,778	288,769	261,241	80,550	369,318
May-09	331,842	1,746	332,191	321,703	101,495	433,686
Jun-09	312,061	1,265	312,314	228,592	71,024	383,338
Jul-09	324,580	1,256	324,831	268,811	82,035	406,866
Aug-09	308,820	1,317	309,083	236,395	76,823	385,906
Sep-09	333,834	1,463	334,127	287,312	96,451	430,577
Oct-09	339,088	1,670	339,422	331,171	109,280	448,702
Nov-09	350,706	1,838	351,074	205,141	69,365	420,439
Dec-09	362,342	2,086	362,759	218,386	76,810	439,569
						405,098

CFTC LIMIT	**12,002**

Appendix - 15

CME Group

A CME/Chicago Board of Trade/NYMEX Company

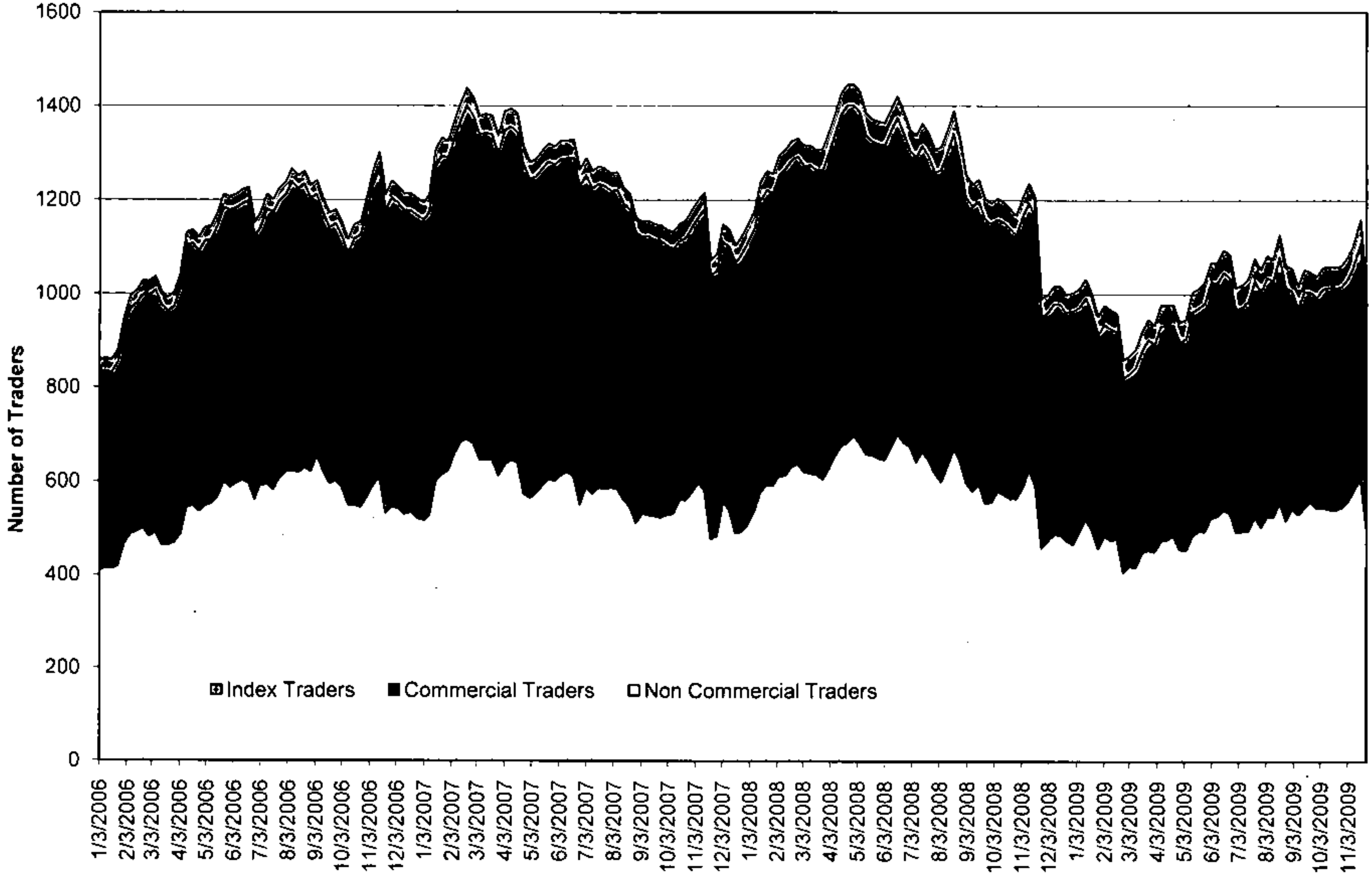
COT Update

CFTC Large Trader Data – Percent of Outright Open Interest Held by Large Speculators and Hedgers

	% of Open Interest Held by Large Specs. 2006	% of Open Interest Held by Large Hedgers 2006	Difference 2006	% of Open Interest Held by Large Specs. 2009	% of Open Interest Held by Large Hedgers 2009	Difference 2009	Reportable Level
Corn	14%	45%	31%	13%	45%	32%	250
Wheat	16%	42%	26%	20%	32%	12%	150
Soybeans	17%	40%	23%	14%	45%	31%	150
Soybean Oil	16%	55%	39%	15%	53%	38%	200

Source: CFTC

Reportable Corn Traders



Source: CFTC

CME Group
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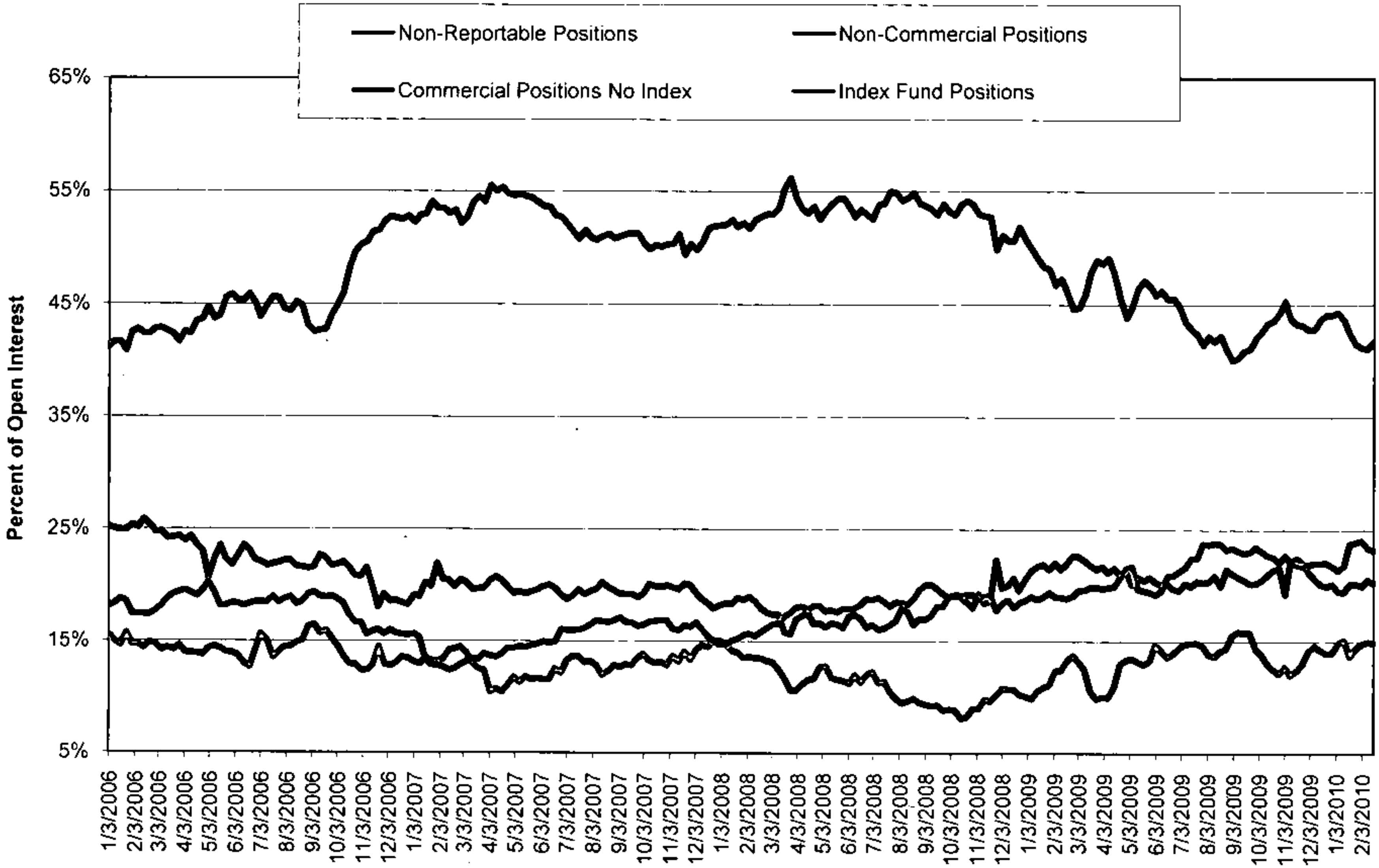
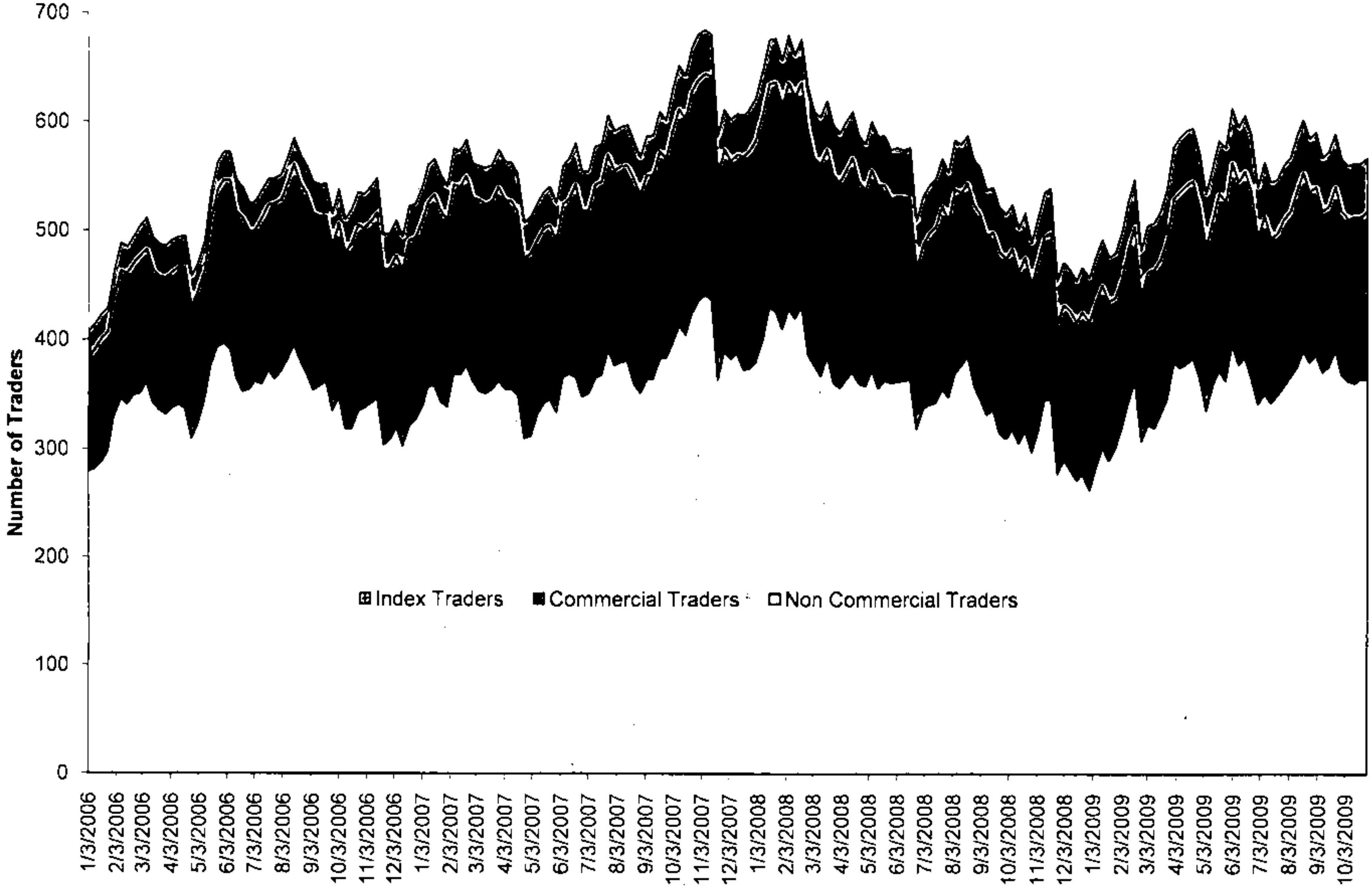
Percentage of Outright Open Interest Held By Category: Corn



Source: CFTC

Reportable Wheat Traders



Source: CFTC

CME Group
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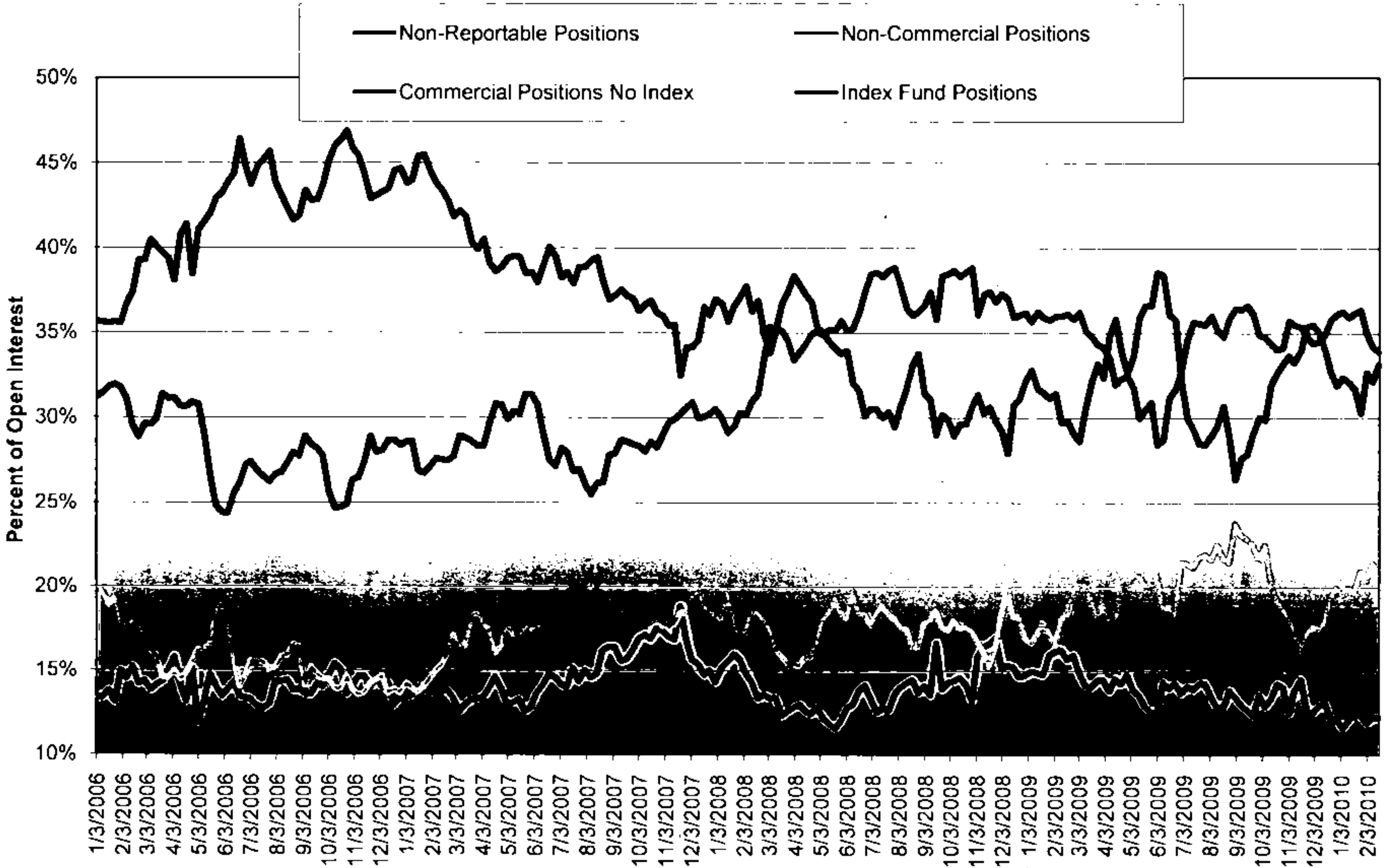
Percentage of Outright Open Interest Held By Category: Wheat



Source: CFTC

CME Group
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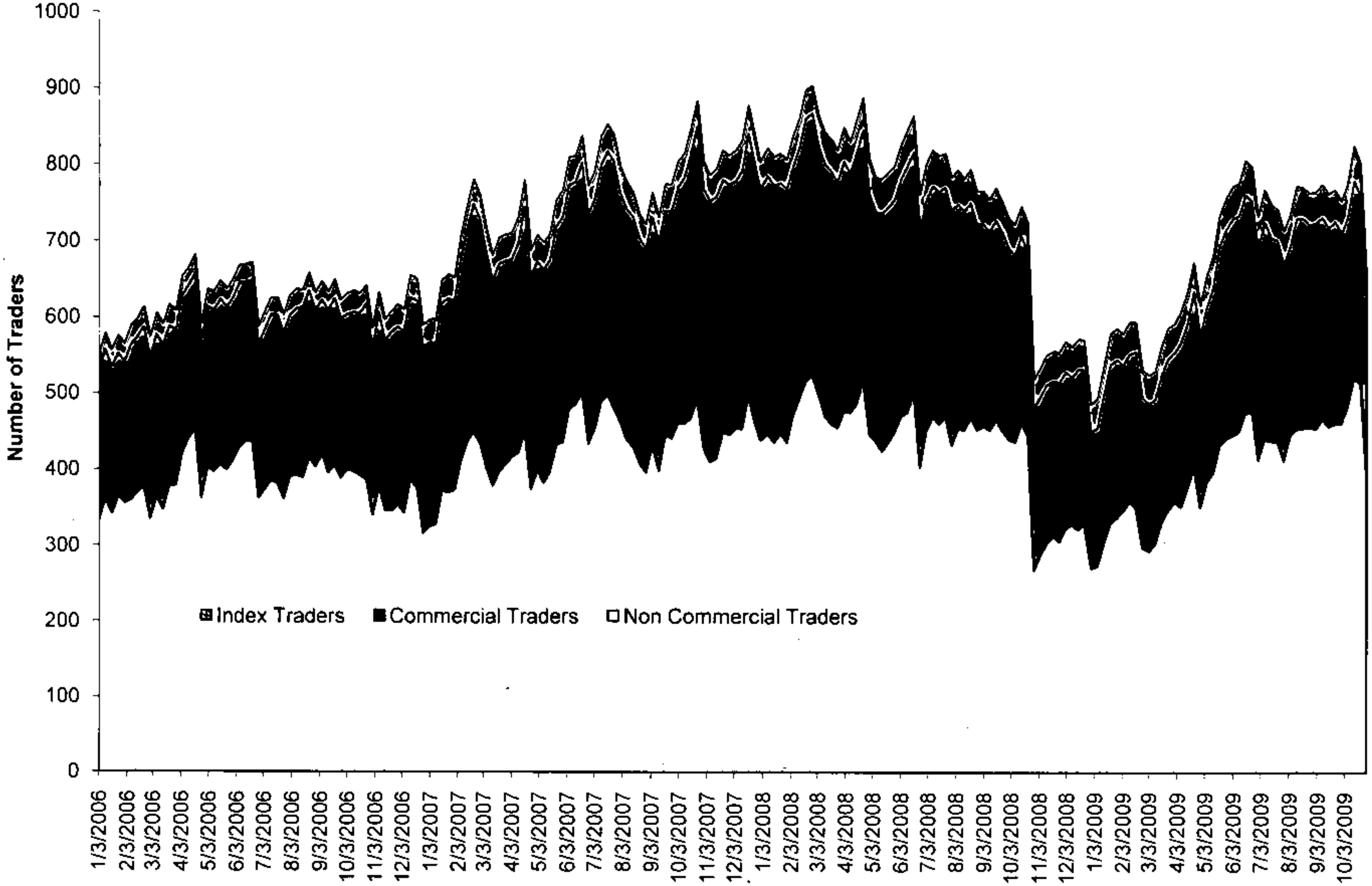
Reportable Soybean Traders



Source: CFTC

CME Group
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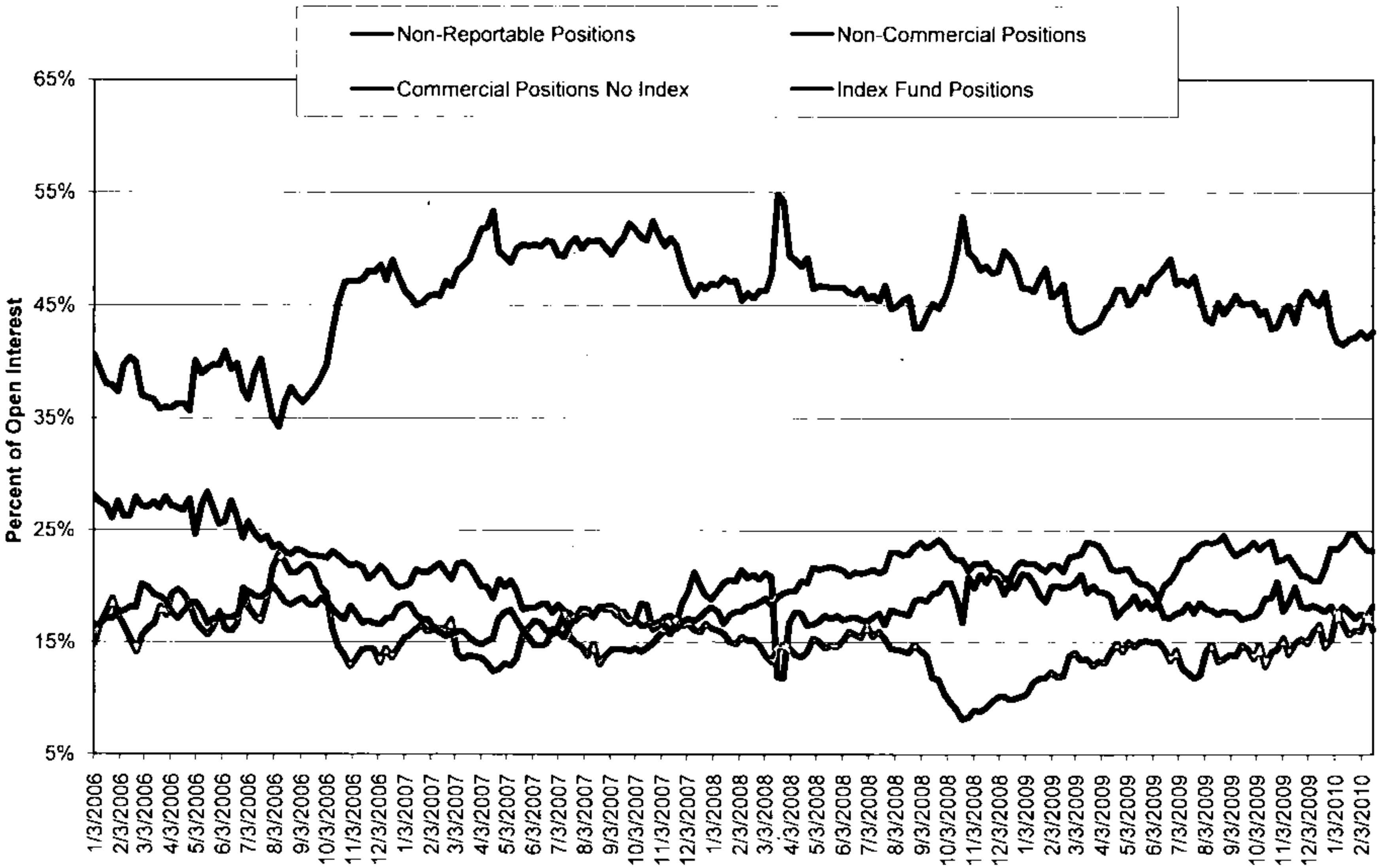
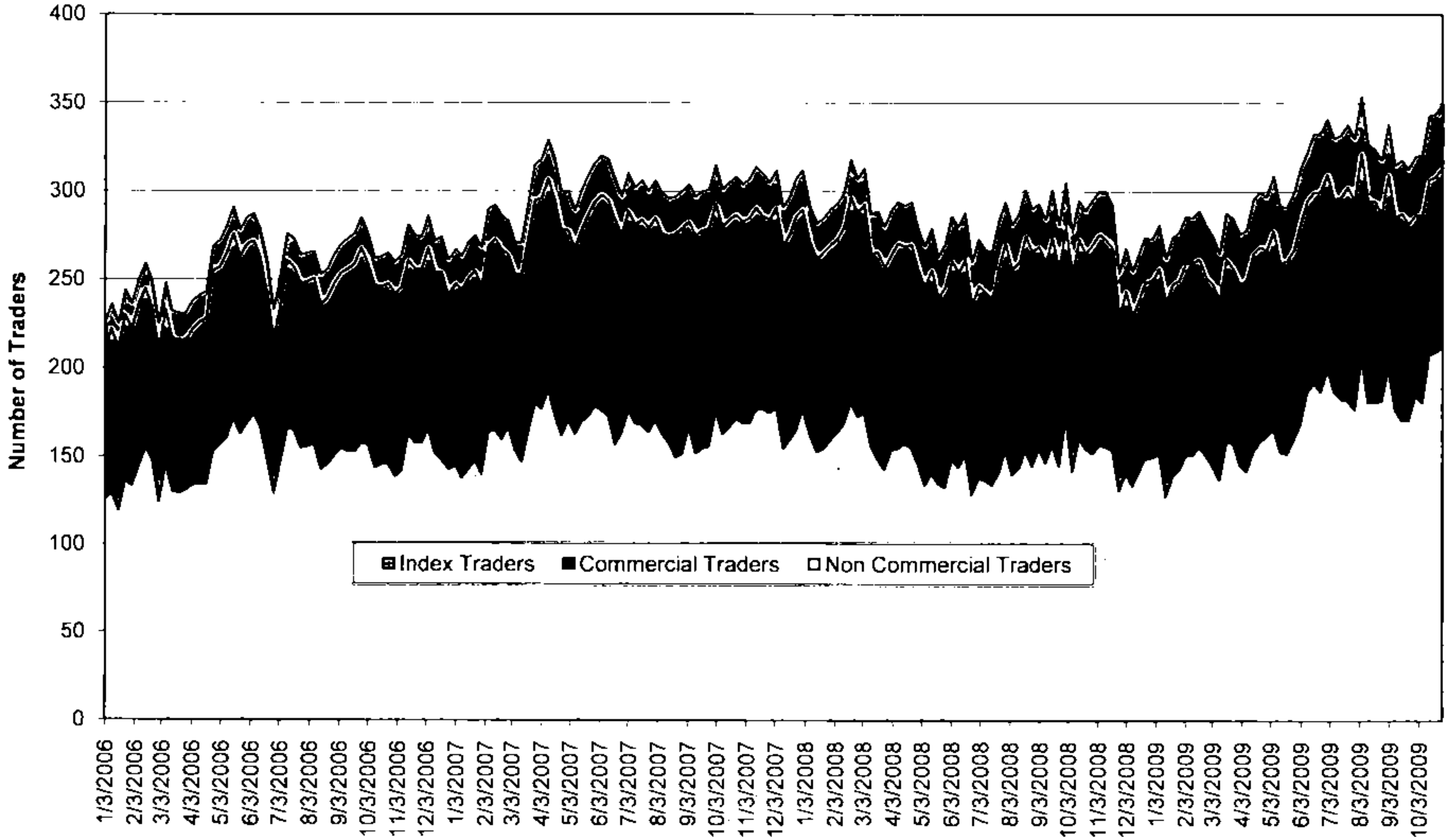
Percentage of Outright Open Interest Held By Category: Soybeans



Source: CFTC

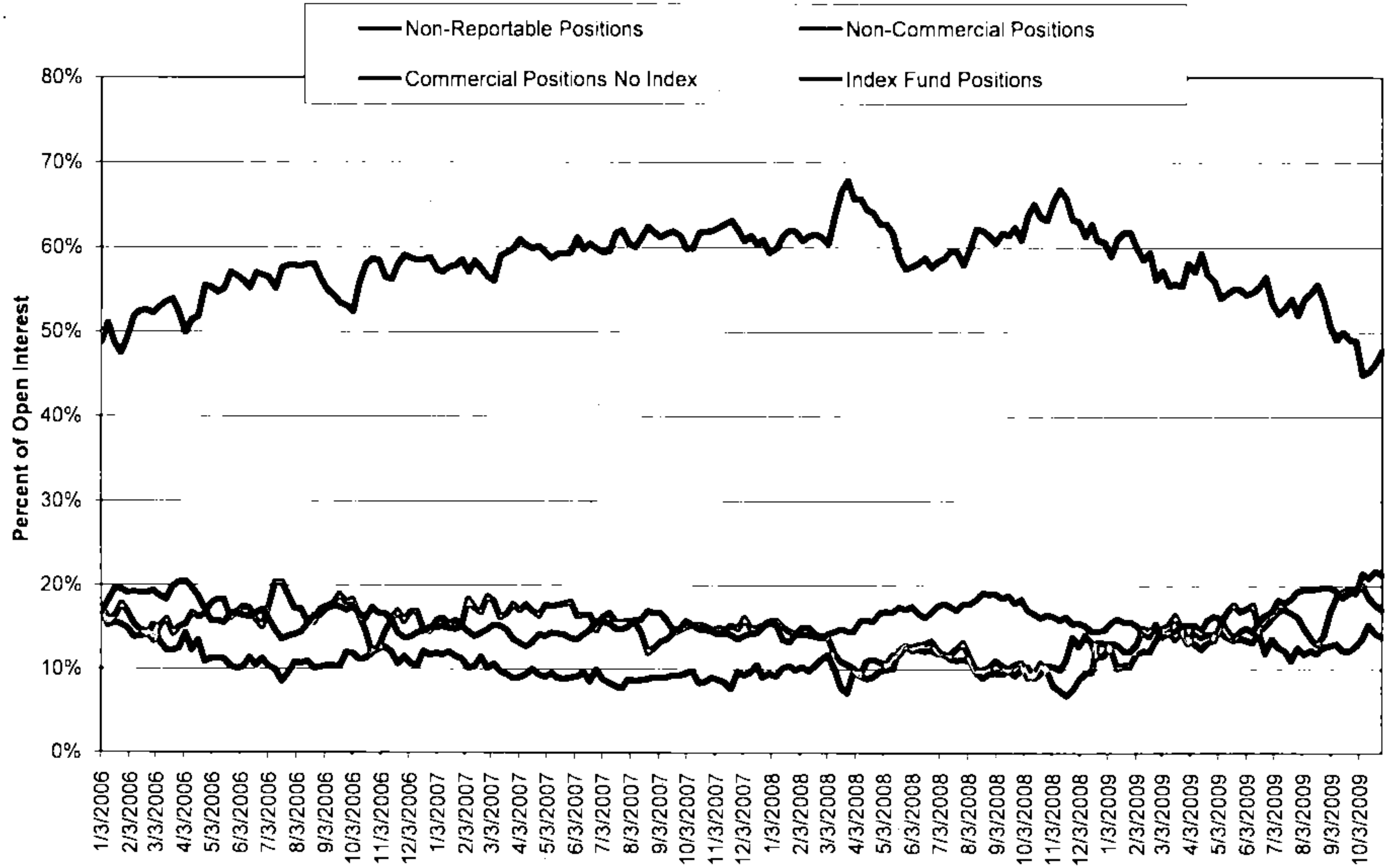
CME Group
A CME/Chicago Board of Trade/NYMEX Company

Reportable Soybean Traders



Source: CFTC

Percentage of Outright Open Interest Held By Category: Soybean Oil



Source: CFTC

CME Group
A CME/Chicago Board of Trade/NYMEX Company

PAC 15-10

Alston&Bird LLP

950 F. Street, N.W.
The Atlantic Building
Washington, DC 20004

202-756-3300
Fax: 202-756-3333

Paul M. Architzel **Direct Dial: 202-756-3492** **E-mail: paul.architzel@alston.com**

June 14, 2010

C.F.T.C.
OFFICE OF THE SECRETARIAT
2010 JUN 16 PM 3 34

VIA E-MAIL.

David Stawick
Secretary
Commodity Future Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition of Chicago Mercantile Exchange, Inc. and The Board of Trade of the City of Chicago, Inc. for Amendment of a Rule Pursuant to Commodity Futures Trading Commission Rule 13.2, 17 C.F.R. §13.2.

Dear Mr. Stawick,

On behalf of the Chicago Mercantile Exchange, Inc., ("CME") a registered derivatives clearing organization and The Board of Trade of the City of Chicago, Inc. ("CBOT") a designated contract market, we respectively petition the Commodity Future Trading Commission ("Commission") under Rule 13.2 to amend Rule 32.13(g) in order to provide an exemption from the agricultural trade option rules for cleared agricultural trade options. As amended, an exemption specifically relating to cleared agricultural trade options would be added to the existing exemption, which would continue in effect.

The petitioned-for amendment would specify that any cleared agricultural trade option must be between two eligible parties. Eligible parties as defined by the rule would include the following:

(1) any party with not less than $10 million in net worth;
(2) a commercial that also qualifies as an Eligible Swap Participant;[1] or,

[1] *See* 17 C.F.R. §35.1(b)(2) (defining the term "eligible swap participant") and 17 C.F.R. §35.1(b)(2)(vi)(C) (stating that an Eligible Swap Participant includes "[a] corporation, partnership, proprietorship, organization, trust or other entity not formed solely for the specific purpose of constituting an eligible swap

(3) a futures commission merchant ("FCM") acting in its capacity as clearing broker.

Under the proposed amendment, cleared-only over-the-counter ("OTC") options on the enumerated agricultural commodities[2] would be available for the first time to a commercial using such options for purposes related to its business that also meets the definition of "Eligible Swap Participant." [3] This would offer agricultural producers and other commercials an additional OTC risk management tool that also provides the financial and regulatory protections of clearing. Cleared-only OTC agricultural options would be offered pursuant to the same regulatory conditions that apply under a recent Order of the Commission under section 4(c) of the Commodity Exchange Act, 7 U.S.C. §1 *et seq.* ("Act") issued on March 24, 2009 permitting cleared-only swaps on certain of the enumerated agricultural commodities ("Cleared Agricultural Swaps Order").[4]

If permitted, cleared-only OTC trade options on the enumerated agricultural commodities would further two important public policy goals--providing enhanced financial integrity and greater transparency for OTC transactions. Permitting such options to be effectuated in a cleared environment would also reduce operational risk through the introduction of the clearinghouse's processing requirements to such transactions. Under the petitioned-for amendment, customer protections would be provided through the eligibility requirements to enter into such transactions and the applicable self-regulatory conditions of the exemption. Offering commercials the opportunity to enter into cleared-only OTC agricultural options would enable market innovation under appropriate regulatory conditions.

I. Requirements for Petition for Rulemaking

Commission Rule 13.2, 17 C.F.R. §13.2, provides that any person may file a petition with the Secretariat of the Commission for the issuance, amendment or repeal of a rule of general application. The Petition must set forth the text of any proposed rule or amendment. Commission Rule 13.2 requires that the Petition state the nature of the

participant ... which has a net worth of $1,000,000 and enters into the swap agreement in connection with the conduct of its businesses; or which has a net worth of $1,000,000 and enters into the swap agreement to manage the risk of an asset or liability owned or incurred in the conduct of its business or reasonably likely to be owned or incurred in the conduct of its business").

[2] Section 1a(4) of the Commodity Exchange Act, defines the term "commodity" in part with reference to a list of agricultural commodities, including among others, wheat, cotton, corn, soybeans, soybean oil and soybean meal. These specifically referenced commodities are the "enumerated agricultural commodities."

[3] *See note 1, supra.*

[4] *See "Order (1) Pursuant to Section 4(c)of the Commodity Exchange Act, Permitting the Chicago Mercantile Exchange to Clear Certain Over-the-Counter Agricultural Swaps and (2) Pursuant to Section 4d of the Commodity Exchange Act, Permitting Customer Positions in Such Cleared-Only Contracts and Associated Funds To Be Commingled With Other Positions and Funds Held in Customer Segregated Accounts,"* 74 *Fed. Reg.* 12316, 12318 (March 24, 2009)("March 24 Order"). That Order permitted the clearing of certain corn basis swaps and corn, wheat and soybean calendar swaps by the CME, noting that "permitting the clearing of these transactions is consistent with the public interest and with the purposes of the Act."

petitioner's interest and permits the petitioner to include in the Petition arguments in support of the issuance, amendment or repeal of the rule. Rule 13.2 further provides that the Secretariat shall refer the Petition to the Commission for such action as the Commission deems appropriate.

II. Statement of Petitioner's Interest

The CME (and CBOT) currently offer clearing services for OTC swaps on certain enumerated agricultural commodities pursuant to the Commission's March 24 Cleared Agricultural Swaps Order.[5] That Order permits the CME to clear OTC swaps on corn, wheat and soybeans, the terms of which are specified by the CBOT and listed by the CBOT as "clearing-only" products. The CME accepts such contracts for clearance through submission via CME Clear Port.

In response to market demand, the CME and the CBOT would now like to include OTC (trade) options on enumerated agricultural commodities in the CME's OTC clearing services, beginning with the same commodities on which cleared-only swaps are offered.[6]

CME and CBOT hereby petition the Commission to amend Rule 32.13(g) so that the terms of the exemption under the agricultural trade option rules are updated to reflect the recent innovation of cleared-only OTC swaps on agricultural commodities and to harmonize the Commission's regulations and treatment of trade options on the enumerated agricultural commodities with the Commission's March 24, 2009, Cleared Agricultural Swaps Order.

III. History of Agricultural Trade Options

As a result of the history and evolution of the Act, the regulatory framework that applies to agricultural trade options has developed separately from that which applies to OTC options on all other commodities. The Futures Trading Practices Act of 1992 ("FTPA") [7] added section 4(c) of the Act, granting the Commission broad authority to exempt transactions from the Act's provisions based upon a finding that the exemption is in the public interest, is limited in application to "appropriate persons,"[8] and would not

[5] The Commission's Cleared Agricultural Swaps Order was issued in response to a petition of the CME and CBOT dated April 21, 2008.

[6] On July 30, 2009, CME announced its intent to offer clearing services on 10 cash-settled European and Asian trade options on corn, wheat, soybeans, soybean meal and soybean oil under the existing exemption of 17 C.F.R. §32.13(g). The CME has postponed launching this service pending discussions with the Commission to clarify certain requirements surrounding the offering. *See* http://cmegroup.mediaroom.com/index.php?s=43&item=2897&pagetemplate_article.

[7] *See* Pub. L. No. 102-546; 106 Stat. 3590 (1992).

[8] *See* 7 U.S.C. § 6(c). Under the FTPA, "appropriate persons" is defined to include banks, insurance companies, investment companies, commodity pools, broker-dealers, FCMs and governmental entities. A corporation or partnership may be deemed an "appropriate person" if it has a net worth exceeding $1,000,000 or assets exceeding $5,000,000. Further, the CFTC may determine that the inclusion of other persons is appropriate based on financial or other qualifications or on the application of appropriate regulatory protections.

have a material adverse effect on the ability of the Commission or any contract market to exercise its regulatory or self-regulatory abilities under the Act.[9] The Commission, under this authority, promulgated Part 35 of its regulations exempting certain swap transactions and the eligible persons entering into such transactions from the provisions of the Act, other than the prohibitions on fraud and manipulation. Part 35 requires that the creditworthiness of any party having an interest under the agreement be a material consideration in entering into or negotiating the terms of the agreement[10] and that a swap agreement not be part of a fungible class of agreements that are standardized as to their material economic terms.[11] Part 35 applies to over-the-counter agreements that are defined in the rule as "swap agreements," including OTC options. Although Part 35 applies generally to swaps on agricultural commodities, the Commission made clear that Part 35 does not apply to OTC options on such commodities.[12] Rather, OTC options on the enumerated agricultural commodities are governed solely by the Commission's agricultural trade option rules.[13]

The Commission promulgated its rules governing agricultural trade options in 1998. These rules removed a long-standing prohibition on the offer and sale of OTC trade options on the enumerated agricultural commodities subject to a number of regulatory requirements. These include the required registration of agricultural trade option dealers in a new registration category of Agricultural Trade Option Merchant ("ATOM"), risk disclosure, minimum financial requirements, and reporting and recordkeeping. The agricultural trade option rules also include an exemption from these requirements for options offered to a commercial solely for purposes related to its business and each party to the transaction has a $10 million net worth.[14]

Few dealers chose to register as ATOMs. Although the Commission amended the agricultural trade option rules in an effort to increase their commercial utility,[15] at present no dealers are registered as ATOMs and actively making markets in agricultural trade options.'

In contrast, there is significant activity in the market for agricultural trade options transacted pursuant to the exemption. Although the market is not transparent with respect to overall levels of volume and open interest,[16] a group of between 5 and 10 market makers, consisting of proprietary trading enterprises, banks and trading companies, actively offer such options to appropriate commercial counterparties. The commercials making use of such options for hedging purposes typically tend to be

[9] *See* 7 U.S.C. 6(c)(2).

[10] 17 C.F.R. 35.2(c).

[11] 17 C.F.R. 35.2(b).

[12] *See "Trade Options on the Enumerated Agricultural Commodities,"* 63 *Fed. Reg.* 18821, 18829 (April 16, 1998).

[13] See, 17 C.F.R. §32.13.

[14] 17 C.F.R. §32.13(g).

[15] See *"Trade Options on the Enumerated Agricultural Commodities,"* 64 *Fed. Reg.* 68011, 68012 (December 6, 1999).

[16] Greater transparency with respect to over-all levels of activity is one public benefit that would result from granting this Petition.

middle-tier agribusinesses, more often than not grain elevators. Elevators generally purchase such options to hedge their risk which arises from the optional pricing features embedded in physical grain forward contracts that they offer to producers. Food processors and other agricultural companies use OTC trade options to manage their risk. The market for exempt agricultural trade options operates alongside the market for OTC agricultural swaps transacted pursuant to Part 35 of the Commission's Rules, with similar counterparties and under similar market conventions.

Commission staff briefed the Agricultural Advisory Committee at its July 2008 meeting on the staff's consideration of harmonizing the treatment of agricultural trade options with trade options on all other commodities. The staff noted that permitting agricultural trade options to trade like any other trade option would "open up new risk-management possibilities for the ag[riculture] community" and resolve "the legal uncertainty about existing products that may or may not be ag[ricultural] trade options."[17]

IV. Cleared-only Swaps on Agricultural Commodities

As discussed above, the Commission on March 24, 2009, issued its Cleared Agricultural Swaps Order permitting the CME to clear OTC swaps on certain enumerated agricultural commodities (corn, wheat and soybeans).[18] The Cleared Agricultural Swaps Order for the first time extended the benefits of clearing to OTC instruments on agricultural commodities.[19] In issuing its Order, the Commission noted the substantial support by commenters for making cleared-only agricultural contracts available.[20]

The Cleared Agricultural Swaps Order is conditioned upon the following requirements being met:

(1) that the eligible contracts be executed pursuant to Part 35;
(2) that the contracts be cleared;
(3) that each cleared-only contract be marked-to-market daily;
(4) that CME apply its margining regime and appropriate risk management procedures;
(5) that CBOT make available open interest and settlement price information;

[17] *See* Transcript of CFTC Agricultural Advisory Committee Meeting, dated July 29, 2008 ("Transcript"), at 188-191 (noting that in 1991 the CFTC proposed lifting the ban on agricultural trade options "which would have allowed them to trade just like any trade option subject only to the fraud and misrepresentation rules") *available at* http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/aac_072908.pdf.

[18] *See* 74 *Fed. Reg.* 12316.

[19] *See Id.* at 12318 (stating that "[p]ermitting the clearing of corn basis swaps and corn, wheat, and soybean calendar swaps by CME would appear to foster both financial innovation and competition"). The Commission also recognized that "[c]learing also may increase the liquidity of the OTC markets and thereby foster competition in those markets."

[20] *See Id.* (noting that of the seven comments letters received, "five letters expressly supported the issuance of an exemptive order to permit clearing of the OTC swaps, citing such benefits as increased transparency and liquidity in the OTC markets, enhanced risk management for market participants, and greater regulatory surveillance including large trader reporting").

(6) that CBOT establish a coordinated market surveillance program and adopt speculative position limits;
(7) that the cleared-only contract not be treated as fungible with any contract listed for trading on CBOT;
(8) that FCMs keep records relating to the transaction; and
(9) that CBOT apply a large trader reporting requirement to such contracts.

As noted by the Commission and by the vast majority of commenters, the Cleared Agricultural Swaps Order furthers the twin public interest goals of increasing financial integrity and transparency for OTC transactions. For the reasons explained below, we believe that the petitioned-for amendment to Rule 32.13(g), which would include similar conditions to cleared agricultural trade options under a new exemption from the agricultural trade option rules will similarly further the public interest.

V. Summary of the Requested Amendment to Rule 32.13(g)

The requested amendment would add to the existing agricultural trade option exemption (17 C.F.R. §32.13(g)) an additional paragraph limited to cleared-only agricultural trade options. This amendment would not make any change with respect to the existing agricultural trade option rules nor would it supersede the existing exemption, which would remain in effect.

The new exemption for cleared-only agricultural trade options would require that each party to the option meet one of three alternative eligibility requirements. The first alternative relies solely on a net worth test of $10 million.[21] The second eligibility alternative is a two-part test: that a party be a commercial user of the commodity and that it be an Eligible Swap Participant as defined in Part 35 of the Commission's rules. The third eligibility alternative applies to FCMs that clear the transaction.

The requested amendment would permit agricultural trade options to be offered and entered into in a cleared environment. For example, under the exemption, there would be no limitation on a producer granting an agricultural trade option.[22] This is necessary in order to permit eligible persons to liquidate a cleared agricultural trade option which they have entered. Moreover, the inclusion of the simple $10 million net worth eligibility test enables entities whose regular line of business is to purchase and sell agricultural trade options to enter into an agricultural trade option with another market

[21] This is the amount of the net worth exemption criterion currently set forth in Commission Rule 32.13(g)(1)(iii). The Commission in 2000, proposed to rely solely on net worth as a basis for the exemption under Rule 32.13(g). However, it did not take final action on the proposal. *See* "*Trade Options on Enumerated Agricultural Commodities*," 65 *Fed. Reg.* 77838 (Dec. 13, 2000) (proposing "a technical revision to the agricultural trade option rule").

[22] Commission Rule 32.13(a)(5)(i) prohibits a producer from granting or selling an agricultural trade option, except as part of a spread transaction. This prohibition does not apply to agricultural trade options that are exempt under the current exemption of Rule 32.13(g) and it would not apply under the new exemptive provision as well. Unlike purchases of an option, grantors of an option do not have a limitation against loss on the option.

maker. This permits such entities to lay off the risk of such transactions with another market maker or similar entity. The amended rule would also make explicit that FCMs, in connection with clearing such options, may enter into and carry such cleared contracts.

The amended exemption would explicitly address the status of a cleared-only agricultural trade option that is not accepted for clearing. This might occur, for example, if an option that was previously entered into is submitted for clearing but does not conform to the required contract specifications, or if one of the parties breaches an applicable credit filter.

The rule would provide that options that are not accepted for clearing shall be terminated, but that such options, if submitted for clearing in good faith, are not in violation of the provisions of the exemption. Termination of the option would be pursuant to the contract specifications of the cleared-only contract. The economic terms of the termination, however, would be as specified by the parties in the underlying bi-lateral agreement.

The proposed amendment also clarifies that an agricultural trade option entered into under the existing exemption may be submitted for clearing at any time if it also satisfies the conditions of the clearing-related exemption, and that the parties may agree that if that option is not accepted for clearing, it would remain in full force and effect as originally entered into. This is reasonable in light of the fact that the original transaction was not entered into in reliance on the transactions being submitted to, and accepted for, clearing.

Additionally, the amendment would harmonize the exemption for agricultural trade options with the conditions that apply in the Commission's March 24, 2009, Cleared Agricultural Swaps Order. For example, an entity relying upon the commercial eligibility standard of the new agricultural trade option exemption would also be required to be an "Eligible Swap Participant."[23] Thus, a commercial entity that is an Eligible Swap Participant entering into a cleared-only OTC transaction for risk management purposes would be able to enter into either a cleared OTC swap or a cleared OTC (trade) option under similar regulatory requirements and conditions.

In this regard, the requested amendment would apply the same conditions on the registered derivatives clearing organization and the designated contract market (as applicable) in respect of cleared agricultural trade options that apply under the Commission's March 24, 2009, Cleared Agricultural Swaps Order. These include regulatory requirements addressing financial oversight, risk management, transparency, position limits, and recordkeeping and reporting requirements. Importantly, these regulatory conditions, which would apply under the exemption for cleared-only agricultural trade options as requested by this Petition, are not conditions of the existing agricultural trade option exemption. Thus, the requested exemption extends to eligible entities greater regulatory as well as greater financial safeguards. In addition to the

[23] Commercials that are entering into a swap to hedge their business risks are required to have a net worth of $1 million pursuant to Commission Rule 35.1(vi)(c).

regulatory protections noted above, the amendment retains the applicability of the option anti-fraud rule, 17 C.F.R. §32.9.

VI. Amendment of Rule 32.13(g) Furthers the Public Interest

Commission staff in a briefing of the Agricultural Advisory Committee during July, 2008, emphasized that the agricultural community "needs all possible risk-management tools" to deal with highly volatile agricultural market conditions.[24] Commission staff acknowledged that the existing agricultural trade option program since its creation clearly has not benefited market participants.[25] The Commission staff also recognized that producers and agribusiness interests have had an additional 10 plus years to develop further risk management expertise.[26]

The petitioned-for amendment furthers the policies of improving transparency and the financial safety and soundness of OTC transactions through clearing and fits squarely within the framework of the proposed financial regulatory reform.[27] The modifications to the exemption are those specifically geared toward operating in a cleared environment. By way of example, the amendment recognizes the role of FCMs in carrying the cleared option position as broker and clearing member.

From their inception, the agricultural trade option rules have included an exemption for sophisticated entities.[28] The requested amendment refines this concept in respect of cleared options by retaining as one eligibility alternative a simple net worth test of $10 million and including a second eligibility alternative that harmonizes the net asset test for commercials with that of Part 35. This is a reasonable result in light of the additional protections that apply to cleared-only agricultural trade options.

In many respects, the protections that would apply to cleared-only agricultural trade options, including for example the clearing guarantee, are greater than those that apply to agricultural trade options under the regulatory framework governing agricultural trade options. Commission staff issued a White Paper in May 1997, entitled "Policy Alternatives Relating to Agricultural Trade Options and Other Agricultural Risk-Shifting Contracts," Division of Economic Analysis ("White Paper"). The White Paper addresses both the benefits and potential risks of off-exchange agricultural trade options.[29] Some of

[24] *See* Transcript at 189.

[25] *See* Transcript at 189 (acknowledging that after the Commission redesigned the agricultural trade option program in 1999 to streamline reporting and disclosure requirements and permit cash settlement only one firm registered as an agricultural trade option merchant).

[26] See *Id.*

[27] *See* Remarks of Chairman Gary Gensler, "OTC Derivatives Reform," American Bar Association, Committee on Derivatives and Futures Law, (January 29, 2010) (noting that "[d]ealers should be required to bring their standardized transactions to regulated clearinghouses once they are arranged") *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/opagensler-26.pdf

[28] *See* "Trade Options on the Enumerated Agricultural Commodities," 63 Fed. Reg. 18821 (April 16, 1998).

[29] *See* White Paper - Policy Alternatives Relating to Agricultural Trade Options and Other Agricultural Risk Shifting Contracts, Division of Economic Analysis at 1 (recognizing that "[r]emoving the current ban on agricultural trade options has both potential benefits and risks," however, noting that "[o]ne approach to striking an appropriate balance between the two would be to lift the prohibition subject to conditions" that

the tangible benefits related to lifting the ban on agricultural trade options that the White Paper identifies include a potential increase in the supply of, and the competition in offering, agricultural options. The White Paper, however, identifies the following risks in relation to lifting the ban on agricultural trade options: risk of fraud, credit risk, liquidity risk, operational risk, systemic risk, and legal risk.[30] Although the regulatory framework put in place by the Commission's agricultural trade option rules were designed to address each of these risks, as noted above, this program has not attracted any market participants. The financial protections and regulatory conditions, including the eligibility requirements, which would apply to cleared-only agricultural trade options under the petitioned-for exemption would provide equivalent or greater protections than those offered by the agricultural trade option rules, and certainly more than under the existing exemption from the agricultural trade option rules.

The conditions that apply to cleared-only swaps and that are included in the requested exemption for cleared-only agricultural trade options address each of the risks identified in the White Paper in the following manner:

A. *Fraud*

The White Paper notes that the potential of fraud increases due to the then "unregulated nature of the option vendors either by direct government oversight or by a self-regulatory organization, from the lack of a developed regulatory framework governing trade options' offer or sale and from a potential lack of transparency of their pricing." The amendment as proposed mitigates the potential for fraud because cleared transactions will be carried by clearing members that are FCMs, which are subject to comprehensive regulation by the Commission and self-regulatory authorities, including a designated contract market (as applicable) and the registered derivatives clearing organization. Further, under the proposed amendment all counterparties must meet an eligibility requirement of either having $10 million in net worth, of being a commercial that is also an Eligible Swap Participant, or of being an FCM, market maker or similar entity.

B. *Credit Risk*

Trade options pose a risk that the counterparty to a contract will be unable to perform all or a portion of its obligations. The agricultural trade option rules address this risk through a number of provisions, including minimum financial requirements for ATOMs. Clearing agricultural trade options, the subject of Petitioners' requested relief, directly addresses credit risk by substituting the clearinghouse for the counterparties to the transaction.

may include restrictions on permitted parties, on the instruments or their use and/or regulation of their marketing) *available at* http://www.cftc.gov/About/CFTCReports/acag8.html.

[30] *See Id.*

C. *Liquidity Risk*

Holders of trade options may face a degree of liquidity risk. The White Paper notes that the market for trade options differs "markedly" in liquidity from exchange markets.[31] The proposed amendment addresses this concern in two ways, by providing that liquidity providers are eligible to lay off the risk of their agricultural trade options by trading with other liquidity providers and by clarifying that cleared agricultural trade options can be liquidated through off-set with another cleared agricultural trade option. This will increase the liquidity of agricultural trade options.

D. *Operational Risk*

Operational risk is defined in the White Paper as "the risk that the monitoring and control of operations cannot be sufficiently maintained and that financial losses occur as a result."[32] The White Paper recognizes that due to the "highly standardized" nature of exchange-traded option contracts, operational risks associated with off-exchange products may be greater than for exchange-traded contracts.[33] In addition, this risk is substantially reduced due in part to "exchange and CFTC disclosure rules and other requirements, including daily marking-to-market of positions and regular customer position statements, which keep individuals informed of accruing losses." The requested amendment, however, minimizes this potential risk by the use of a registered derivatives clearing organization which has automated systems, with open positions being marked to market on a daily basis, thus allowing holders of trade options to better monitor their value.

E. *Legal Risk*

Modifying the present regulatory framework presents the potential legal risk that parties who fail to conform their activities within the terms of the exemption may potentially violate one of the other Commission rules.[34] The legal risk, however, will be addressed by granting the petition and issuance of a clarifying rule.

It is clear that the petitioned-for amendment provides greater safeguards than the current exemption under Rule 32.13(g). It is equally clear from the above analysis, that the requested exemption effectively addresses each of the risks identified by the staff in the offer and sale of agricultural trade options. In doing so, the requested exemption will further the public interest by providing the agricultural sector with an important risk management tool in a manner that provides greater transparency, greater financial integrity, and greater customer protections through self-regulatory and Commission oversight than is currently available.

[31] *See Id* at 8.

[32] See *Id.* at 8.

[33] See *Id.*

[34] *See Id.* at 8 (noting that failure to conform activities to the terms of an agricultural trade option exemption might "expose" a party to "the legal risk that a particular over-the-counter derivative contract offered by it was not covered by the exemption and that its offer or sale violated either that exemption or some other provisions of the Act or Commission rules").

VII. Analysis Under Section 15 Supports the Petition

Section 15 requires that the Commission, before promulgating any rule, consider the costs and benefits of its action in light of five considerations. These include: protection of market participants and the public; efficiency; competitiveness and financial integrity of futures markets; price discovery; sound risk management practices and other public interest considerations.

For the reasons discussed above, the benefits of the petitioned-for amendment clearly outweigh any costs as measured by the five Section 15 considerations. As discussed above, the requested exemption provides for the protection of market participants and the public by making clearing available to agricultural trade options under a number of regulatory and self-regulatory conditions that currently do not apply to such transactions. This will provide for the financial integrity of the transactions and improve price discovery and transparency. By making clearing available, sound risk management practices will be available with respect to each cleared transaction. Finally, making cleared-only agricultural trade options available will increase the competitiveness of the markets generally for risk management contracts on the enumerated agricultural contracts.

At the same time as providing these benefits, the requested rule will reduce the inherent costs to the market by the current prohibition of the offer and sale of cleared agricultural trade options.

VIII. Text of the Proposed Rule

PART 32–Commodity Option Transactions

1. The authority citation for Part 30 is proposed to read as follows:

   Authority: 7 U.S.C. 1a, 2, 6c and 12a, unless otherwise noted.

2. Section 32.13 is proposed to be amended by adding a new paragraph (2) and by redesignating paragraph (2) as paragraph (3) and amending it to read as follows:

§32.13. Exemption from prohibition of commodity option transactions from trade options on certain agricultural commodities.

(a) * * *

(g) *Exemption*

(1) * * *

(2) The provisions of §§3.13, 32.2, 32.11 of this chapter and this section shall not apply to a cleared-only commodity option contract that complies with the following conditions:

(i) The option contract is submitted for clearing to a registered derivatives clearing organization;

(ii) Each party that purchases or sells a cleared-only commodity option meets one of the following eligibility requirements:

(A) The party to the option contract has a net worth of not less than $10 million;

(B) The party to the option contract is a person reasonably believed to be an "Eligible Swap Participant" as defined in §35.1 of this Chapter and is reasonably believed also to be a producer, processor, or commercial user of, or a merchant handling, the commodity which is the subject of the commodity option transaction, or the products or byproducts thereof, or an affiliate thereof acting on such person's behalf, and that such producer, processor, commercial user or merchant is entering into the commodity option transaction solely for purposes related to its business as such; or

(C) The party, in connection with the clearing of such option, is a futures commission merchant in its role as broker.

(iii) The cleared-only option is not treated as fungible with any listed option trading on the designated contract market or cleared by the registered derivatives clearing organization.

(iv) Each such cleared-only option is marked to market on a daily basis, and final settlement prices shall be established in accordance with the rules of a designated contract market or registered derivatives clearing organization.

(v) The derivatives clearing organization which clears such cleared-only option contracts shall:

(A) Apply its margining system and calculate performance bond rates for each cleared-only option contract in accordance with its normal and customary practices.

(B) Apply appropriate risk management procedures with respect to transactions and open interest in the cleared-only options; and

(C) Conduct financial surveillance and oversight of its clearing members acting as clearing broker in respect of cleared-only options cleared pursuant to this paragraph (2) and conduct oversight sufficient to assure the registered derivatives clearing organization that each such clearing member has the appropriate operational capabilities necessary to manage defaults in such contracts.

(vi) The derivatives clearing organization or the applicable designated contract market shall:

(A) Make available open interest and settlement price information for the cleared options on a daily basis in the same manner as for option contracts listed for trading by a designated contract market;

(B) Establish and maintain a market surveillance program that encompasses the cleared options and the corresponding listed options;

(C) Adopt speculative position limits for each of the cleared-only option contracts that are the same as the limits applicable to the corresponding listed options pursuant to §150.2 of this Chapter;

(D) Apply large trader reporting requirements to cleared-only option contracts in accordance with its rules; and

(E) Provide the information required by, and in the manner provided by, Parts 15 and 16 of this Chapter.

(vii) Each futures commission merchant acting under this paragraph (2) shall keep books and records as set forth in §1.35 of this Chapter, shall be subject to inspection in accordance with the requirements of Commission Regulation 1.31, and provide to the Commission the information required by, and in the manner provided by, Parts 15 and 17 of this Chapter.

(3) Provided, however, that:

(i) An option contract entered into in reliance upon paragraph (2) that is submitted for clearing in good faith but that is not accepted for clearing by the registered derivatives clearing organization shall be terminated under the rules of the derivatives clearing organization or designated contract market, as applicable, at the time that the registered derivatives clearing organization notifies the parties or their carrying clearing members of its non-acceptance of the contract, on such terms as provided for in the option contract, but shall not be considered to be in violation of the provisions of §§3.13, 32.2, 32.11 of this chapter and this section by virtue of not being accepted for clearing;

(ii) An option entered into in reliance on paragraph (g)(1) of this section that also meets the conditions of paragraph (g)(2) of this section may be submitted for clearing at any time; *provided however*, the parties may agree that if following submission for clearing such option contract is not accepted for clearing, the option contract need not be terminated, but may remain in full force and effect under its original terms; and

(iii) The provisions of §32.9 shall continue to apply to option contracts agreements or transactions entered into under this paragraph (g).

Respectfully submitted,

Paul M. Architzel

Paul M. Architzel

cc: Tim Andriesen, CME
David Lehman, CME
Christopher Bowen, CME
Chairman Gensler
Commissioner Dunn
Commissioner Chilton
Commissioner Sommers
Commissioner O'Malia
Dan Berkovitz, General Counsel
Richard Shilts, Director DMO
Ananda Radhakrishnan, Director DCIO
David VanWagner, DMO
Don Heitman, DMO
Phyllis Dietz, DCIO

NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

~~TAC 7/17~~

TAC 16

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OFFICE OF THE SECRETARIAT

March 7, 2000

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

Re: Petition for Rulemaking to Amend CFTC Regulation 4.21(a)

Dear Ms. Webb:

National Futures Association ("NFA") respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 4.21(a). These amendments would allow NFA to enforce through its rules the use by CPOs of a shorter disclosure document called a "profile" for soliciting a prospective pool participant prior to the delivery to the participant of a full disclosure document. The profile document would be limited to certain key information about the pool and would provide specific cautionary disclosures as explained more fully below.

I. Text of the Proposed Amendments (additions are underscored and deletions are stricken)

PART 4 — COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

* * *

§ 4.21 Required Delivery of Pool Disclosure Document.

(a) ~~Except in accordance with rules promulgated by a registered futures association regarding profile documents.~~ No commodity pool operator registered or required to be registered under the Act may, directly or indirectly, solicit, accept or receive funds, securities or other property from a prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the commodity pool operator delivers or causes to be delivered to the prospective participant a Disclosure Document for the pool containing the information set forth in § 4.24; *Provided, however,* that a profile document or, where the prospective participant is an accredited investor, as defined in 17 CFR 230.501(a), a notice of intended offering and statement of the terms of the intended offering, may be provided prior to delivery of a Disclosure Document, subject to compliance with rules promulgated by a registered futures association pursuant to Section 17(j) of the Act.

II. Nature of NFA's Interest

As the Commission is aware, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. NFA is interested in streamlining the regulatory process so that its Members can more efficiently and effectively comply with the Act, Commission regulations and NFA rules. NFA believes that the proposed amendments to Regulation 4.21(a), which would allow for the use of a profile document by CPOs, furthers this goal.

III. Supporting Arguments

As the Commission is aware, in 1998 NFA was asked by the Commission to develop a rule proposal similar to the profile document rule implemented by the Securities and Exchange Commission ("SEC") effective June 1, 1998. Similar to the SEC rule, NFA has developed a rule to permit CPOs to conduct initial customer solicitations through a shorter disclosure document called a "profile." Unlike the SEC rule, however, NFA's proposed rule provides that a customer must be given and sign the full disclosure document prior to investing in the pool. NFA's proposed rule states that a profile document should provide a summary of key information regarding an investment in the commodity pool being offered. Among other things, the rule also requires that a profile document disclose the risk factors material to the particular pool being offered and disclose any conflicts of interest material to the offered pool.

The proposed NFA rule providing for a profile document for use by CPOs has been reviewed extensively by CFTC staff since its original submission in September of 1998. As a result, the original rule proposal has been revised and a new interpretive notice has been drafted to resolve Commission concerns. The proposed rule and interpretive notice have recently been submitted for CFTC review and approval. CFTC staff has informed NFA that implementing the NFA rule proposal would also require that CFTC Regulation 4.21(a) be amended to allow the use of a profile document by CPOs.

NFA respectfully petitions the Commission to amend Regulation 4.21(a) as described herein.

Respectfully submitted,

Daniel J. Roth
Executive Vice President
and General Counsel

DJR:ckm(sub\petiton re 4.21a)

cc: Chairman William J. Rainer
Commissioner Barbara Pedersen Holum
Commissioner David D. Spears
Commissioner James E. Newsome
Commissioner Thomas J. Erickson
Phyllis J. Cela, Esq.
John C. Lawton, Esq.
Alan L. Seifert, Esq.
David Van Wagner, Esq.
Riva Spear Adriance, Esq.

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521

OFFICE OF THE
SECRETARIAT

March 13, 2000

Mr. Daniel J. Roth
Executive Vice President
and General Counsel
National Futures Association
200 W. Madison Street
Chicago, IL 60606-3447

Dear Mr. Roth:

By letter dated March 7, 2000, you requested on behalf of the National Futures Association that the Commission consider a petition submitted under Regulation 13.2 to amend CFTC Regulation 4.21(a). This is to acknowledge receipt of the petition and to inform you that this request has been referred to the Commission for such action the Commission deems appropriate. I will inform you of any action taken by the Commission on the petition.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521

OFFICE OF THE
SECRETARIAT

May 15, 1998

Ms. Joni Lupovitz
Attorney at Law
McDermott, Will & Emery
600 13th Street, N.W.
Washington, D.C. 20005-3096

Dear Ms. Lupovitz:

By letter dated May 12, 1998, you requested on behalf of First Options of Chicago, Inc. that the Commission consider a petition for the amendment of CFTC Rule 1.31. This is to acknowledge receipt of the petition and to inform you that the petition has been referred to the Commission for such action the Commission deems appropriate. I will inform you of any action taken by the Commission on the petition.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

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CFTC

MCDERMOTT, WILL & EMERY

A Partnership Including
Professional Corporations
600 13th Street, N.W.
Washington, D.C. 20005-3096
202-756-8000
Facsimile 202-756-8087
http://www.mwe.com

Joni Lupovitz
Attorney at Law
jlupovitz@mwe.com
202-756-8116

Boston
Chicago
Los Angeles
Miami
Moscow
Newport Beach
New York
St. Petersburg
Silicon Valley
Vilnius
Washington, D.C.

May 12, 1998

BY HAND DELIVERY

Jean A. Webb, Secretary
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: **Petition for Amendment of Rule 1.31**

Dear Ms. Webb:

Pursuant to Rule 13.2 of the Commodity Futures Trading Commission ("CFTC" or "Commission") Public Rulemaking Procedures, we respectfully submit this petition on behalf of our client, First Options of Chicago, Inc. ("FOC"). This petition seeks the amendment of CFTC Rule 1.31, 17 C.F.R. §1.31 ("CFTC Reg. § __") to permit use of a variety of qualifying means of electronic recordkeeping for all categories of required records and for the entire required recordkeeping period under the Commodity Exchange Act ("CEA" or "Act") and Commission regulations.

FOC is a registered securities broker-dealer and futures commission merchant ("FCM"), and is a member of the principal domestic and foreign securities, commodities and options exchanges. FOC averages tens of thousands of transactions per day on the floors of the Chicago Board of Trade and the Chicago Mercantile Exchange, in addition to a greater volume of transactions on other commodities, securities, and options exchanges. A large percentage of FOC's retail commodity futures trading business involves electronic orders.

We have consulted with many industry participants in preparing FOC's proposal to amend Rule 1.31, and have reason to believe that there is widespread support for this electronic recordkeeping proposal. The Managed Futures Association, for example, has authorized us to represent that it supports FOC's Petition to Amend Rule 1.31. In addition, the Operations Division of the Futures Industry Association, Inc. supports FOC's request that the CFTC publish FOC's proposed amendments to Rule 1.31 for public comment pursuant to CFTC Reg. §13.3.

I. INTRODUCTION

Given recent advances in technology, many means of electronic recordkeeping are viable -- and possibly superior -- alternatives to the recordkeeping systems currently used by FOC and other CFTC registrants. Many registrants store required records in paper files in on-site storage areas or off-site warehouses. An electronic recordkeeping system that immediately produces or reproduces all required records on CD-ROM, optical tape or disk, microfiche/microfilm, or other electronic storage media would enhance the efficiency, accuracy, and security of such registrants' recordkeeping procedures. As a result, registrants' ability to respond readily and completely to document requests from the Commission and other government agencies and self-regulatory organizations ("SROs") would be improved. Moreover, given the increasing use of electronic order-routing systems, electronically delivered customer confirmations and account statements, and electronically generated records, a compatible electronic recordkeeping system would be efficient and rational.

In recognition of such technological developments, the U.S. Securities and Exchange Commission ("SEC") recently amended its record retention regulations to permit use of electronic storage media. As described below, the SEC rules are essentially the same as CFTC recordkeeping rules in terms of measures to protect the integrity and accessibility of required records. The SEC rules, however, permit electronic recordkeeping for a broader category of documents, for the entire period record retention is required, and for a broader scope of electronic storage media (including CD-ROM). FOC respectfully suggests that the CFTC should do likewise.

II. SUMMARY OF PROPOSAL

FOC requests that the CFTC amend its recordkeeping rules to parallel the SEC's recordkeeping regulations. FOC proposes that the CFTC permit electronic recordkeeping for the entire required record retention period, without restriction on the type of documents or images that may be stored electronically, as long as certain conditions regarding reliability, security, and accessibility are satisfied.

As detailed in Section IV below, the CFTC should amend Rule 1.31 to eliminate references to specific technology for specific types of records and, instead, provide general standards for acceptable alternative forms of storage media for all records. FOC suggests that the CFTC replace the detailed requirements set forth in CFTC Reg. § 1.31(b)-(d) with the following:

1. general definitions of "micrographic media" (*e.g.*, microfilm or microfiche) and "electronic storage media" (*i.e.*, digital storage media or systems);

2. general specifications for permissible electronic storage media, including the capability to:

   a. preserve records in a non-rewriteable, non-erasable format;

   b. verify automatically the accuracy of the recording process;

   c. serialize and time-date the original and duplicate units of storage media; and

   d. download records and indexes; and

3. general requirements and procedures for registrants that elect to use electronic recordkeeping systems, including: prior notification of regulators; providing access and reproduction facilities for the CFTC and other authorities; indexing stored records; and an audit system.

The use of electronic recordkeeping pursuant to these proposed amendments would provide increased flexibility for registrants and significant regulatory benefits. First, it will be difficult if not impossible to alter records without detection if they are created by or scanned into an electronic system. Second, access to information would be vastly improved by the enhanced facilities of electronic filing and indexing and the relative ease of electronic search and retrieval (compared to manual filing and searches through boxes of paper records stored in warehouses). Third, as the SEC has concluded after more than 25 years of experience with microfilm, such alternative storage methods for printed and handwritten records generally do not adversely affect enforcement efforts. Fourth, electronic storage systems are generally more secure than paper records stored in busy offices and off-site warehouses, which may be subject to fires, flooding, or other unintentional physical disruption or destruction. Fifth, standards that are not technology-specific are less likely to be quickly outdated by new technology. For example, the CFTC's current rules permit computer-generated records to be stored on optical disk only in ASCII or EBCDIC format, which are text-based formats that do not store electronic images or World Wide Web pages.

Moreover, nearly half of all CFTC-registered FCMs are also registered with the SEC as broker-dealers. CFTC Advisory, Alternative Method of Compliance for Monthly, Confirmation, and Purchase-and-Sale Statements, 62 Fed. Reg. 31507, 31510 n.27 (June 10, 1997) (noting that as of March 31, 1997, 113 of 236 FCMs were registered with the SEC). If CFTC recordkeeping rules were coordinated with SEC requirements, persons registered with both the SEC and CFTC would be permitted to use a single set of recordkeeping procedures to fulfill recordkeeping obligations for both their securities and commodities businesses, and thus avoid inconsistent recordkeeping requirements.

For example, under the proposed amendments to Rule 1.31, FOC and other registrants would be permitted (but not required) to scan and store electronically most documents required to be retained pursuant to CFTC Regs. §§ 1.31 through 1.37, including account documents, written customer orders, and confirmation, purchase-and-sale, and monthly statements. Registrants could scan the paper documents for electronic storage, produce serialized CD-ROMs containing the electronic records in WORM (write once, read many) or some other non-rewritable, non-erasable media, create a specialized index of the scanned documents, and verify database and images off the hard-drive and the CD-ROM. The electronic index would have specialized database fields containing order and account information to enable personnel readily to search and access the records stored on CD-ROM. Such indexes would be retained in duplicate.

Attached as Exhibit A are two sample original order tickets, which were scanned onto CD-ROM and then downloaded and printed. The reproductions are attached as Exhibit B. These sample reproductions demonstrate that the quality of the electronic storage media and reproduction are pristine. Even differences in handwriting and time-stamps are clearly visible.

In sum, it would be sound public policy to promulgate broad standards for compliance with the CFTC's regulatory objectives and to permit record storage by any media or technology -- whether electronic, film, paper, or another storage media -- that meets such standards. Registrants should have the flexibility to use any type of recordkeeping system, provided that it meets general conditions for security, reliability, and accessibility, and maintains records for the required time, without alterations or deletions.

III. REGULATORY BACKGROUND

A. SEC Amended Electronic Recordkeeping Regulations

The SEC recently amended its record retention rules to permit the use of optical disk, CD-ROM, and other electronic storage media as long as the media satisfy certain conditions. The SEC regulations now permit immediate use of electronic storage (rather than "hard copy" or paper records) for most required records, including order tickets and duplicate records (even if the original record is maintained on optical disk or other electronic storage media).

The SEC "amendments reflect a recognition of technological developments that will provide economic as well as time-saving advantages for broker-dealers by expanding the scope of recordkeeping options while at the same time continuing to require broker-dealers to maintain records in a manner that preserves their integrity." 62 Fed. Reg. 6469 (SEC Feb. 12, 1997) (attached as Exhibit C hereto).

In proposing the recordkeeping amendments, the SEC initially expressed some concern about the use of electronic technology to preserve handwritten records or records containing handwritten text, primarily because from an examinations and enforcement standpoint, optical disk and microfilm/microfiche images arguably make it more difficult to detect forgery and alterations to handwritten text. In adopting the amendments, however, the SEC recognized that its experience since 1970 with the use of microfilm to store handwritten records has been positive. Moreover, few broker-dealers currently keep documents in hard copy or paper format, and many broker-dealers enter most orders directly through electronic systems rather than creating traditional order tickets. Accordingly, the SEC decided that allowing preservation of handwritten records in electronic storage media would not significantly increase the difficulty of detecting forgery or alterations. 62 Fed. Reg. at 6470-71.

The SEC recordkeeping rules provide that acceptable electronic storage media must satisfy the following criteria:

- preserve the records exclusively in a non-rewriteable, non-erasable format;

- verify automatically the quality and accuracy of the storage media recording process;

- serialize and time-date the original and, if applicable, the duplicate units of storage media; and

- have the capacity readily to download records and indexes.

17 C.F.R. § 240.17a-4(f)(2)(ii).

Furthermore, the SEC requires electronic recordkeepers to:

1. At all times have available facilities for immediate, easily readable projection or production of micrographic (i.e., microfilm, microfiche) or electronic storage media images and for producing easily readable images;

2. Be ready at all times to provide immediately any facsimile enlargement which the SEC or its representatives may request;

3. Store separately from the original a duplicate copy of the record stored for the time required;

4. Organize and index accurately all information maintained on both original and any duplicate storage media:

   a. indexes must be available at all times for examination by the SEC and SROs;

   b. each index must be duplicated and the duplicate copies must be stored separately from the original copy of each index; and

   c. original and duplicate indexes must be preserved for the time required for the indexed records;

5. Maintain an audit system providing for accountability regarding inputting of records required to be maintained and inputting of any changes made to every original and duplicate record maintained and preserved thereby;

   a. audit system results must at all times be available for examination by the SEC and SROs; and

   b. audit results must be preserved for the time required for the audited records;

6. Maintain and provide promptly upon request by the SEC or SRO all information necessary to access records and indexes stored on the electronic storage media; or place in escrow and keep current a copy of the physical and logical file format of the electronic storage

media, the field format for all different information types written on the electronic storage media and the source code, together with the appropriate documentation and information necessary to access records and indexes; and

7. Obtain written undertakings from an independent third party who has access to and ability to download information from the recordkeeper's electronic storage media, to download and provide electronically stored records to the SEC, if the broker-dealer fails to do so.

17 C.F.R. § 240.17a-4(f)(3).

B. CFTC Provisions for Electronic Recordkeeping

CFTC regulations, pursuant to 1993 amendments, permit computer-generated records immediately to be produced on optical disk, provided that additional requirements are satisfied. Computer, accounting machine, or business machine records may be immediately produced or reproduced on microfilm or microfiche and kept in that form. In addition, microfilm or microfiche reproductions may be substituted for hard copies of most other required records for the final three years of the five-year record retention period. CFTC Reg. § 1.31(b). The CFTC regulations provide, however, that: "Trading cards and written customer orders, required to be kept pursuant to § 1.35(a-1)(1), (a-1)(2), and (d), must be retained in hard-copy form for the full five-year period." CFTC Reg. § 1.31(b)(2).

Where optical disk storage is permitted, CFTC Reg. § 1.31(d) requires the use of non-rewriteable, WORM (write once, read many) media and technology which has write-verify capability that continuously and automatically verifies the quality and accuracy of the information stored and automatically corrects quality and accuracy defects. In addition, the system must:

(i) use removable disks;
(ii) serialize the disks;
(iii) use a permanent and non-erasable time-date, . . . time-date all files of information placed on the disk, reflecting the computer run time of the file of information; and
(iv) write all files in ASCII or EBCDIC format.

CFTC Reg. § 1.31(d).

In proposing the 1993 optical disk amendments, the Commission noted that an optical disk "system must first provide reasonable assurance that once a record is created, the record cannot be altered without detection. Second, the system must provide speedy and high quality access to records stored on the medium. Third, in the event that the person storing the records cannot or will not produce a hard copy of such reports, the Commission must have an expedient means to do so itself . . . . WORM drive technology, if appropriately configured, would satisfy the Commission's proposed criteria." 57 Fed. Reg. 48,480-81.

C. CFTC Advisory for Electronic Orders

Last year, the Commission issued an Advisory setting forth an alternative method of compliance with the written records requirements of CFTC Regs. §§ 1.31 and 1.35 for customer orders prepared by electronic order-routing systems. 62 Fed. Reg. 7675 (CFTC Feb. 20, 1997) (the "February 1997 Advisory"). The February Advisory states that to the extent that a customer order is prepared and transmitted to and reported from an exchange trading pit by an electronic order-routing system, or a customer order is prepared by an electronic off-floor order management system, and certain standards are satisfied, then the "written" records requirements of Regs. §§ 1.31 and 1.35 will be deemed satisfied by the electronic record generated by the system. Specifically, pursuant to the February Advisory, such electronic records must:

1. Include the customer order information required under CFTC Reg. § 1.35(a-1)(1), (2)(i), (a-1)(4) and/or 1.35(d);

2. Include any modification, including any change and/or cancellation, that is made to an order and indicate the time the modification is recorded in the system;

3. Record all Commission-required and other order-related times, including order entry and exit times, and the time of any modification made to a customer order, including any change and/or cancellation, to the highest level of precision achievable by the operating system, but at least to the second. The times captured must not use a clock that can be modified by the person entering the order; and

4. Be kept in hard copy and/or allowable hard copy substitution media, as provided under CFTC Reg. 1.31. The stored records shall be open to

> inspection by the Commission or DOJ as required under CFTC Reg. §1.31 and be made readily available to the Commission or DOJ in machine-readable media or hard copy upon request. Records stored on machine-readable media must use a format and coding structure specified in the Commission request. To the extent that records temporarily are stored in erasable form, appropriate security measures must be implemented by the system operator to prohibit any unauthorized access to the records and to maintain an accurate record of when and by whom records are accessed or modified.

The February 1997 Advisory also noted that it may be necessary to amend CFTC Regulation 1.31 to account for further technological developments. Id. at 7677 n.26.

D. CFTC Advisory for Monthly, Confirmation, and Purchase-and-Sale Statements

Last summer, the Commission also issued an Advisory setting forth an alternative method of compliance with CFTC Regs. §§ 1.31, 1.33, and 1.46 for the delivery and retention of monthly, confirmation, and purchase-and-sale statements ("Statements"). 62 Fed. Reg. 31,507 (CFTC June 10, 1997) (the "June Advisory"). The June Advisory permits FCMs, with customer consent, to deliver such Statements solely by means of electronic media. Furthermore, "[t]o facilitate FCMs' efforts to use electronic media when possible and to avoid imposing duplicative or inconsistent requirements on broker-dealer firms," the Commission's June Advisory expressly permits an FCM to maintain copies of such Statements as allowed by the SEC's recent electronic recordkeeping guidelines, described in Section III.A, above. 62 Fed. Reg. at 31,510.

The June Advisory recognized that as of March 31, 1997, 113 of 236 FCMs were registered with the SEC as broker-dealers. "Therefore, the Commission has attempted, where possible, to coordinate its regulatory efforts with SEC requirements." Id. at 31,510 n.27.

E. Gaps and Inconsistencies in Current CFTC Recordkeeping Requirements and Paper Storage

The CFTC's 1993 optical disk amendments, February 1997 Advisory for Electronic Orders, and June 1997 Advisory for Monthly, Confirmation, and Purchase-and-Sale Statements have made some strides in updating the CFTC's recordkeeping requirements to account for improved electronic recordkeeping technology. The piecemeal approach, however, has resulted in varied requirements for different types of records and, in the case of the optical disk amendments, technical specifications that are too restrictive in the face of technological developments.

Among other things, the current regulations: (1) do not expressly permit use of CD-ROM or optical tape for record storage (except where the June Advisory permits CFTC registrants to follow SEC guidelines); (2) permit only certain records to be stored on microfilm/microfiche and only for the final three years of the five-year retention period; and (3) require that trading cards and written customer orders be kept in hard-copy form for the full five-year period. Given the advances in electronic storage and retrieval technology, these limitations and restrictions are no longer necessary.

In most cases, electronic record storage is better than storage of hard copies. Electronic storage alleviates many of the security and retrieval problems inherent in the storage of a large volume of paper records. Paper documents are at greater risk of being misfiled, lost or destroyed. Boxes of documents stored in off-site warehouses are subject to fires, flooding, and filing errors. Moreover, the search and retrieval of specified records from a warehouse of paper documents is more difficult and time-consuming than the search and retrieval from electronic media or microfiche, which may be more convenient to store and search on-site.

F. NFA Proposal To Amend Rule 1.31

The National Futures Association ("NFA") recently proposed informally that the Commission amend Rule 1.31 to eliminate references to specific technology that must be used to comply with CFTC recordkeeping requirements. NFA has recommended that Rule 1.31 require that registrants' recordkeeping systems meet general reliability and accessibility standards, to provide greater flexibility in dealing with constantly changing technology. To this end, NFA believes that there should be a general requirement that documents can be kept in any storage media as long as the media meets certain general standards for accessibility and security of the records. Specifically, NFA has proposed that the CFTC eliminate the specific requirements in Reg. § 1.31(b) to (d), and replace them with: (1) a definition of "readily accessible" (in connection with the requirement that certain records be maintained for five years, and "readily accessible" for two years); (2) a requirement that the registrant have and enforce reasonable procedures to keep its records from being altered or destroyed; and (3) address whether specific types of records, such as trading cards and written customer orders, should be kept in hard copy form.

FOC agrees in principle with NFA's proposal to simplify Commission recordkeeping rules to permit the use of qualifying media. We do not agree, however, that there need be a special exception for trading cards, written customer orders, or other categories of required records. Rather, we think that the advantages of electronic recordkeeping, including the increased security of electronic formats and the improved quality of electronically stored images, outweigh any risk of difficulty in detection of manual alteration of such records before their electronic storage.

IV. PROPOSED AMENDMENTS TO CFTC RULE 1.31

The following proposed amendments to CFTC Reg. § 1.31 would permit recordkeeping with qualifying electronic storage media for all categories of required records for the entire required recordkeeping period. FOC proposes that Reg. § 1.31 be amended by revising paragraphs (b) through (d) to read as follows:

§ 1.31 Books and records; keeping and inspection.

* * * * *

(b) The records required to be maintained and preserved pursuant to §§ 1.32-1.37 may be immediately produced or reproduced on "micrographic media" (as defined in this section) or by means of "electronic storage media" (as defined in this section) that meet the conditions set forth in this paragraph and be maintained and preserved for the required time in that form.

(1) For purposes of this section:

(i) The term ***micrographic media*** means microfilm or microfiche, or any similar medium; and

(ii) The term ***electronic storage media*** means any digital storage medium or system and, in the case of both paragraphs (b)(1)(i) and (b)(1)(ii) of this section, that meets the applicable conditions set forth in this paragraph (b).

(2) If electronic storage media is used to keep records required by the Act or these regulations:

(i) The person required to keep such records must notify the person's designated self-regulatory authority before using electronic storage media. If using any electronic storage media other than optical disk technology (including CD-ROM), such person must notify the designated self-regulatory authority at least 90 days before using such storage media. In either case, such person must provide the person's own representation or one from the storage medium vendor or other third party with appropriate expertise that the selected storage media meets the conditions set forth in paragraph (b)(2)(ii) below.

(ii) The electronic storage media must:

(A) Preserve the records exclusively in a non-rewriteable, non-erasable format;

(B) Verify automatically the quality and accuracy of the storage media recording process;

(C) Serialize the original and, if applicable, duplicate units of storage media, and time-date for the required period of retention the information placed on such electronic storage media; and

(D) Have the capacity to readily download indexes and records preserved on the electronic storage media to any medium acceptable under this paragraph (b) as required by the Commission.

(3) If micrographic media or electronic storage media is used to keep records required by the Act or these regulations, the person required to keep such records shall:

(i) At all times have available, for examination by any representative of the Commission or U.S. Department of Justice, facilities for immediate, easily readable projection or production of micrographic media or electronic storage media images and for producing easily readable images.

(ii) Be ready at all times to provide, and immediately provide, any facsimile enlargement which the Commission or its representatives may request.

(iii) Organize and index accurately all information maintained on both original and any duplicate storage media.

(A) At all times, such indexes must be available for examination by the staffs of the Commission and the U.S. Department of Justice.

(B) Each index must be duplicated and the duplicate copies must be stored separately from the original copy of each index.

(C) Original and duplicate indexes must be preserved for the time required for the indexed records.

(iv) Have in place an audit system providing for accountability regarding inputting of records required to be maintained and preserved pursuant to §§ 1.32-1.37 to electronic storage media and inputting of any changes made to every original and duplicate record maintained and preserved thereby.

(A) At all times, the results of such audit system must be available for examination by the staffs of the Commission and the U.S. Department of Justice.

(B) The audit results must be preserved for the time required for the audited records.

(v) Maintain, keep current, and provide promptly upon request by the staffs of the Commission or the U.S. Department of Justice all information necessary to access records and indexes stored on the electronic storage media; or place in escrow and keep current a copy of the physical and logical file format of the electronic storage media, the field format of all different information types written on the electronic storage media and the source code, together with the appropriate documentation and information necessary to access records and indexes.

Finally, while the foregoing provisions generally dovetail with the SEC rules, the Commission also should consider a provision or statement that recognizes that there may be some variations in presentation when records, images and graphics are transmitted (and then possibly retransmitted) by electronic means, and then displayed either electronically or in hard copy.

The registrant's recordkeeping obligations should be satisfied by storing and reconstructing such electronic data and images in materially the same presentation as originally transmitted with underlying files preserved. This would allow for some slight variations in reproduction, where embedded images and data do not necessarily reproduce identically, depending on the technology used to access, view, and/or reproduce the information.

* * * * *

Thank you for your consideration of this petition. Please contact the undersigned or my partner, Paul J. Pantano, Jr., if you have any questions or need further information.

Sincerely yours,

Joni Lupovitz

Joni Lupovitz

Counsel for First Options of Chicago, Inc.

cc: I. Michael Greenberger, Esq., Director
CFTC Division of Trading & Markets

Edson G. Case, Jr., Esq.,
CFTC Deputy General Counsel

John G. Gaine, Esq., President
Managed Funds Association

Daniel J. Roth, Esq., General Counsel
National Futures Association

Barbara L. Wierzynski, Esq., Exec. Vice President &
General Counsel, Futures Industry Association, Inc.

A

EXHIBIT A

543 SAMPLE 469

FIRST OPTIONS LIT DIVISION

COUNT NO. 17210000 BROKER ABC MEMO

$ A B C D E F G H I J K L M N [✓ O] P Q R S T U V W X Y Z 2 3 4 5 6 7 8 9 % S

BUY	C D L M S Q X	SELL
5 WN 365		I 365 LLB/315

OPEN ☐ CLOSE ☐ OPEN ☐ CLOSE

ABLE BUSINESS PRINTING (312) 461-9610 FAX (312) 461-9144

539 SAMPLE 469

FIRST OPTIONS LIT DIVISION

COUNT NO. 17210001 BROKER ABC MEMO

$ A B C D E F G H I J K L M N O P Q R S T U V W X Y Z 2 3 4 5 6 7 8 9 % S

BUY	C D L M S Q X	SELL
10 SN 852		10 852 LLB/315

OPEN ☐ CLOSE ☐ OPEN ☐ CLOSE

B

539 SAMPLE 469

EXHIBIT B

FIRST OPTIONS LIT DIVISION

ACCOUNT NO. 17210001 BROKER ABC MEMO

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z 2 3 4 5 6 7 8 9 % S

1998 JUN -2 PM 2:

BUY		SELL
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□ OPEN □ CLOSE		□ OPEN □ CLOSE

AVAILABLE BUSINESS PRINTING (312) 461-9810 FAX (312) 461-9144

543

SAMPLE 469

FIRST OPTIONS
LIT DIVISION

ACCOUNT NO. 1721 0000 BROKER ABC MEMO

A B C D E F G H I J K L M N [✓ O] P Q R S T U V W X Y Z 2 3 4 5 6 7 8 9 % S

1998 JUN -2 PM 2:

BUY		SELL
5 WN 365	C D L M S Q X	I 365 LLB/315
□ OPEN □ CLOSE		□ OPEN □ CLOSE

AVAILABLE BUSINESS PRINTING (312) 461-9610 FAX (312) 461-9144

C

EXHIBIT C

FOR FURTHER INFORMATION CONTACT: Betsy Prout Lefler, Special Counsel, Gail Marshall-Smith, Special Counsel, or David Oestreicher, Special Counsel, (202) 942–0158, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 5–1, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

Background

On August 28, 1996, the Securities and Exchange Commission ("Commission") adopted Rule 11Ac1–4, the "Limit Order Display Rule," and amendments to Rule "Ac1–1, the "ECN Amendment," to require OTC market makers and exchange specialists to display certain customer limit orders, and to publicly disseminate the best prices that the OTC market maker or exchange specialist has placed in certain electronic communications networks ("ECNs"), or to comply indirectly with the ECN Amendment by using an ECN that furnishes the best market maker and specialist prices therein to the public quotation system.

On January 20, 1997, the Order Execution Rules became effective. As of that date, compliance with the rules became mandatory for all exchange-traded securities and 50 Nasdaq securities. Compliance with the rules for the remaining Nasdaq securities is to be completed in accordance with a schedule established by the Commission.[1] Under the previously announced schedule, compliance with the Order Handling Rules would have been required with respect to another 100 Nasdaq securities on February 7, 1997, and another 850 Nasdaq securities on February 28, 1997. In addition, on March 28, 1997, compliance would have been required with respect to all remaining Nasdaq securities under the ECN Rule, and with respect to another 1500 Nasdaq securities under the Limit Order Display Rule. Thereafter, compliance under the Limit Order Display Rule was to be phased-in over several months.

The Commission has been closely monitoring the implementation of the Order Execution Rules, and recently received two letters from representatives of numerous industry participants ("Industry Letters") requesting that the Commission adopt a more conservative schedule for implementing the Order Execution Rules.[2] Accordingly, the Commission has determined that it is appropriate to modify the schedule to provide a more gradual phase-in to allow market participants more time to adapt to the Order Execution Rules.[3] The new schedule is as follows: On February 10, 1997, 50 Nasdaq securities, and on February 24, 1997, an additional 50 Nasdaq securities, shall be phased-in for compliance under the Order Execution Rules.[4] Furthermore, in response to the Industry Letters, the Commission is exempting responsible brokers and dealers, electronic communications networks, exchanges, and associations, until April 14, 1997, from the requirements of the ECN Amendment with respect to all Nasdaq securities not phased-in as of February 24, 1997, and from the requirements of the Limit Order Display Rule with respect to the 2350 Nasdaq securities that will not be phased-in as of February 24, 1997. Under the prior schedule, all Nasdaq securities would have been phased-in by March 28, 1997 for compliance with the requirements of the ECN Amendment. Likewise, 850 of these securities would have been phased-in on February 28, and another 1500 on March 28, 1997, for compliance with the Limit Order Display Rule.

The Commission believes it is imperative to continue to phase-in implementation of the Order Execution Rules with respect to additional Nasdaq securities. The Commission has granted exemptive relief to monitor operation of the rules carefully, and will develop a further phase-in schedule for the Nasdaq securities not phased-in as of February 24, 1997.

The Commission finds that the modifications of the compliance dates described above, and the exemptive relief provided herein to responsible brokers and dealers, electronic communications networks, exchanges, and associations are consistent with the public interest, the protection of investors and the removal of impediments to and perfection of the mechanism of a national market system.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30(a)(28), (61), and (62).

Dated: February 5, 1997.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97–3432 Filed 2–11–97; 8:45 am]

BILLING CODE 8010–01–M

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17 CFR Part 240

[Release No. 34–38245; File No. S7–21–93]

RIN 3235–AF91

Reporting Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is amending its broker-dealer record preservation rule to allow broker-dealers to employ, under certain conditions, electronic storage media to maintain records required to be retained. The amendments reflect a recognition of technological developments that will provide economic as well as time-saving advantages for broker-dealers by expanding the scope of recordkeeping options while at the same time continuing to require broker-dealers to maintain records in a manner that preserves their integrity. The Commission is also issuing an interpretation of its record preservation rule relating to the treatment of electronically generated communications.

EFFECTIVE DATE: The amendments become effective April 14, 1997.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director (202/942–0132), Peter R. Geraghty, Assistant Director (202/942–0177) or Barbara A. Stettner, Staff Attorney (202/942–0734), Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 5–1, Washington, DC 20549.

SUPPLEMENTARY INFORMATION

I. Introduction

On July 9, 1993, the Commission issued a release ("Proposing Release") requesting comment on proposed amendments to its broker-dealer record

[1] *See* Securities Exchange Act Release Nos. 37619A (September 6, 1997) ("Adopting Release"), 37972 (November 22, 1996), 38110 (January 2, 1997), and 38139 (January 8, 1997). The Commission notes that a broker-dealer's duty of best execution discussed in the Adopting Release applies whether or not the security has been phased-in under the Order Execution Rules.

[2] *See* letter from Bernard L. Madoff, Securities Industry Association, to Richard R. Lindsey, dated January 30, 1997, and letter from John N. Tognino, Securities Traders Association, to Richard R. Lindsey, dated January 31, 1997.

[3] The Commission also amended subsection (a)(25)(ii) of the Quote Rule, thereby expanding the coverage of the Quote Rule to all exchange-traded securities. Thereafter, the Commission determined that it was appropriate to make this aspect of the amendments effective April 10, 1997. *See* Securities Exchange Act Release No. 38110, *supra* note 1. The present order does not change that date and, therefore, the effective date of subsection (a)(25)(ii) of the Quote Rule remains April 10, 1997.

[4] Currently, compliance with the Order Handling Rules is required for 50 of the 1000 Nasdaq securities with the highest average daily trading volume. These 50 securities have been identified by Nasdaq. Similarly, Nasdaq is to identify the next two groups of 50 stocks to be phased-in under the Order Handling Rules.

preservation rule, Rule 17a–4,[1] that would allow broker-dealers to employ, under certain conditions, optical storage technology.[2] The proposed amendments also would codify a staff no-action position that allows broker-dealers to use microfiche as a storage medium.[3] Simultaneous with the issuance of the Proposing Release, the Division of Market Regulation ("Division"), with the concurrence of the Commission, issued a no-action letter allowing broker-dealers to utilize optical storage technology immediately, under certain conditions.[4] Based on the comments received and the experience gained by the Commission under the no-action letter, the Commission is adopting the proposed amendments with certain changes discussed herein.

Set forth below is a summary of the proposed amendments, a summary of the comment letters received in response to the Proposing Release, a description of the final rule amendments, and an interpretation relating to the retention of electronically generated communications. The Commission is also providing notice of a staff related no-action position regarding other recordkeeping requirements under the Securities Exchange Act of 1934 ("Exchange Act").

The Commission's Proposal

The Commission proposed to amend its record retention rule, Rule 17a–4, to expand broker-dealer record retention options by permitting broker-dealers to use optical storage technology for information required to be maintained under these rules. The Proposing Release described optical storage technology as storage technology which "allows for digital data recording in a non-rewriteable, non-erasable format, such as write once, read many ("WORM") * * *. Non-rewriteable optical storage records digital information by employing a laser heat source to burn a pattern on a metallic film on a disk surface that can hold billions of bytes of data."

In the Proposing Release, the Commission noted the importance for recordkeeping of ready access, reliability, and permanence of records. Therefore, the proposed rule included safeguards against data erasure, provisions for immediate verification of the stored material, and requirements for back-up facilities. Specifically, the conditions included requirements that broker-dealers using optical disk storage systems employ non-rewriteable, non-erasable technology that verifies automatically the quality and accuracy of the optical storage recording process, duplicate in a separate optical disk all information preserved and maintained by means of optical storage technology, serialize the original and duplicate optical disks, and time-date the information placed on the optical disks. In addition, to facilitate full access to records during examinations by the self-regulatory organizations ("SROs") and the Commission, broker-dealers would be required to index the optical disks and place the index on optical disk, and would be required to have the capability to readily reproduce records kept on optical disks in any medium acceptable under the final rule amendment, as required by the SROs and the Commission.

The Proposing Release also solicited comment regarding the adequacy of optical disk technology to preserve handwritten records or records that contain handwritten text, given the difficulties associated with detecting alterations made to handwritten text preserved through optical disk technology.[5]

The Commission received 13 comment letters in response to the Proposing Release.[6] Several commenters explained that the description of optical storage technology in the Proposing Release included only one specific type of writing technology known as ablative writing,[7] and requested clarification that the final rule would apply to other forms of optical disk technology that met the requirements of the rule. In addition, a few commenters objected to limiting the acceptable storage medium to optical disk technology and recommended that the rule apply to other electronic storage media, including optical tape.[8] More recently, the SIA requested clarification as to whether the Commission considers CD–ROM to be a form of optical disk technology.[9] Commenters that addressed the issue of the adequacy of optical disk technology in preserving handwritten records or records that contain handwritten text objected to any restrictions on the types of records broker-dealers can maintain using optical storage technology.

II. Description of Rule Amendments

A. Scope of Permissible Electronic Storage Media

In the Proposing Release, the Commission did not intend the definition of optical storage technology to include only an ablative methodology of storage. The Commission recognizes that other methods of electronic storage technology exist, including optical tape and CD–ROM, which are available in a WORM, non-rewriteable version.[10] The Commission is adopting a rule today which, instead of specifying the type of storage technology that may be used, sets forth standards that the electronic storage media must satisfy to be considered an acceptable method of storage under Rule 17a–4. Specifically, because optical tape, CD–ROM, and certain other methods of electronic storage are available in WORM and can provide the same safeguards against data manipulation and erasure that optical disk provides, the final rule clarifies that broker-dealers may employ any electronic storage media that meets the conditions set forth in the final rule.[11]

B. Handwritten Records

In the Proposing Release, the Commission expressed concern and requested comment regarding the use of optical disk technology to preserve

[1] 17 CFR 240.17a–4. Rule 17a–4 sets forth the records to be preserved by certain exchange members, brokers, and dealers.

[2] Securities Exchange Act Release No. 32609 (July 9, 1993), 58 FR 38092 (July 15, 1993).

[3] Letter from Nelson S. Kibler, Assistant Director, Division of Market Regulation, SEC to Robert F. Price, Alex. Brown & Sons (November 3, 1979).

[4] Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, SEC to Michael D. Udoff, Chairman, *Ad Hoc* Record Retention Committee, Securities Industry Association ("SIA") (June 18, 1993).

[5] In response to these concerns, the Division's no-action letter permitted optical storage of all paper records, including handwritten records, except those records required to be made under paragraphs (a)(6) and (a)(7) of Rule 17a–3 (proprietary and customer order tickets).

[6] The comment letters are available for public inspection and copying in the Commission's public reference room located at 450 Fifth Street, NW., Washington, DC. (File No. S7–21–93).

[7] Ablative technology means that, by use of a laser, a pattern is burned onto a metallic film on an optical disk. Other methods of optical disk technology utilize a laser to record information onto the optical disk, but unlike ablative technology, the laser does not necessarily "burn" a pattern onto the disk.

[8] The SIA commented that optical tape provides the same safeguards against data erasure and manipulation as optical disk provides but allows for storage of greater amounts of data. Letter from Michael D. Udoff, Chairman, *Ad Hoc* Record Retention Committee of the SIA to Jonathan G. Katz, Secretary, SEC (September 30, 1993).

[9] Letter from Mark A. Egert, Assistant General Counsel, SIA to Michael A. Macchiaroli, Associate Director, Division of Market Regulation, SEC (February 15, 1996) (arguing that CD–ROMs are simply one of several different optical disk sizes that are commercially available.)

[10] The Commission understands that additional methods also available in a WORM, non-rewritable version include, for example, alloying, bubble-forming, moth-eye (Plasmon), phase-change, dye/polymer, and magneto-optic.

[11] The amendment the Commission is adopting today also permits the use of "micrographic media" which is defined to include microfilm or microfiche, or any similar media, which codifies an earlier Commission staff no-action position. *See* Letter from Nelson S. Kibler, *supra* note 3.

handwritten records and records containing handwritten text. As indicated in the Proposing Release, the Commission's primary concern was that, from the standpoint of examinations and enforcement of the securities laws, optical disk images (as well as microfilm or microfiche images) make it difficult to detect forgery and alterations made to handwritten text.

The Commission recognizes that microfilm is a form of record retention for handwritten records that has been permitted since 1970, and the Commission understands few broker-dealers currently keep documents in hard copy or paper format. The Commission's experience since 1970 relating to the retention of handwritten records on microfilm has generally been positive. The Commission further understands that many of the larger broker-dealers no longer create traditional order tickets (with or without handwritten notations) because such broker-dealers enter most orders directly through electronic systems which automatically retain an electronic record of the trade entry.

In view of the existing use of microfilm and microfiche for record retention, the Commission believes that allowing preservation of handwritten records in electronic storage media would not significantly increase the difficulty of detecting forgery or alterations on these records. Accordingly, the Commission is permitting storage of handwritten records and records containing handwritten text using electronic storage media meeting the requirements set forth in the final rule adopted today.[12] Nonetheless, in the future, if difficulties arise in detecting abuses in handwritten records stored in electronic format, the Commission may revisit this issue both with regard to electronic storage media, as well as microfilm and microfiche.[13]

C. Creation of a Duplicate Record

The Proposing Release would have required a broker-dealer to copy all of the information contained on an original disk onto a separate, duplicate disk. The SIA commented that broker-dealers should be permitted to store the duplicate record on any medium acceptable under Rule 17a–4. The SIA explained that clearing firms frequently have to provide copies of records to their correspondent firms that may not have optical disk technology. Therefore, according to the SIA, clearing firms may be obligated to maintain certain records in another media for the correspondents' use.[14] The Commission agrees that it is appropriate to permit storage of the duplicate record on any medium acceptable under Rule 17a–4, and accordingly, the final amendments reflect this change.[15]

D. Audit System Requirement

The Proposing Release would have required a broker-dealer to "have in place an audit system providing for accountability regarding all access to records maintained and preserved using optical storage technology and any changes made to every original and duplicate optical disk." Commenters sought clarification as to whether this provision requires maintenance of a log of all persons who have the capability or authority to access optical disks, or maintenance of a log indicating each instance where data is added to a disk. The rule adopted by the Commission today requires an audit system to be utilized only when records required to be maintained under Rule 17a–4 are being entered or when any additions to existing records are made. Therefore, an audit record is not required when a record is accessed but cannot be altered by the reader.

E. Third Party Down-Load Provider

The Proposing Release would require broker-dealers to have arrangements with at least one third party that has the ability to download information from the broker-dealer's electronic storage system to another acceptable medium. The third party must submit undertakings to the SRO for the broker-dealer indicating that it agrees to promptly furnish information necessary for the Commission's staff and its designees to download information from a broker-dealer's electronic storage system to another acceptable medium, and take reasonable steps to provide access to information contained on a broker-dealer's electronic storage system. The Commission is adopting this requirement substantially as proposed.

F. Escrow Agent

Under the Proposing Release, broker-dealers would be required to keep current all information necessary to download records and indices stored on optical disks. Alternatively, broker-dealers who use outside service bureaus to preserve records could place in escrow and keep current a copy of the information necessary to access the format (i.e., the logical layout) of the optical disks and to download records stored on optical disks. This condition was intended to ensure access to information preserved on optical disks when the broker-dealer is no longer operational, when the broker-dealer refuses to cooperate with investigative efforts of the Commission or the SROs, or when the optical disk has not been properly indexed. The SIA commented that they believed this requirement duplicated the required third party undertaking in the proposed amendments. The third party undertaking was intended to act as a back-up to the escrow requirement, and therefore the Commission does not agree that it would be unnecessary and duplicative to require broker-dealers to keep or escrow the information necessary to download records from optical disk. Accordingly, the final rule adopted today includes such proposed requirement.

III. Staff No-Action Position

The Commission also is providing notice that the staff of the Division will not recommend enforcement action to the Commission if broker-dealers, transfer agents, and clearing agencies fulfill their record retention and preservation requirements set forth in the following rules under the Exchange Act by using electronic storage media as permitted by the final amendments to Rule 17a–4(f) described herein:

Rule 3a51–1 (17 CFR 240.3a51–1)
Rule 15a–6 (17 CFR 240.15a–6)
Rule 15c1–7 (17 CFR 240.15c1–7)
Rule 15c2–5 (17 CFR 240.15c2–5)
Rule 15c2–11 (17 CFR 240.15c2–11)
Rule 15c3–1 (17 CFR 240.15c3–1)
Rule 15c3–3 (17 CFR 240.15c3–3)
Rule 15g–3 (17 CFR 240.15g–3)
Rule 15g–4 (17 CFR 240.15g–4)
Rule 15g–5 (17 CFR 240.15g–5)

[12] *But see infra* note 16 and accompanying text for certain limited exceptions.

[13] Recently, the Commission published its views with respect to the use of electronic media by broker-dealers, transfer agents, and investment advisers to deliver information as required under the Exchange Act and the Investment Advisers Act of 1940. Securities Exchange Act Release No. 37182 (May 9, 1996), 61 FR 24644 (May 15, 1996) ("May Interpretive Release"). As the Commission noted in the May Interpretive Release, the staff of the Division also reminds broker-dealers, transfer agents, and clearing agencies of their responsibilities to prevent, and the potential liability associated with, unauthorized transactions. In this regard, broker-dealers, transfer agents, and clearing agencies should have reasonable assurance that information preserved by means of electronic storage media, including customer signatures, is authentic. *See id.* at note 29.

[14] See Letter from Michael D. Udoff, *supra* note 8.

[15] Another issue raised by several commenters concerns the time at which the duplicate must be created. Broker-dealers will be permitted to wait to make the duplicate until the original optical disk is full, provided that broker-dealers maintain the duplicate data on another acceptable medium such as paper or micrographic media until it creates the duplicate optical disk.

Rule 15g–6 (17 CFR 240.15g–6)
Rule 17a–2 (17 CFR 240.17a–2)
Rule 17a–5 (17 CFR 240.17a–5)
Rule 17a–6 (17 CFR 240.17a–6)
Rule 17a–7 (17 CFR 240.17a–7)
Rule 17a–8 (17 CFR 240.17a–8)
Rule 17f–1 (17 CFR 240.17f–1)
Rule 17f–2 (17 CFR 240.17f–2)
Rule 17Ad–6 (17 CFR 240.17Ad–6)
Rule 17Ad–10 (17 CFR 240.17Ad–10)
Rule 17Ad–11 (17 CFR 240.17Ad–11)
Rule 17Ad–13 (17 CFR 240.17Ad–13)
Rule 17Ad–15 (17 CFR 240.17Ad–15)

The staff of the Division believes that the recordkeeping requirements under Exchange Act Rules 15g–2 and 15g–9[16] should not be met by means of electronic storage media, and the records required by such rules should be maintained and preserved in paper format for the prescribed time period. Rules 15g–2 and 15g–9 require broker-dealers to obtain from a customer prior to effecting transactions in penny stocks (1) a manually signed acknowledgement of the receipt of a risk disclosure document, (2) a written agreement to transactions involving penny stocks, and (3) a manually signed and dated copy of a written suitability statement. Because the Commission, in the May Interpretative Release, did not permit the use of electronic media to satisfy the requirements of Rules 15g–2 and 15g–9, the staff of the Division believes it would not be appropriate to permit the storage of records required by such rules using electronic storage media.[17]

IV. Electronic Communications

Finally, the Commission is aware that many questions have been raised regarding the applicability of Rule 17a–4(b)(4) to electronic mail communications ("e-mail") and Internet communications. In the May Interpretive Release, the Commission discussed its beliefs regarding the adaptation of SRO supervisory review requirements governing communications with customers to accommodate the use of electronic communications by broker-dealers. The Commission recommended that the SROs work with broker-dealers with respect to the adaptation of such rules and recommended that the SRO rules concerning the supervisory requirements for electronic communications "should be based on the content and audience of the message and not merely the electronic form of the communication."[18]

The Commission understands that broker-dealers use e-mail and the Internet to communicate important information relating to the broker-dealer's business internally, to customers, and to the general public. The Commission is also aware that many broker-dealers use such electronic systems to communicate about issues unrelated to the business of the broker-dealer. Consistent with the Commission's recommendation to the SROs regarding the appropriate standard for prior supervisory review for electronic communications, the Commission believes that for record retention purposes under Rule 17a–4, the content of the electronic communication is determinative, and therefore broker-dealers must retain only those e-mail and Internet communications (including inter-office communications) which relate to the broker-dealer's "business as such."

V. Summary of Final Regulatory Flexibility Analysis

The Regulatory Flexibility Act, which became effective on January 1, 1981, imposes procedural steps applicable to agency rulemaking that has a "significant economic impact on a substantial number of small entities."[19] The Chairman of the Commission has certified pursuant to the Regulatory Flexibility Act that the final amendments to Rule 17a–4 will not have a significant economic impact on a substantial number of small entities because the amendments do not alter the regulatory requirements for broker-dealers using currently accepted media for record retention purposes (i.e., paper, microfilm, or microfiche). A copy of the certification is attached to this release as Appendix A.

VI. Paperwork Reduction Act

In connection with the Proposing Release, on August 12, 1993, notice was published in the **Federal Register**[20] that, pursuant to the Paperwork Reduction Act of 1980 ("Old PRA"),[21] the Commission had submitted to the Office of Management and Budget ("OMB") request for approval of the proposed amendments to Rule 17a–4. No comments were received with respect to the notice. The OMB control number, 3235–0279, was originally issued in 1993 and was reauthorized on June 30, 1996. Comment was sought with respect to the reauthorization and no comment was received.[22] The OMB number was issued pursuant to the Old PRA, prior to the amendment of such act in 1995.

The Proposing Release included certain requirements that would be unique to broker-dealers which chose to use optical storage systems and which qualified as collections of information under the Old PRA. The final rule amendments do not contain substantive modifications to the collections of information originally set forth in the Proposing Release. The collection of information is in accordance with the clearance requirements of 44 U.S.C. 3507. The final amendments clarify that broker-dealers may use any electronic storage media that meets the requirements of the rule. Since the final rule amendment expands the scope of recordkeeping options and does not alter the options currently permitted under the rule, broker-dealers may chose to continue to store information using paper, microfilm, or microfiche, or may chose to employ electronic storage media as permitted by the final rule amendments. If broker-dealers chose the electronic storage media option, then compliance with the collection of information requirement is mandatory.

A. Collection of Information Under Rule 17a–4

Under the final rule amendments, users of electronic storage media must have in place an audit system that provides for accountability regarding inputting of records required to be maintained and preserved pursuant to

[16] 17 CFR 240.15g–2 and 240.15g–9.

[17] *See* May Interpretive Release at note 50.

[18] *See id.* at note 5. The Commission notes that the New York Stock Exchange, Inc. ("NYSE") has submitted a proposal to modify its supervisory rules which will require prior supervisory review of those communications with the general public and customers which include advertisements, market letters, sales literature, and similar types of communications, as well as research reports. The proposal also requires members to develop reasonable procedures for review of registered representatives' communications with the public relating to their business. *See* File No. SR–NYSE–96–26.

[19] Although Section 601(b) of the Regulatory Flexibility Act defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions of the term "small entity" for purposes of Commission rulemaking in accordance with the Regulatory Flexibility Act. Those definitions are set forth in Rule 0–10, 17 CFR 240.0–10. *See* Securities Exchange Act Release No. 18452 (January 26, 1982), 47 FR 5215 (February 4, 1982). A broker-dealer is a "small business" or "small organization" under Rule 0–10 if the broker-dealer (i) had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17–5(d) or, if not required to file such statements, a broker-dealer that had total net capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (ii) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in 17 CFR 240.0–10.

[20] 58 FR 42992 (August 12, 1993).

[21] 44 U.S.C. 3501 *et seq.*

[22] 61 FR 14586 (April 2, 1996).

Rules 17a–3 and 17a–4 to electronic storage media and inputting of any changes made to every original and duplicate record maintained and preserved thereby. Although the Commission is not specifying the contents of each audit system, data automatically or otherwise stored (in the computer or in hard copy) regarding inputting of records and changes to existing records will be part of that system. The Commission envisions that names of individuals actually inputting records and making particular changes, and the identity of documents changed and the identity of new documents created, are the kind of information that automatically would be collected pursuant to the audit system requirement. The results of the audit system must be available for examination by the staffs of the Commission and the appropriate SROs and must be preserved for the time required for the audited records.

In addition, the entity employing the electronic storage media must organize and index all information maintained on both original and duplicate electronic storage media, and each index must be duplicated. The entity employing the technology must also maintain, keep current, and provide promptly upon request by the Commission or SROs all information necessary to access records and indexes stored on electronic storage media, or escrow and keep current a copy of the physical and logical file format, the field format of all different information types written on the electronic storage media and the source code, together with appropriate documentation and information necessary to access records and indexes.

The recordkeeping requirements described above are unlikely to prove burdensome to users because the recordkeeping requirements are specifically tied to the design and use of electronic storage media. To the extent that the final rule amendments create any burden on users, however, such burden should be small, even negligible, relative to the reduced recordkeeping burden that will result from broker-dealers' ability to use electronic storage media.

B. Proposed Use of the Information

The information contained in the records required to be preserved by those subject to Rule 17a–4 will be used by examiners and other representatives of the Commission and the SROs to ensure that broker-dealers are in compliance with applicable financial responsibility, antifraud, and antimanipulation rules as well as other rules and regulations of the Commission and the SROs. The collections of information generally will not be made publicly available. The ultimate purpose of the final amendment is the protection of investors.

VII. Statutory Analysis

Pursuant to the Securities Exchange Act of 1934 and particularly section 17(a)(1) thereof, 15 U.S.C. 78q(a)(1), the Commission is adopting amendments to § 240.17a–4 of Title 17 of the Code of Federal Regulations in the manner set forth below.

List of Subjects in 17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

Text of Final Rule

In accordance with the foregoing, Title 17, chapter II, part 240 of the Code of Federal Regulations is amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934.

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78w, 78x, 78*ll*(d), 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

2. Section 240.17a–4 is amended by revising paragraph (f) to read as follows:

§ 240.17a–4 Records to be preserved by certain exchange members, brokers and dealers.

* * * * *

(f) The records required to be maintained and preserved pursuant to §§ 240.17a–3 and 240.17a–4 may be immediately produced or reproduced on "micrographic media" (as defined in this section) or by means of "electronic storage media" (as defined in this section) that meet the conditions set forth in this paragraph and be maintained and preserved for the required time in that form.

(1) For purposes of this section:

(i) The term *micrographic media* means microfilm or microfiche, or any similar medium; and

(ii) The term *electronic storage media* means any digital storage medium or system and, in the case of both paragraphs (f)(1)(i) and (f)(1)(ii) of this section, that meets the applicable conditions set forth in this paragraph (f).

(2) If electronic storage media is used by a member, broker, or dealer, it shall comply with the following requirements:

(i) The member, broker, or dealer must notify its examining authority designated pursuant to section 17(d) of the Act (15 U.S.C. 78q(d)) prior to employing electronic storage media. If employing any electronic storage media other than optical disk technology (including CD–ROM), the member, broker, or dealer must notify its designated examining authority at least 90 days prior to employing such storage media. In either case, the member, broker, or dealer must provide its own representation or one from the storage medium vendor or other third party with appropriate expertise that the selected storage media meets the conditions set forth in this paragraph (f)(2).

(ii) The electronic storage media must:

(A) Preserve the records exclusively in a non-rewriteable, non-erasable format;

(B) Verify automatically the quality and accuracy of the storage media recording process;

(C) Serialize the original and, if applicable, duplicate units of storage media, and time-date for the required period of retention the information placed on such electronic storage media; and

(D) Have the capacity to readily download indexes and records preserved on the electronic storage media to any medium acceptable under this paragraph (f) as required by the Commission or the self-regulatory organizations of which the member, broker, or dealer is a member.

(3) If a member, broker, or dealer uses micrographic media or electronic storage media, it shall:

(i) At all times have available, for examination by the staffs of the Commission and self-regulatory organizations of which it is a member, facilities for immediate, easily readable projection or production of micrographic media or electronic storage media images and for producing easily readable images.

(ii) Be ready at all times to provide, and immediately provide, any facsimile enlargement which the Commission or its representatives may request.

(iii) Store separately from the original, a duplicate copy of the record stored on any medium acceptable under § 240.17a–4 for the time required.

(iv) Organize and index accurately all information maintained on both original and any duplicate storage media.

(A) At all times, a member, broker, or dealer must be able to have such indexes available for examination by the staffs of the Commission and the self-regulatory organizations of which the broker or dealer is a member.

(B) Each index must be duplicated and the duplicate copies must be stored separately from the original copy of each index.

(C) Original and duplicate indexes must be preserved for the time required for the indexed records.

(v) The member, broker, or dealer must have in place an audit system providing for accountability regarding inputting of records required to be maintained and preserved pursuant to §§ 240.17a–3 and 240.17a–4 to electronic storage media and inputting of any changes made to every original and duplicate record maintained and preserved thereby.

(A) At all times, a member, broker, or dealer must be able to have the results of such audit system available for examination by the staffs of the Commission and the self-regulatory organizations of which the broker or dealer is a member.

(B) The audit results must be preserved for the time required for the audited records.

(vi) The member, broker, or dealer must maintain, keep current, and provide promptly upon request by the staffs of the Commission or the self-regulatory organizations of which the member, broker, or broker-dealer is a member all information necessary to access records and indexes stored on the electronic storage media; or place in escrow and keep current a copy of the physical and logical file format of the electronic storage media, the field format of all different information types written on the electronic storage media and the source code, together with the appropriate documentation and information necessary to access records and indexes.

(vii) For every member, broker, or dealer exclusively using electronic storage media for some or all of its record preservation under this section, at least one third party ("the undersigned"), who has access to and the ability to download information from the member's, broker's, or dealer's electronic storage media to any acceptable medium under this section, shall file with the designated examining authority for the member, broker, or dealer the following undertakings with respect to such records:

The undersigned hereby undertakes to furnish promptly to the U.S. Securities and Exchange Commission ("Commission"), its designees or representatives, upon reasonable request, such information as is deemed necessary by the Commission's or designee's staff to download information kept on the broker's or dealer's electronic storage media to any medium acceptable under Rule 17a–4.

Furthermore, the undersigned hereby undertakes to take reasonable steps to provide access to information contained on the broker's or dealer's electronic storage media, including, as appropriate, arrangements for the downloading of any record required to be maintained and preserved by the broker or dealer pursuant to Rules 17a–3 and 17a–4 under the Securities Exchange Act of 1934 in a format acceptable to the Commission's staff or its designee. Such arrangements will provide specifically that in the event of a failure on the part of a broker or dealer to download the record into a readable format and after reasonable notice to the broker or dealer, upon being provided with the appropriate electronic storage medium, the undersigned will undertake to do so, as the Commission's staff or its designee may request.

* * * * *

By the Commission.

Dated: February 5, 1997.

Margaret H. McFarland,

Deputy Secretary.

Note: Appendix A to the Preamble will not appear in the Code of Federal Regulations.

Appendix A—Regulatory Flexibility Act Certification

I, Arthur Levitt, Chairman of the Securities and Exchange Commission, hereby certify pursuant to 5 U.S.C. 605(b) that the final amendments to Rule 17a–4 set forth in Securities Exchange Release No. 34–38245 will not have a significant economic impact on a substantial number of small entities. Specifically, the amendments do not alter the regulatory requirements for broker-dealers using currently accepted media for record retention purposes (i.e., paper, microfilm, or microfiche). Instead, the amendments expand the record retention media options by allowing broker-dealers to utilize certain electronic storage media to store records required under 17 CFR 240.17a–3 and 240.17a–4. Accordingly, the amendments will not change the impact of current regulatory record preservation requirements on a substantial number of small entities.

Dated: January 31, 1997.

Arthur Levitt,

Chairman.

[FR Doc. 97–3426 Filed 2–11–97; 8:45 am]

BILLING CODE 8010–01–P

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17 CFR Part 240

[Release No. 34–38248; File No. S7–7–94]

RIN 3235–AG14

Net Capital Rule

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is amending Rule 15c3–1 under the Securities Exchange Act of 1934 ("Exchange Act"), the net capital rule, to permit broker-dealers to employ theoretical option pricing models in determining net capital requirements for listed options and related positions. Alternatively, broker-dealers may elect a strategy-based methodology. The amendments are intended to simplify the net capital rule's treatment of options for capital purposes and more accurately reflect the risk inherent in broker-dealer options positions.

EFFECTIVE DATE: The amendments become effective September 1, 1997.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director (202) 942–0131, Peter R. Geraghty, Assistant Director (202) 942–0177, or Louis A. Randazzo, Special Counsel (202) 942–0191, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 5–1, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

The Commission is adopting amendments to Rule 15c3–1 under the Exchange Act to permit broker-dealers to employ theoretical option pricing models to calculate required net capital for listed options and the related positions that hedge those options. In adopting these amendments, the Commission is continuing its process of revising the net capital rule that was contemplated when the Commission solicited comments on a range of capital related issues in 1993.[1] The amendments being adopted today were proposed in initial form in March of 1994 and would allow broker-dealers to use an options pricing model to determine capital charges for listed options and related positions.[2] Simultaneously with the Commission's proposal, the Division of Market Regulation ("Division") issued a no-action letter allowing broker-dealers to utilize the options pricing approach immediately.[3] Based on the experience gained by the Commission under the no-action letter, and the nature of the comments received during the public comment period, the Commission is

[1] Securities Exchange Act Release No. 32256 (May 4, 1993), 58 FR 27486 (May 10, 1993) ("Concept Release").

[2] Securities Exchange Act Release No. 33761 (March 15, 1994), 59 FR 13275 (March 21, 1994) ("Proposing Release").

[3] Letter from Brandon Becker, Division of Market Regulation, SEC to Mary L. Bender, First Vice President, CBOE and Timothy Hinkes, Vice President, The Options Clearing Corporation ("OCC") (March 15, 1994) ("1994 No-Action Letter").

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
Facsimile: (202) 418-5521

June 26, 1998

Joni Lupovitz, Esq.
McDermott, Will & Emery
600 13th Street, NW
Washington, D.C. 20005-3096

Dear Ms. Lupovitz:

The Commission acknowledges receipt of the petition by First Options of Chicago, Inc. ("FOC") for amendment of Commission Regulation 1.31, submitted pursuant to Commission Regulation 13.2. FOC's petition seeks amendments to the recordkeeping requirements established by Commission Regulation 1.31. It contends that the current requirements should be amended to permit use of a range of electronic storage media to maintain all categories of covered records, including trading cards and written customer orders, for the entire required recordkeeping period.

The Commission recently authorized the publication of a Federal Register release proposing amendments to Regulation 1.31. That release, 63 Fed. Reg. 30668 (June 5, 1998), proposes amendments and discusses issues similar to those raised in FOC's petition. Comments on the proposed amendments may be filed within 60 days of the date of its publication in the Federal Register.

The Commission has determined to treat your petition as a comment to that release. The petition will provide valuable input to the rulemaking process. The petition will be made part of the public record of the proposal and will be considered in adopting any final rule.

If you need further information about the status of your petition, please contact Ed Case of the Division of Trading and Markets at (202) 418-5150.

Sincerely yours,

Catherine D. Dixon

Catherine D. Dixon
Assistant Secretary of the Commission

cc: Paul J. Pantano, Jr., Esq.
John G. Gaine, Esq., President, Managed Funds Association
Daniel J. Roth, Esq., General Counsel, National Futures Association
Barbara L. Wierzynski, Esq., Executive Vice President
and General Counsel, Futures Industry Association, Inc.

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521

OFFICE OF THE SECRETARIAT

June 9, 1998

Mr. Daniel J. Roth
General Counsel
National Futures Association
200 W. Madison Street
Chicago, IL 60606-3447

Dear Mr. Roth:

By letters dated June 5, 1998, you requested on behalf of the National Futures Association that the Commission consider petitions for rulemaking to amend CFTC Regulations 4.13 and 4.14, as well as Regulations 1.3, 1.55, 4.7, 35.1, amd 36.1. This is to acknowledge receipt of the petitions and to inform you that the petitions have been referred to the Commission for such action the Commission deems appropriate. I will inform you of any action taken by the Commission on the petitions.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

19980329

NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

June 5, 1998

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition for Rulemaking to Amend CFTC Regulations 4.13 and 4.14

Dear Ms. Webb:

National Futures Association ("NFA") respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulations 4.13 and 4.14. NFA petitions the Commission to amend Regulation 4.13 to exempt managers of collective investment vehicles from commodity pool operator ("CPO") registration if they operate only vehicles that do a *de minimus* amount of futures transactions. NFA also petitions the Commission to amend CFTC Regulation 4.14 to provide a similar exemption from commodity trading advisor ("CTA") registration for persons who provide their trading advice soley to these vehicles and to collective investment vehicles described in CFTC Regulation 4.5. The information required by CFTC Regulation 13.2 follows.

I. Text of the Proposed Amendments

PART 4 — COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

§ 4.13 Exemption from registration as a commodity pool operator

(a) A person is not required to register under the Act as a commodity pool operator if:

* * *

(3)(i) It operates only commodity pools that use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1); *Provided, however,* That in addition, with respect to positions in commodity futures and commodity option contracts which do not come within the meaning and intent of § 1.3(z)(1), the aggregate initial margin and premiums required to establish such positions for any pool does not exceed five percent of the liquidation value of that pool's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; And *Provided further,* That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such five percent;

(ii) It has not and does not market participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets;

(iii) It discloses in writing to each prospective participant the purpose of and the limitations on the scope of the commodity futures and commodity options trading in which the pool will engage; and

(iv) It submits to such special calls as the Commission may make to require it to demonstrate compliance with the provisions of this § 4.13(a)(3); and

(v) It maintains all books and records prepared in connection with its activities as a commodity pool operator for a period of five years from the date of preparation and keeps such books and records readily accessible during the first two years of the five year period. All such books and records shall be open to inspection by any representative of the Commission or the United States Department of Justice.

(b)(1) No person who is exempt from registration as a commodity pool operator under paragraph (a)(1), (a)(2), or (a)(3) of this section and who is not registered as such pursuant to that exemption may, directly or indirectly, solicit, accept or receive funds, securities or other property from any prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the person delivers or causes to be delivered to the prospective participant a written statement that must disclose this fact as follows: "The commodity pool operator of this pool is not required to register, and has not registered, with the Commodity Futures Trading Commission. Therefore, unlike a registered commodity pool operator, this commodity pool operator is not required by the Commission to furnish a Disclosure Document, periodic Account Statements, and an Annual Report to participants in the pool." The person must:

(i) Describe in the statement the exemption pursuant to which it is not registered as a commodity pool operator;

(ii) Provide its name, main business address and main business telephone number on the statement;

(iii) Manually sign the statement as follows: if such person is a corporation, by the chief executive officer, chief financial officer or counterpart thereto; if a partnership, by a general partner; and if a sole proprietorship, by the sole proprietor; and

(iv) By the earlier of seven business days after the date the statement is first delivered to a prospective participant and the date upon which the pool commences trading in commodity interests:

(A) File two copies of the statement with the Commission at the address specified in § 4.2; and

(B) File one copy of the statement with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department).

* * *

(d) If a person exempt from registration under the Act as a commodity pool operator under paragraph (a)(1), (a)(2), or (a)(3) of this section registers as a commodity pool operator, that person must comply with this Part 4 as if such person were not exempt from registration as a commodity pool operator.

§ 4.14 Exemption from registration as a commodity trading advisor

(a) A person is not required to register under the Act as a commodity trading advisor if:

* * *

(9)(i) The person's commodity interest trading advice:

(A) Is directed solely to and for the use of commodity pools that meet the requirements of and are operated by a person exempt from registration under § 4.13(a)(3) or are operated by a person excluded from the definition of commodity pool operator under § 4.5;

(B) Is solely incidental to its business of providing investment advice to such pools in instruments that are either exempt from regulation pursuant to the Commission's regulations or excluded from Commission regulation under the Act; and

(C) Employs only such strategies as are consistent with eligibility status under § 4.13(a)(3).

(ii) The person is not otherwise holding itself out as a commodity trading advisor; and

(iii) Prior to the date upon which such person intends to engage in business as a commodity trading advisor, the person files a notice of exemption with the Commission.

(A) The notice must provide the name, main business address, and main business telephone number of the person filing the notice.

(B) The notice must represent that the person qualifies for exemption under this § 4.14(a)(9) and that it will comply with the criteria of this section.

(C) The notice shall be effective upon filing, *Provided, however,* That an exemption claimed hereunder shall cease to be effective upon any change which would render the representations made pursuant to paragraph (a)(9)((iii)(B) of this section inaccurate or the continuation of such representations false or misleading.

(iv) In the event a person who has filed a notice of exemption under this § 4.14(a)(9) subsequently becomes registered as a commodity trading advisor, the person must file a supplemental notice of that fact.

(v) Any notice required to be filed hereunder must be:

(A) In writing;

(B) Signed by a duly authorized representative; and

(C) Filed, along with a copy, with the Commission at the address specified in § 4.2.

(D) A copy also must be filed with the National Futures Association at its headquarters office (ATTN: Director of Compliance, Compliance Department).

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. Registered CPOs and registered CTAs who manage futures accounts are required to be Members of NFA and are regulated by NFA. Therefore, NFA is interested in ensuring that CPOs and CTAs are regulated in the most efficient and effective manner. NFA believes that the proposed *de minimus* exemption futhers this goal.

III. Supporting Arguments

NFA's Board of Directors, at the recommendation of the Special Committee for the Review of a Multi-Tiered Regulatory Approach, petitions the Commission to amend its rules to adopt an exemption from CPO registration for managers of collective investment vehicles that do a *de minimus* amount of futures transactions and do not hold themselves out as commodity pools. The exemption would apply to CPOs of hedge funds and other collective investment vehicles that do not commit more than 5% of the liquidation value of their portfolios to initial margin and premiums for commodity futures or options transactions that are not hedging transactions.

The collective investment vehicles covered by the proposed exemption are not sold to the public as commodity pools, and investors do not invest in them as a means of investing in the futures markets. Since the managers of these vehicles are currently required to be registered, however, they are required to be Members of NFA and are regulated and audited by NFA. By exempting these managers from registration, they would no longer be required to be Members of NFA. This would would free up NFA's resources for regulating and auditing firms that are more directly involved in the futures markets.

CFTC Regulation 4.5 excludes investment companies, insurance companies, banks and trust companies, and fiduciaries of ERISA plans from the definition of commodity pool operator. The Special Committee considered whether to take this same approach and recommend that § 4.5 be amended to exclude hedge fund managers from the definition of commodity pool operator. The Special Committee decided, however, to recommend that the Commission take a middle ground and amend § 4.13 to merely exempt these managers from CPO registration.

An exclusion from the definition of commodity pool operator is a complete exemption from all of the provisions of the Act that apply to CPOs, including the anti-fraud provisions. An exemption from registration under § 4.13, on the other hand, does not exempt the CPO from the anti-fraud provisions of the Act. Since the proposed *de minimus* exemption will apply to persons who manage unregulated hedge funds, some of which may have unsophisticated customers, the Special Committee felt that the anti-fraud protections of the Act should apply.

In drafting the exemption, the Special Committee generally followed the language of § 4.5(c)(2), except that it tried to make the language consistent with the current § 4.13 exemptions by making the requirements self-executing rather than requiring the pool operator to provide representations that it will comply with them. As with the other § 4.13 exemptions, the CPO would also be required to notify participants, the Commission, and NFA that it is an exempt pool; to maintain its books and records for five years and make them available to the Commission and the Department of Justice; and to comply with Part 4 if it decides to register in spite of the exemption. The CPO would not, however, be required to provide participants with FCM brokerage statements since this information would not be particularly helpful to investors. Information on hedge transactions is unenlightening without corresponding information for the transactions being hedged, and other futures transactions will be merely a blip on the radar screen compared to the fund's overall investments.

The Board of Directors, at the Special Committee's recommendation, is also petitioning the Commission to amend CFTC Regulaton 4.14 to exempt trading advisors who provide commodity trading advice only to pools subject to the proposed *de minimus* exemption and to § 4.5 entities. The language generally tracks § 4.14(a)(8), which exempts trading advisors for § 4.5 entities. The Special Committee did broaden the "solely incidental" requirement to allow exempt CTAs to provide investment advice for all types of instruments that are not regulated by the CFTC rather than simply to provide investment advice concerning securities.

NFA respectfully petitions the Commission to amend Regulations 4.13 and 4.14 as described above.

Respectfully submitted,

Daniel J. Roth
General Counsel

kpc(committe\deminimus-petition)

cc: Chairperson Brooksley Born
Commissioner Barbara Pedersen Holum
Commissioner John E. Tull, Jr.
Commissioner David D. Spears
Geoffrey Aronow, Esq.
I. Michael Greenberger, Esq.
Alan L. Seifert, Esq.
Lawrence B. Patent, Esq.
David Van Wagner, Esq.

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521

OFFICE OF THE
SECRETARIAT

June 9, 1998

Mr. Daniel J. Roth
General Counsel
National Futures Association
200 W. Madison Street
Chicago, IL 60606-3447

Dear Mr. Roth:

By letters dated June 5, 1998, you requested on behalf of the National Futures Association that the Commission consider petitions for rulemaking to amend CFTC Regulations 4.13 and 4.14, as well as Regulations 1.3, 1.55, 4.7, 35.1, amd 36.1. This is to acknowledge receipt of the petitions and to inform you that the petitions have been referred to the Commission for such action the Commission deems appropriate. I will inform you of any action taken by the Commission on the petitions.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

19980330

NFA NATIONAL FUTURES ASSOCIATION

200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

June 5, 1998

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition for Rulemaking to Amend CFTC Regulations 1.3, 1.55, 4.7, 35.1, and 36.1

Dear Ms. Webb:

National Futures Association ("NFA") respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulations 1.3, 1.55, 4.7, 35.1, and 36.1. These amendments would adopt a uniform definition for those types of customers who are generally considered sophisticated and, therefore, are authorized to engage in certain types of transactions or are excluded from particular regulatory requirements. The uniform definition would apply to qualified eligible participants, qualified eligible clients, eligible swap participants, eligible participants for exchange transactions under § 4(c) of the Commodity Exchange Act, and entities that do not have to receive standardized risk disclosure. The uniform definition generally follows the definition of eligible swap participant currently found in CFTC Regulation 35.1, with several modifications.

The proposed definition would ease NFA Members' compliance burdens without sacrificing any regulatory protections. It would do so by creating, in effect, a "safe harbor" in that any customer falling within the definition would qualify under all of the Commission rules that provide different levels of protection for customers that meet certain criteria. Each of these individual rules could, of course, include additional categories of qualified customers tailored to the circumstances of that particular rule.

I. Text of the Proposed Amendments

PART I — GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

§ 1.3 Definitions.

The following terms, as used in the Commodity Exchange Act, or in the rules and regulations in this chapter, shall have the meanings hereby assigned to them, unless the context otherwise requires:

* * *

(tt) *Enumerated person* means, and shall be limited to, the following persons or classes of persons:

(1) A bank or trust company (acting on its own behalf or on behalf of another enumerated person);

(2) A savings association or credit union;

(3) An insurance company;

(4) An investment company subject to regulation under the Investment Company Act of 1940 (15 U.S.C. § 80a-1 *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, *provided* that such investment company or foreign person is not formed solely for the specific purpose of qualifying as an enumerated person and has total assets exceeding $5,000,000;

(5) A commodity pool formed and operated by a person subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, *provided* that such commodity pool or foreign person is not formed solely for the specific purpose of qualifying as an enumerated person and has total assets exceeding $5,000,000;

(6) A corporation, partnership, organization, trust, or other entity which has total assets exceeding $10,000,000 and is not formed solely for the specific purpose of qualifying as an enumerated person;

(7) An employee benefit plan subject to the Employee Retirement Income Security Act of 1974 or a foreign person performing a similar role or function subject as such to foreign regulation, with total assets exceeding $5,000,000 or whose investment decisions are made by a bank, a trust company, an insurance company, an investment adviser subject to regulation under the Investment Advisers Act of 1940 (15 U.S.C. § 80b-1 *et seq.*), a commodity trading advisor subject to regulation under the Act, or a foreign person performing a similar role or function subject as such to foreign regulation;

(8) Any governmental entity (including the United States, any state, or any foreign government) or political subdivision thereof, or any multinational or supranational entity or any instrumentality, agency, or department of any of the foregoing;

(9) A broker-dealer subject to regulation under the Securities Exchange Act of 1934 (15 U.S.C. § 78a *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another enumerated person;

(10) A futures commission merchant subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another enumerated person;

(11) A commodity pool operator or commodity trading advisor subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation;

(12) An investment adviser registered under the Investment Advisers Act of 1940 or a foreign person performing a similar role or function subject as such to foreign regulation;

(13) A floor broker or floor trader subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation; or

(14) A natural person, sole proprietorship, or self-directed benefit or retirement plan directed by a natural person

(i) who has total assets exceeding at least $10,000,000, or

(ii) whose individual net worth, or joint net worth with that person's spouse, at the time of the transaction or event for which qualification as an enumerated person is sought, exceeds $1,000,000 and either

(A) owns securities (including pool participations) of issuers not affiliated with such person and other investments with an aggregate market value of at least $2,000,000,

(B) has had on deposit with a futures commission merchant, for its own account at any time during the six months preceding the transaction or event for which qualification as an enumerated person is sought, at least $200,000 in exchange-specified initial margin and option premiums for commodity interest transactions, or

(C) owns a portfolio comprised of a combination of the funds or property specified in (A) and (B) of this subsection in which the sum of the funds or property includable under (A), expressed as a percentage of the minimum amount required thereunder, and the amount of futures margin and option premiums includable under (B), expressed as a percentage of the minimum amount required thereunder, equals at least one hundred percent. An example of a composite portfolio acceptable under this subparagraph (C) would consist of $1,000,000 in securities and other property (50% of (A)) and $100,000 in exchange-specified initial margin and option premiums (50% of (B)), or

(iii) who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year and either

(A) owns securities (including pool participations) of issuers not affiliated with such person and other investments with an aggregate market value of at least $2,000,000,

(B) has had on deposit with a futures commission merchant, for its own account at any time during the six months preceding the transaction or event for which qualification as an enumerated person is sought, at least $200,000 in exchange-specified initial margin and option premiums for commodity interest transactions, or

(C) owns a portfolio comprised of a combination of the funds or property specified in (A) and (B) of this subsection in which the sum of the funds or property includable under (A), expressed as a percentage of the minimum amount required thereunder, and the amount of futures margin and option premiums includable under (B), expressed as a percentage of the minimum amount required thereunder, equals at least one hundred percent. An example of a composite portfolio acceptable under this subparagraph (C) would consist of $1,000,000 in securities and other property (50% of (A)) and $100,000 in exchange-specified initial margin and option premiums (50% of (B)).

* * *

§ 1.55 Distribution of "Risk Disclosure Statement" by futures commission merchants and introducing brokers.

* * *

(f) A futures commission merchant or, in the case of an introduced account an introducing broker, may open a commodity futures account for a customer without furnishing such customer the disclosure statements or obtaining the acknowledgments required under paragraph (a) of this section, § 1.65(a)(3), and § 30.6(a), § 33.7(a), and § 190.10(c) of this chapter, provided that the futures commission merchant or introducing broker reasonably believes that the customer is, at the time at which the account is opened, an enumerated person as defined in § 1.3(tt) of this chapter.

* * *

PART 4 — COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

§ 4.7 Exemption from certain part 4 requirements with respect to pools whose participants are limited to qualified eligible participants and with respect to commodity trading advisors' accounts for clients that are qualified eligible clients.

(a) *Relief for Commodity Pool Operators*

(1) Definitions

For the purposes of this section:

* * *

(ii) The term "qualified eligible participant" means any person who the commodity pool operator reasonably believes, at the time of the sale to that person of a pool participation in the exempt pool, to be

(A) An enumerated person as defined in § 1.3(tt) of this chapter,

(B) A principal of the commodity pool operator or the commodity trading advisor for the pool, as principal is defined in § 3.1 of this chapter,

(C) An employee of the commodity pool operator or the commodity trading advisor for the pool (other than an employee performing solely clerical, secretarial, or administrative functions) who, in connection with his or her regular functions or duties, participates in the investment activities of the commodity pool operator or commodity trading advisor, provided that the employee has been performing such functions and duties for or on behalf of the commodity pool operator or commodity trading advisor, or substantially similar functions or duties for or on behalf of another commodity pool operator or commodity trading advisor, for at least 12 months,

(D) A trust funded by a natural person who is an enumerated person as defined in § 1.3(tt)(14) of this chapter, or

(E) A person that is not a United States person for purposes of this Rule 4.7. For the purposes of this Rule 4.7, the term "United States " means the United States, its states, territories or possessions, or an enclave of the United States government, its agencies or instrumentalities, and the following persons are not considered to be "United States persons";

(1) a natural person who is not a resident of the United States;

(2) a partnership, corporation or other entity, other than an entity organized principally for passive investment, organized under the laws of a foreign jurisdiction and which has its principal place of business in a foreign jurisdiction;

(3) an estate or trust, the income of which is not subject to United States income tax regardless of source;

(4) an entity organized principally for passive investment such as a pool, investment company or other similar entity, *Provided* that units of participantion in the entity held by United States persons represent in the aggregate less than 10% of the beneficial interest in the entity, and that such entity was not formed principally for the purpose of facilitating investment by United States persons in a pool with respect to which the operator is exempt from certain requirements of Part 4 of the Commission's regulations by virtue of its participants being non-United States persons; and

(5) a pension plan for the employees, officers or principals of an entity organized and with its principal place of business outside the United States.

* * *

(b) *Relief for Commodity Trading Advisors*

(1) Definitions

For the purposes of this section:

* * *

(ii) The term "qualified eligible client" means any person who the commodity trading advisor reasonably believes, at the time that person opens an exempt account with the commodity trading advisor, to be

(A) An enumerated person as defined in § 1.3(tt) of this chapter,

(B) A principal of the commodity trading advisor, as principal is defined in § 3.1 of this chapter,

(C) An employee of the commodity trading advisor (other than an employee performing solely clerical, secretarial, or administrative functions) who, in connection with his or her regular functions or duties, participates in the investment activities of the commodity trading advisor, provided that the employee has been performing such functions and duties for or on behalf of the commodity trading advisor, or substantially similar functions or duties for or on behalf of another commodity trading advisor, for at least 12 months,

(D) A trust funded by a natural person who is an enumerated person as defined in § 1.3(tt)(14) of this chapter, or

(E) A person that is not a United States person as defined in subsection (a)(1)(ii)(C) of this Rule 4.7.

* * *

PART 35 — EXEMPTION OF SWAP AGREEMENTS

§ 35.1 Definitions

* * *

(b) *Definitions.* As used in this Part:

* * *

(2) "Eligible swap participant" means

(i) An enumerated person as defined in § 1.3(tt) of this chapter; or

(ii) A corporation, partnership, organization, trust, or other entity not formed solely for the specific purpose of constituting an eligible swap participant

(A) the obligations of which under the swap agreement are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by an entity referenced in § 1.3(tt)-(8) of this chapter, or

(B) which has a net worth of $1,000,000 and enters into the swap agreement in connection with the conduct of its business; or which has a net worth of $1,000,000 and enters into the swap agreement to manage the risk of an asset or liability owned or incurred in the conduct of its business or reasonably likely to be owned or incurred in the conduct of its business.

* * *

PART 36 — EXEMPTION OF SECTION 4(c) CONTRACT MARKET TRANSACTIONS

§ 36.1 Definitions

* * *

(b) *Definitions.* As used in this Part:

* * *

(2) "Eligible participant" means:

(i) An enumerated person as defined in § 1.3(tt) of this chapter; or

(ii) A corporation, partnership, organization, trust, or other entity not formed solely for the specific purpose of constituting an eligible participant, which has a net worth of $1,000,000 and enters into a section 4(c) contract market transaction in connection with the conduct of its business; or which has a net worth of $1,000,000 and enters into section 4(c) contract market transaction to manage the risk of an asset or liability owned or incurred in the conduct of its business or reasonably likely to be owned or incurred in the conduct of its business.

* * *

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. NFA is interested in streamlining the regulatory process so that its Members can more efficiently and effectively comply with the Act, Commission regulations, and NFA rules. NFA believes that the proposed uniform definition furthers this goal.

III. Supporting Arguments

NFA's Special Committee for the Review of a Multi-Tiered Regulatory Approach was formed to review the current regulatory structure and identify those areas where not all customers need the same degree of protection. The Special Committee recognized that an important element of this task is to define which customers do not need as many regulatory protections.

A. The Need for A Uniform Definition

The Special Committee reviewed current CFTC regulations and noted that there are at least five different definitions of sophisticated customer. They are:

- Qualified eligible participant (CFTC Regulation 4.7(a)(1)(ii));
- Qualified eligible client (CFTC Regulation 4.7(b)(1)(ii));
- Eligible swap participant (CFTC Regulation 35.1);
- Eligible participant for exchange transactions under § 4(c) of the Act (CFTC Regulation 36.1); and
- Entities who do not have to receive risk disclosure statements under CFTC Regulation 1.55.

In addition, a pending Commission proposal contains a sixth definition in CFTC Regulation 1.35 (as proposed) for customers eligible to be included in block orders that are allocated post-execution.[1]

None of the current definitions are exactly the same. The definition of qualified eligible participant ("QEP") includes all foreign persons, while the definition of qualified eligible client ("QEC") does not. Furthermore, the QEP and QEC definitions are very complicated, using several tests involving amount of investments, assets, net worth, and income. In later definitions the Commission has moved away from these complicated tests and has concentrated primarily on type of entity and total assets, with some types of entities having no minimum asset requirement. However, even the Commission's more recent definitions are not entirely consistent. For example, investment companies must have $5 million in assets to engage in § 4(c) contract market transactions but not to engage in swap transactions, governmental entities are included in all definitions except the recently adopted § 1.55 definition, and natural persons who have total assets in excess of $10 million are included in all of the recent definitions except that of eligible customer in the Commission's § 1.35 proposal.

Having several different definitions provides inconsistent results. It is not clear, for example, why governmental entities should be given § 1.55 risk disclosures for

[1] 63 Fed. Reg. 695 (January 7, 1998).

conventional futures transactions when they can engage in complex, unregulated swap transactions without restriction. Using multiple definitions also creates administrative inefficiencies and possible confusion for FCMs attempting to apply the definition in different contexts.

B. NFA's Proposal

NFA's Board of Directors, at the recommendation of the Special Committee, petitions the Commission to amend Commission Regulation 1.3 to add a new definition of "enumerated person." The definition in proposed Regulation 1.3(tt) would then be incorporated by reference in all of the current regulations that include a definition of customers believed to be sophisticated enough to engage in the transactions authorized by the regulation or to be excluded by the regulation from particular regulatory requirements.

NFA chose the neutral term "enumerated persons" to describe those persons covered by the uniform definition. The Special Committee considered the term "sophisticated customer" but rejected it because some people feel it suggests a subjective test based on each customer's level of knowledge rather than the objective test actually incorporated in the definition. The Special Committee ruled out the term "qualified person" because it is too similar to other terms used in the futures and securities industries (e.g., qualified eligible participant, qualified purchaser). The term "eligible" was eliminated for the same reason.

The Special Committee modeled the proposed definition of "enumerated person" on the definition of eligible swap participant. The definition of eligible swap participant is much simpler to apply than the QEP or QEC definition. This approach is also consistent with the direction the Commission has taken in its more recent rule-making proceedings.

In drafting the uniform definition the Special Committee did, however, make several changes to the definition of eligible swap participant. The Special Committee modifed the definition of eligible swap participant by:

- Imposing a $5 million asset requirement on investment companies, to be consistent with the asset requirement imposed on commodity pools;

- Broadening the qualifications for natural persons to allow them to meet either the current test for eligible swap participants or the current test for qualified eligible participants and expanding the category for natural persons to include sole proprietorships and self-directed benefit plans;

- Including CPOs, CTAs, floor brokers, and floor traders;

- Including investment advisers registered under the Investment Adviser's Act of 1940; and

- Expanding the list of money managers who can provide management advice to ERISA plans, or their foreign equivalents, to include the foreign equivalents of regulated investment advisers and CTAs.

NFA believes that all of these persons qualify as "appropriate persons" under § 4(c) of the Commodity Exchange Act. In particular, NFA believes that the Commission could determine that natural persons who meet the current requirements under Regulation 4.7(a)(1)(ii) are appropriate persons under § 4(c)(3)(K) in light of their financial qualifications and investment experience and that CPOs, CTAs, floor brokers, floor traders, and registered investment advisers are appropriate persons due to their qualifications as registered entities in the financial services industry.

Several of the alternative qualifications for corporations, partnerships, and similar entities in the definition of eligible swap participant are specific to swap transactions and are not easily incorporated into a uniform definition. NFA believes that these alternative tests should be included in the definition of eligible swap participant under CFTC Regulation 35.1 rather than in the uniform definition. Other transaction-specific categories would also be included as an add-on to the particular regulation where they apply rather than being forced into a uniform definition where they do not belong. As proposed:

- A QEP or QEC (CFTC Regulations 4.7(a)(1)(ii) and 4.7(b)(1)(ii)) would include principals of the CPO or CTA, other knowledgeable employees of the CPO or CTA, trusts funded by a natural person who is included in the uniform definition, and all foreign persons (regardless of category or asset level);

- An eligible swap participant (CFTC Regulation 35.1) would include a corporation, partnership, or similar entity that meets the transaction-specific tests currently found in that regulation; and

- An eligible participant under CFTC Regulation 36.1 would include a corporation, partnership, or similar entity that meets the transaction-specific tests currently found in that regulation.

NFA respectfully petitions the Commission to amend Regulations 1.3, 1.55, 4.7, 35.1, and 36.1 as described above.

Respectfully submitted,

Daniel J. Roth
General Counsel

kpc(committe\uniform definition-petition)

cc: Chairperson Brooksley Born
Commissioner Barbara Pedersen Holum
Commissioner John E. Tull, Jr.
Commissioner David D. Spears
Geoffrey Aronow, Esq.
J. Michael Greenberger, Esq.
Alan L. Siefert, Esq.
Lawrence B. Patent, Esq.
David Van Wagner, Esq.

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NFA NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

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1998 SEP 14 P 1:10

OFFICE OF THE SECRETARIAT

September 10, 1998

Ms. Jean A. Webb
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition for Rulemaking to Amend CFTC Regulations 4.21(a) and 4.31(a)

Dear Ms. Webb:

National Futures Association ("NFA") respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulations 4.21(a) and 4.31(a). These amendments would provide relief from the CFTC's requirement that a disclosure document be delivered prior to a CPO or CTA soliciting a prospective client. These amendments would allow NFA to enforce through its rules the use of a shorter disclosure document called a "profile" for soliciting a prospective investor prior to the delivery to the investor of a full disclosure document. The profile document would be limited to certain key information about the pool or trading program and would provide specific cautionary disclosures as explained more fully below.

I. Text of the Proposed Amendments (additions are underscored and deletions are stricken through)

PART 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

* * *

§4.21 Required delivery of pool Disclosure Document.

(a) Except in accordance with rules promulgated by a registered futures association regarding profile documents, ~~N~~no commodity pool operator registered or required to be registered under the Act may, directly or indirectly, solicit, accept or receive funds, securities or other property from a prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the commodity pool operator delivers or causes to be delivered to the prospective participant a Disclosure Document for the pool containing the information set forth in §4.24; *Provided, however,* that where the prospective participant is an accredited investor, as defined in 17 CFR 230.501(a), a notice of intended offering and statement of the terms of the intended offering may be provided prior to delivery of a Disclosure Document, subject to compliance with rules promulgated by a registered futures association pursuant to section 17(j) of the Act.

* * *

§4.31 Required delivery of Disclosure Document to prospective clients.

(a) Except in accordance with rules promulgated by a registered futures association regarding profile documents, ~~N~~no commodity trading advisor registered or required to be registered under the Act may solicit a prospective client, or enter into an agreement with a prospective client to direct the client's commodity interest account or to guide the client's commodity interest trading by means of a systematic program that recommends specific transactions, unless the commodity trading advisor, at or before the time it engages in the solicitation or enters into the agreement (whichever is earlier), delivers or causes to be delivered to the prospective client a Disclosure Document for the trading program pursuant to which the trading advisor seeks to direct the client's account or to guide the client's trading, containing the information set forth in §§4.34 and 4.35.

* * *

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. NFA is interested in streamlining the regulatory process so that its Members can more efficiently and effectively comply with the Act, Commission regulations and NFA rules. NFA believes that the proposed amendments to Regulations 4.21(a) and 4.31(a) which would allow for the use of a profile document furthers this goal.

III. Supporting Arguments

As you may know, the Commission recently asked NFA to develop a rule proposal similar to the profile document rule implemented by the Securities and Exchange Commission ("SEC") effective June 1, 1998. The SEC adopted a rule permitting mutual funds to solicit and accept fund investments through a shorter disclosure document called a "profile." This profile document summarizes, in a standardized format, key information about the fund, including the fund's investment strategies, risks, performance and fees. The profile document must also inform the prospective investor that a copy of the full prospectus is available upon request. After reviewing the profile document, an interested prospective investor has the choice of requesting a copy of the fund's prospectus or making an investment in the fund based on the profile document. If an investor decides to purchase shares in a fund based on the profile document, however, the fund must provide a copy of the prospectus to the investor with a copy of the purchase confirmation.

Implementing such an NFA rule proposal, however, would also require that CFTC Regulations 4.21(a) and 4.31(a) be amended to provide relief from the CFTC's requirement that a disclosure document be delivered prior to soliciting a prospective client.

The rule which NFA developed, and which is currently pending CFTC review and approval, would permit member CPOs to solicit prospective investors with a profile document. Unlike the SEC's rule, however, CPOs would still be required to deliver a disclosure document prior to accepting any funds or property from a prospective client. The profile document itself would be limited to certain key information about the pool and the CPO and would provide specific cautionary disclosures. With regard to performance disclosures, the CPO would be limited to providing actual performance of the offered pool. The profile document would, however, notify the prospective investor if other performance information is presented in the disclosure document.

The following eight points describe the contents of a profile document and make comparisons to the SEC's rule. The main changes from the SEC's rule are based on the differing nature of a pool investment and a mutual fund investment.

1. Cover Page – The SEC's rule requires a cover page which contains the Fund's name and, at the Fund's option, the Fund's investment objective or the type of fund offered. A statement identifying the document as a "profile" without using the term "prospectus," the approximate date of the profile's first use, a cautionary legend regarding the summary nature of the profile, and directions on where to get a prospectus or further infor-

mation are also required. NFA's proposed rule requires all this information plus, immediately following the cover page, an additional cautionary statement regarding the risky nature of commodity pools and a statement that neither NFA nor the CFTC has passed on the merits of participating in the pool or the adequacy or accuracy of the profile document. NFA's rule also requires that the cover page include a break-even analysis with respect to an investment in the pool.

2. Objectives/Goals and Principal Investment Strategies – The SEC's rule requires that the profile include information about the Fund's investment objective or goals as required by the prospectus rules for mutual funds. In addition, the profile must include information about the Fund's principal investment strategies. NFA's proposed rule does not require information about the pool's investment objectives or goals but does require a non-marketing orientated discussion of the trading strategy to be used by the pool.

3. Principal Risks of Investing – The SEC's rule requires narrative disclosure, a bar chart, and a table required by the mutual fund prospectus rule which highlights the principal risks of investing in the Fund. This section must also include information on the Fund's average annual total returns. NFA's rule requires the cautionary statement regarding the risks of investing in the pool and a statement identifying any risks unique to the particular pool. NFA's profile rule also requires, if applicable, a statement in the body of the profile indicating the extent to which a participant may be held liable for obligations of the pool in excess of the funds contributed by the participant for the purchase of an interest in the pool. In addition, NFA's rule requires that the document include the capsule performance for the offered pool, with reference, if applicable, to the fact that the disclosure document contains performance information on other pools operated by the CPO, or for pools with no operating history, performance of major CTAs trading the pool.

4. Fees and Expenses – The SEC's rule requires disclosure of fees and expenses, including commissions, associated with an investment in the Fund. NFA's rule requires this information as part of the break-even analysis.

5. Identity of Certain Key Persons – The SEC's rule requires that the investment adviser, subadviser, and portfolio manager be identified. In addition, for those persons associated with the investment adviser who are primarily responsible for the day-to-day management of the Fund's portfolio, the profile must summarize each person's business experience for the last five years and indicate their length of service with the adviser. NFA's rule requires that the profile identify each principal of the pool operator, the pool's trading manager and its principals and, if any, any major CTA and its principals. NFA's rule does not require disclosure of the business background of these individuals. Since prospective participants will still have to receive the disclosure document before investing in the pool, staff felt it was unnecessary to disclose this information in both documents. NFA's rule does, however, require a summary of any material administrative or criminal actions, whether pending or concluded, within five years of the date of the profile, against the commodity pool operator or any of its principals.

6. Purchase/Sale of Shares – The SEC's rule requires that the profile disclose the Fund's minimum initial or subsequent investment requirements, the initial sales load and, if applicable, the initial sales load breakpoints or waivers. With regard to the sales of shares, the SEC's rule requires that the document disclose the procedures for redeeming shares and identify any charges or sales loads that may be assessed. NFA's rule requires the profile to provide a brief description of any restrictions on transfers of a participant's interest in the pool and information on how a participant may redeem his interest in the pool. As previously noted, NFA's proposal also requires the CPO to include the break-even table on the cover page of the profile document.

7. Distributions and Tax Information – The SEC's profile rule requires a description of how frequently the fund intends to make distributions and what options for reinvestment of distributions are available for investors. The document must also indicate the tax status of these distributions. NFA's profile rule does not include this information since regular distributions are generally not a feature of a pool investment and the taxable status of any distribution is best determined by an investor and its tax adviser.

8. Other Services Available – Under this section, the SEC requires that the document provide a brief summary of services available to Fund shareholders. NFA did not include this section in the proposed rule because it was not applicable to a pool investment.

As the benefits of this profile document are also applicable to CTAs, the rule proposal also permits CTAs to use a profile document to solicit prospective clients. As with CPOs, however, the CTA will be required to deliver the disclosure document prior to entering into any agreement to direct or guide a client's commodity futures account.

NFA respectfully petitions the Commission to amend Regulations 4.21(a) and 4.31(a) as described herein.

Respectfully submitted,

Daniel J. Roth
General Counsel

DJR:ckm(sub\petiton re profile)

cc: Chairperson Brooksley Born
Commissioner Barbara Pedersen Holum
Commissioner John E. Tull, Jr.
Commissioner David D. Spears
Commissioner James E. Newsome
Geoffrey Aronow, Esq.
I. Michael Greenberger, Esq.
Alan L. Seifert, Esq.
Lawrence B. Patent, Esq.
David Van Wagner, Esq.

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521

OFFICE OF THE
SECRETARIAT

September 15, 1998

Mr. Daniel J. Roth
General Counsel
National Futures Association
200 W. Madison Street
Chicago, IL 60606-3447

Dear Mr. Roth:

By letter dated September 10, 1998, you requested on behalf of the National Futures Association that the Commission consider petitions for rulemaking to amend CFTC Regulations 4.21(a) and 4.31(a). This is to acknowledge receipt of the petition and to inform you that the petition has been referred to the Commission for such action the Commission deems appropriate. I will inform you of any action taken by the Commission on the petition.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

20000105

NFA NATIONAL FUTURES ASSOCIATION

200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

March 7, 2000

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OFFICE OF THE SECRETARIAT

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

Re: Petition for Rulemaking to Amend CFTC Regulation 4.21(a)

Dear Ms. Webb:

National Futures Association ("NFA") respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 4.21(a). These amendments would allow NFA to enforce through its rules the use by CPOs of a shorter disclosure document called a "profile" for soliciting a prospective pool participant prior to the delivery to the participant of a full disclosure document. The profile document would be limited to certain key information about the pool and would provide specific cautionary disclosures as explained more fully below.

I. Text of the Proposed Amendments (additions are underscored and deletions are stricken)

PART 4 — COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

* * *

§ 4.21 Required Delivery of Pool Disclosure Document.

(a) ~~Except in accordance with rules promulgated by a registered futures association regarding profile documents.~~ No commodity pool operator registered or required to be registered under the Act may, directly or indirectly, solicit, accept or receive funds, securities or other property from a prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the commodity pool operator delivers or causes to be delivered to the prospective participant a Disclosure Document for the pool containing the information set forth in § 4.24; *Provided, however,* that a profile document or, where the prospective participant is an accredited investor, as defined in 17 CFR 230.501(a), a notice of intended offering and statement of the terms of the intended offering, may be provided prior to delivery of a Disclosure Document, subject to compliance with rules promulgated by a registered futures association pursuant to Section 17(j) of the Act.

II. Nature of NFA's Interest

As the Commission is aware, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. NFA is interested in streamlining the regulatory process so that its Members can more efficiently and effectively comply with the Act, Commission regulations and NFA rules. NFA believes that the proposed amendments to Regulation 4.21(a), which would allow for the use of a profile document by CPOs, furthers this goal.

III. Supporting Arguments

As the Commission is aware, in 1998 NFA was asked by the Commission to develop a rule proposal similar to the profile document rule implemented by the Securities and Exchange Commission ("SEC") effective June 1, 1998. Similar to the SEC rule, NFA has developed a rule to permit CPOs to conduct initial customer solicitations through a shorter disclosure document called a "profile." Unlike the SEC rule, however, NFA's proposed rule provides that a customer must be given and sign the full disclosure document prior to investing in the pool. NFA's proposed rule states that a profile document should provide a summary of key information regarding an investment in the commodity pool being offered. Among other things, the rule also requires that a profile document disclose the risk factors material to the particular pool being offered and disclose any conflicts of interest material to the offered pool.

The proposed NFA rule providing for a profile document for use by CPOs has been reviewed extensively by CFTC staff since its original submission in September of 1998. As a result, the original rule proposal has been revised and a new interpretive notice has been drafted to resolve Commission concerns. The proposed rule and interpretive notice have recently been submitted for CFTC review and approval. CFTC staff has informed NFA that implementing the NFA rule proposal would also require that CFTC Regulation 4.21(a) be amended to allow the use of a profile document by CPOs.

NFA respectfully petitions the Commission to amend Regulation 4.21(a) as described herein.

Respectfully submitted,

Daniel J. Roth
Executive Vice President
and General Counsel

DJR:ckm(sub\petiton re 4.21a)

cc: Chairman William J. Rainer
Commissioner Barbara Pedersen Holum
Commissioner David D. Spears
Commissioner James E. Newsome
Commissioner Thomas J. Erickson
Phyllis J. Cela, Esq.
John C. Lawton, Esq.
Alan L. Seifert, Esq.
David Van Wagner, Esq.
Riva Spear Adriance, Esq.

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521

OFFICE OF THE
SECRETARIAT

March 13, 2000

Mr. Daniel J. Roth
Executive Vice President
and General Counsel
National Futures Association
200 W. Madison Street
Chicago, IL 60606-3447

Dear Mr. Roth:

By letter dated March 7, 2000, you requested on behalf of the National Futures Association that the Commission consider a petition submitted under Regulation 13.2 to amend CFTC Regulation 4.21(a). This is to acknowledge receipt of the petition and to inform you that this request has been referred to the Commission for such action the Commission deems appropriate. I will inform you of any action taken by the Commission on the petition.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5430
Facsimile: (202) 418-5536

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OFC. OF THE SECRETARIAT

DIVISION OF
TRADING & MARKETS

August 13, 2001

David Arkush and David C.Vladeck
Public Citizen Litigation Group
1600 20th St., N.W.
Washington. D.C. 20009

Re: Petition for Rulemaking Concerning Privacy Notices

Dear Mr. Arkush and Mr. Vladeck:

The Commodity Futures Trading Commission ("CFTC") has received the Petition for Rulemaking ("Petition") referenced above. At this agency, such petitions are governed by Rule 13.2.[1] The Secretariat has referred this matter to the Division of Trading and Markets ("Division"), and we hereby acknowledge receipt of the Petition.

As you know, the privacy legislation as originally adopted (Section 509(3)(B) of Title V of the Gramm-Leach-Bliley Act, hereafter "GLB"), specifically excluded "persons or entities" subject to CFTC jurisdiction from the coverage of GLB. This exclusion was eliminated with the enactment of the Commodity Futures Modernization Act of 2000 ("CFMA") on December 21, 2000.[2] Under Section 124 of the CFMA, Congress amended the Commodity Exchange Act ("CEA") to add a new Section 5g to the CEA to include the CFTC and certain financial institutions subject to its jurisdiction within the coverage of Title V of GLB. That section of the CFMA makes the CFTC a "federal functional regulator" and mandates that it promulgate privacy rules for certain entities subject to its jurisdiction. These entities are: (1) futures commission merchants, (2) commodity trading advisors, (3) commodity pool operators, and (4) introducing brokers.

Pursuant to the mandate of the CFMA, the CFTC proposed privacy rules in March, 2001, modeled upon the rules published by the other federal functional regulators.[3] and provided a comment period until April 18, 2001.[4] On April 27, 2001,

[1] 17 C.F.R. §13.2 (2000).

[2] Pub. L. No. 106-554, 114 Stat. 2763 (2000), amending 7 U.S.C. §1 et seq.

[3] These agencies have also been recipients of the petition. They are the federal banking agencies (Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision); the National Credit Union Administration, the Securities and Exchange Commission, and the Federal Trade Commission.

[4] 66 Fed. Reg. 15,550 (March 19, 2001).

the CFTC published final rules relating to privacy, with a compliance date of March 31, 2002.[5]

The CFTC believes that it is important for the relevant federal regulators to work together to safeguard consumer information. Toward that end, representatives of the CFTC attend the interagency meetings whose purpose is to ensure, to the extent possible, consistent administrative interpretation of the privacy rules implementing GLB. Accordingly, the CFTC will work with the other federal functional regulators in exploring solutions to the issues you discuss and will notify you of any Commission action in response to the Petition. We do not believe, however, that it is appropriate for the CFTC alone to provide a more detailed response at this time. If you have any questions or concerns, please contact Susan Elliott, an attorney in this Division, at (202) 418-5464.

Very truly yours,

John C. Lawton

John C. Lawton
Acting Director

cc: Ralph Nader
Public Citizen
Consumer Federation of America
Consumers Union
Electronic Privacy Information Center
Remar Sutton
Center for Media Education
Commercial Alert
Computer Professionals for Social Responsibility
Consumer Action
Consumer Project on Technology
Consumer Task Force on Auto Issues
Essential Information
JunkBusters Corp.
National Consumers League
Net Action
Privacy Rights Clearinghouse
U.S. Public Interest Research Group

[5] 66 Fed. Reg. 21,235 (April 27, 2001); to be published as 17 C.F.R. Part 160.

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OFC. OF THE SECRETARIAT

PUBLIC CITIZEN LITIGATION GROUP
1600 20TH STREET N.W.
WASHINGTON, D.C. 20009-1001
—
(202) 588-1000

July 26, 2001

Secretary
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Secretariat
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Communications Division
Office of the Comptroller
Of the Currency
Independence Square
250 E. Street, N.W.
Washington, D.C. 20219-0001

Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Manager, Dissemination Branch
Information Management and Services
Division
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C 20549

PETITION FOR RULEMAKING

Dear Sirs/Madams:

Ralph Nader, Public Citizen, Inc., the Consumer Federation of America, Consumers Union, the Electronic Privacy Information Center, Remar Sutton, the Center for Media Education, Commercial Alert, Computer Professionals for Social Responsibility, Consumer Action, the Consumer Project on Technology, the Consumer Task Force on Auto Issues, Essential Information, JunkBusters Corp., the National Consumers League, Net Action, the Privacy Rights Clearinghouse, and the U.S. Public Interest Research Group submit this petition under § 553(e) of the Administrative

Procedure Act, 5 U.S.C. §§ 551-559, to the agencies charged with rulemaking authority under Subtitle A of Title V of the Gramm-Leach-Bliley Act (the "GLBA" or "Act"), Pub. L. No. 106-102, 113 Stat. 1338 (codified at 15 U.S.C. §§ 6801-6810).[1] Petitioners request a rulemaking to amend the regulations implementing the GLBA to ensure that consumers are provided with better notice and more convenient means of exercising their right to opt out of information sharing.[2]

In passing §§ 501-510 of the GLBA, Congress gave consumers the right to prevent financial institutions from transferring their personal financial information to third parties. To that end, the Act requires the institutions to notify customers of the right to opt out and to provide convenient means of exercising it. However, in notices mailed out thus far, most financial institutions have employed dense, misleading statements and confusing, cumbersome procedures to prevent consumers from opting out. Such notices evince a clear failure of the Act's implementing regulations to effectuate congressional intent. Accordingly, we ask the Agencies to revise the regulations and require that financial institutions provide understandable notices and convenient opt-out mechanisms.

1. The GLBA cannot protect privacy unless the Agencies require readable notices and reasonable opt-out opportunities.

The GLBA manifests a congressional desire for readable notices and reasonable

[1] The agencies charged with rulemaking authority under the GLBA (the "Agencies") include the Federal banking agencies (the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation ("FDIC") and the Office of Thrift Supervision ("OTS")), the National Credit Union Administration ("NCUA"), the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), and the Federal Trade Commission ("FTC"). 15 U.S.C. § 6804(a)(1).

[2] *See* 12 C.F.R. §§ 40.1-.18 (OCC); 12 C.F.R. §§ 216.1-.18 (FRB); 12 C.F.R. §§ 332.1-.18 (FDIC); 12 C.F.R. §§ 573.1-.18 (OTS); 12 C.F.R. §§ 716.1-.18 (NCUA); 17 C.F.R. §§ 248.1-.18 (SEC); 17 C.F.R. §§ 160.1-.18 (CFTC); 16 C.F.R. §§ 313.1-.18 (FTC).

mechanisms for consumers to exercise their opt-out right Although Congress declared that "each financial institution has an affirmative and continuing obligation to respect the privacy of its customers," 15 U.S.C. § 6801, it placed much of the burden of privacy protection on consumers. Crucially, rather than adopting an informed consent (opt-in) regime for privacy protection, see, e.g., Cable Communications Privacy Act, 47 U.S.C. § 551(b)(1); Video Privacy Protection Act, 18 U.S.C. § 2710(b)(2)(B); Children's Online Privacy Protection Act, 15 U.S.C. § 6502(b)(1)(A)(ii), which every petitioner strongly prefers to the GLBA's privacy provisions, Congress enacted a scheme that utilizes notice and a limited opt-out right. The Act requires that financial institutions give consumers notice of their practices, the law, and consumer rights, then allows them broad discretion to sell or share private information absent explicit consumer objection. This framework of privacy protection can only function properly—indeed, can only be intelligible—if consumers can understand the privacy notices they receive and assert their preferences with ease. Without understandable notice and convenient opt-out mechanisms, the Act provides no privacy protection at all.

Congress therefore instructed financial institutions on the content of notices, 15 U.S.C. §§ 6802-6803, rather than granting them excessive control over what consumers learn about their rights. Indeed, the Act could hardly be clearer in its requirements: Section 6802(a) mandates that no financial institution may disclose private financial information to a third party until the institution complies fully with the notice and opt-out requirements of the Act. Section 6802(b) requires that financial institutions provide "clear[]" and "conspicuous" notice of consumers' opt-out rights. And § 6803(a) reaffirms that each institution must give "clear and conspicuous" notice to consumers of its policies and practices regarding the disclosure of personal financial information. By employing the words "clear" and "conspicuous" repeatedly, the Act demonstrates an unambiguous congressional desire for consumers to be able to exercise their rights. Therefore, in order to effectuate congressional intent, the Agencies must ensure that consumers receive understandable notices and reasonable opt-out devices.

2. Recent privacy notices show that regulations under the GLBA are failing to protect consumer privacy.

When the Agencies undertook the task of promulgating regulations under the GLBA, it was difficult to predict what notice and opt-out mechanisms financial institutions would employ. However, the Agencies must have hoped for better results than what the institutions have produced. We commend the Agencies for amending the definition of "conspicuous" to require that notices should be "designed to call attention to the nature and significance of the information contained." 65 Fed. Reg. 33,649 (May 24, 2000). But the notices delivered thus far plainly have failed to fulfill that mandate or satisfy any other fair measure of readability and convenience.

In the weeks approaching the July 1, 2001 deadline for financial institutions to send out notices, consumers began receiving dense, complicated, misleading statements with burdensome and confusing opt-out procedures. It seems that these notices were written by lawyers trained in the art of obfuscation, not by communication experts trained to express ideas clearly. Notices entitled "Our Privacy Commitment," Wal-Mart Credit Card, and "Protecting Your Privacy: Our Pledge to You," Mellon Dreyfus, go to great lengths to bury their already opaque explanations of the law and company practices beneath self-serving and often misleading representations of a commitment to protecting privacy. The Wells Fargo notice, for example, makes no affirmative mention of financial information sharing until the bottom of its second page, well after consumers have read a "Pledge" containing, among other platitudes, the statement that the company is "committed to protecting your privacy at all times." As a result of such tactics, the first sections of many mailings read like promotional material rather than legal notices.

Explanations of how to opt out invariably appear at the end of the notices. Thus, before they learn how to opt out, consumers must trudge through up to ten pages of fine print with as many words and more legal jargon than this detailed petition for rulemaking. (At least one notice even contains a glossary of terms Wells Fargo.) Furthermore, many of the passages explaining how to opt out are obviously designed to discourage consumers from exercising their rights under the statute When institutions provide toll-free numbers, seemingly the easiest opt-out mechanism, some make them available only at unusual hours. Chevron Credit Bank (offering a telephone line open 7 30 a m.-4.30 p.m. Pacific Time on business days) If a notice provides an opt-out form with boxes to check off—boxes ostensibly designed to enable consumers to instruct an institution not to sell or trade private information—financial institutions sometimes bury the boxes in a thicket of misleading statements. American Express places the check-off boxes beneath the bold-faced heading, "**Offers for . . . Products and Services.**" American Express. The line immediately adjacent to the check-off box states, "Please exclude me from mailings of offers . . . ," id., implying that, in order to exercise their right to opt out, consumers have to forego valuable opportunities As if that might not be enough to dissuade consumers from exercising their opt-out rights, the line immediately following the check-off box, italicized for emphasis, states, "*If you opt out, you may not receive offers . . . that may be* *of value to you*." Id. Furthermore, examples of "valuable offers" that a consumer will miss sometimes include items that people most interested in privacy protection might want, such as "software designed to increase the security of your home computer." Mellon Dreyfus.

Many notices make a final attempt to dissuade consumers from opting out by implying that consumers may have already opted out or that opting out will have little effect. Some state in boldfaced type, **"If you have previously informed us of your preference, you do not need to do so again."** Wal-Mart Credit Card; Exxon Credit Card. Of course, consumers are extremely unlikely to have expressed preferences previously because, as Congress and the Agencies recognized in requiring notices, most consumers are unfamiliar with the law and have never before been given notice of their rights under the GLBA. Other notices simply remind consumers that, even if they opt out, the financial institution will continue to share their information with marketing partners, service providers, and affiliated companies. To an uninformed consumer, this may seem to render opting out a waste of time.

Mark Hochhauser, a Ph.D. in psychology who studies readability and offers readability consulting services, conducted a revealing analysis of thirty-four privacy notices. Mark Hochhauser, Lost in the Fine Print II: Readability of Financial Privacy Notices, Privacy Rights Clearinghouse, May 2001, at http://privacyrights.org/ar/GLB-Reading.htm (July 9, 2001). Hochhauser found that, on average, the notices are written at a third- or fourth-year college reading level rather than the junior-high level that literacy experts recommend for the general public. Id. Some are written at the level of a first-year graduate school student; others are so highly complex that experts cannot even reliably measure their reading level. Id. Although specialists recommend that sentences contain a maximum of fifteen to twenty words, id., key phases of the privacy notices are often as long as forty-five words and contain double, triple, quadruple, and even quintuple negatives To explain the opt-out right, Chevron's notice states, in forty words,

> If you prefer that we not disclose nonpublic personal information about you to nonaffiliated third parties, you may opt out of those disclosures, that is, you may direct us not to make those disclosures (other than disclosures permitted by law).

Wells Fargo's explanation is even more misleading. Rather than merely leaving consumers confused, Wells Fargo managed to craft a statement that may give consumers an impression of the law, their rights, and the institution's practices that is completely contrary to reality:

> We do not share customer information with outside companies for the purpose of marketing the products or services of those companies, unless you have been given the opportunity in advance to decline this option.

After reading this sentence, many consumers will think they need not take any action because they will reasonably believe the institution will give them an opportunity to opt into any specific information sharing scheme Through a combination of small font sizes, "sans serif" fonts,[3] small margins, demanding grammatical structure, obtuse word choice, and misleading statements, the notices deprive consumers of their right to prevent financial institutions from sharing private information.[4]

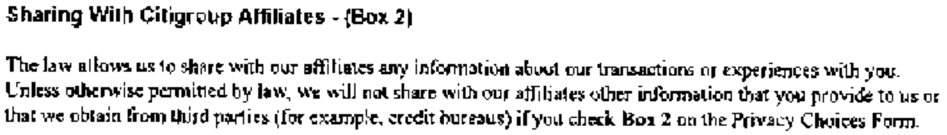
The status quo notices and opt-out mechanisms have yielded startling results. As of June 21, 2001, according to the American Bankers Association, only 0.5% of consumers had exercised their opt-out right. Moreover, the same ABA poll found that 22% of banking customers said they received a privacy notice but did not read it, and 41%

[3] Sans serif fonts such as this one lack picks at the edges of each character and are therefore somewhat harder to read than serif fonts.

could not even recall receiving a notice. John Martin, Opting Out – Or Not, ABCNews.com, June 21, 2001, at http://abcnews.go.com/sections/wnt/DailyNews/privacy_notices_010621.html (July 9, 2001). Since so few consumers have exercised the opt-out right, and so many do not even recall receiving privacy notices, the notices cannot have been "clear and conspicuous," and the means to opt out cannot have been "reasonable."

3. Recent privacy notices lack adequate definitions of important terms and phrases.

The most crucial tools financial institutions employ in obfuscating information are poorly defined words and concepts. For example, the notices almost invariably employ the term "family" to refer to affiliates. Words are often defined many pages before or after their most significant use in the notices, so that consumers will not yet know or will have forgotten the meanings of key phrases when they read them. To illustrate these problems, attempt to make sense of the following paragraph quickly:



Sharing With Citigroup Affiliates - (Box 2)

The law allows us to share with our affiliates any information about our transactions or experiences with you. Unless otherwise permitted by law, we will not share with our affiliates other information that you provide to us or that we obtain from third parties (for example, credit bureaus) if you check **Box 2** on the Privacy Choices Form.

Citi Financial.[5] After reading the above paragraph, some may wonder what the effect of stating a preference would be—or if there would be any effect at all. In fact, such skepticism is warranted because checking "Box 2" on Citigroup's "Privacy Choices Form" will actually do nothing. When examined closely, the paragraph states that consumers can

[4] No doubt, the Agencies would not appreciate receiving this petition not to allow the aforementioned notices to continue falling to inform consumers of their rights to privacy protection through opt-outs in an 8-point sans serif font and in sentences other than those that are not too long or redundant and use ideal grammatical structure and sentence length.

[5] We must admit some uncertainty in interpreting this paragraph. The analysis that follows is our best

only tell Citigroup not to share with its affiliates information that the law already prohibits it from sharing That is an utterly vacuous option.

Citigroup was able to craft such a bizarre and misleading passage only because the Agencies have failed to give sufficient direction for defining and utilizing key terms and phrases. The paragraph employs ambiguous phrases such as "other information" (what other information?), "unless otherwise permitted by law" (in actuality, the law almost always permits disclosure), and "information about our transactions or experiences with you" (read. "your nonpublic personal information" or, simply, "your private information") to mislead consumers with an impenetrable explanation of a nonexistent right. Financial institutions would be far less capable of constructing such passages if the Agencies would provide more guidance regarding the definition and use of important words and phrases.[6]

ACTION REQUESTED

We ask the Agencies to initiate a rulemaking as soon as possible to amend existing regulations implementing the GLBA to ensure that consumers have meaningful opportunities to exercise their rights. The regulations should require that financial institutions provide notice that consumers can understand and opt-out mechanisms that consumers can use conveniently. To that end, each notice should be truly "clear and conspicuous," following a standardized or tightly modeled format with the most important components—those explaining the law and consumer rights—coming at the beginning of

attempt to decipher it.

[6] Petitioners understand that some of the confusing language in the above paragraph derives from Citigroup's simultaneous compliance with disclosure provisions in both the Fair Credit Reporting Act and the GLBA. But the mere fact of simultaneous compliance with two statutes does not excuse the company's effort to mislead consumers. Indeed, the potential for such confusion only bolsters the argument for better

the notice. Finally, consumers should be provided multiple convenient means of opting out

We recognize that the Agencies have decided to grant each financial institution the flexibility to describe its own information sharing practices. But there is no reason to allow each institution to craft its own explanation of the relevant law and consumer rights. That information is standard across the board. Since the same law applies to all financial institutions, no institution needs flexibility to tailor legal explanations to its particular practices.[7] Handing financial institutions virtually unfettered discretion to determine how to inform consumers of their rights only gives them an opportunity to try to subvert or obscure those rights. Furthermore, the receipt of numerous notices, each with a different explanation of consumer rights and a different opt-out mechanism, only adds to consumer confusion. Both the regulated industries and the Agencies lauded standardization in agreeing that the Agencies should issue identical regulations so that financial institutions would not have to navigate a patchwork of rules. See, e.g., 65 Fed. Reg. 33,646 (May 24, 2000); Comments of the Securities Industry Association, 2 (March 31, 2000) ("Differing approaches and regulations by the various agencies will be burdensome and costly for the industry [and] confusing for consumers.").[8] Under a provision for consumer privacy protection, consumers deserve the benefits of standardization at least as much as financial

agency prescriptions regarding the definition and use of key phrases.

[7] Unless, of course, a particular institution engages in none of the relevant information sharing. In those limited cases, it is perfectly reasonable that the institutions not be required to explain the law at all.

[8] See also Comments of Chase Manhattan Bank, 2-3 (March 30, 2000). Chase, making comments typical of many industry commenters, argued that consistent regulations were "critical" to both industry and consumers and that "[t]he privacy rights of consumers and privacy obligations of financial institutions should not depend upon which primary regulator happens to regulate the particular financial institution." Likewise, petitioners believe that the rights of consumers should not depend upon which financial institution a particular consumer happens to engage for services.

institutions do.[9] Likewise, consumers deserve the same benefits from flexibility that the Agencies appreciated in granting financial institutions freedom to explain their own privacy practices and craft their own opt-out mechanisms. The Agencies should give consumers more options for asserting their opt-out rights so that they may do so in the manner most practicable for them.

To implement the above policies, we make the following specific recommendations regarding notices and opt-out mechanisms:

1. Each notice should state prominently at the top of its first page, in a large, bold-faced font—and in a simple, easily comprehensible phrase—that consumer information may be shared and that consumers have a "right" to opt out of certain information sharing. We suggest using a statement and format such as the following:

WE ARE ALLOWED TO DISCLOSE YOUR PRIVATE INFORMATION TO OTHER COMPANIES UNLESS YOU TELL US NOT TO.

YOU HAVE A RIGHT TO PREVENT US FROM DISCLOSING YOUR PRIVATE INFORMATION TO OTHER COMPANIES.

BUT IF YOU DO NOT RESPOND WITHIN 30 DAYS, WE MAY BEGIN SHARING YOUR INFORMATION. YOU WILL STILL HAVE THE RIGHT TO TELL US TO STOP AT ANY TIME. BUT ONCE WE HAVE SHARED INFORMATION WITH OTHER COMPANIES, WE CANNOT GET IT BACK FROM THEM OR STOP THEM FROM USING IT.

[9] Petitioners do not wish to suggest that only consumers would benefit from standardization. While standardized notices would better enable consumers to understand and compare policies and to exercise their rights, they would also benefit financial institutions. Foremost, standardization would make it easier and less costly for the institutions to comply with regulations by sparing them much of the burden crafting notices. Many institutions expressed concern over complying with ambiguous requirements such as "ample line spacing" and "wide margins" and the directive to avoid "explanations subject to different interpretations." See, e.g., Chase Manhattan, 7-8, Comments of USAGroup, 4 (March 30, 2000). Standardization would help allay other industry concerns as well by preventing litigation over whether a particular notice qualifies, see e.g., Comments of MasterCard International, 9 (March 31, 2000), and forestalling the possibility that financial institutions will interpret the regulations as requiring longer, more confusing, or more technical notices than necessary. See e.g., USA Group, 3-5

This notice includes a detachable postcard, an email address, and a toll-free telephone number that you may use to tell not to share your private information with other companies. You may use any of those methods—the postcard, an email, or the telephone—to notify us of your preference. Please read the rest of this notice to learn more about our policies, the law, and your rights.

2. With respect to opt-out mechanisms, the Agencies should require all financial institutions to provide a toll-free telephone number available twenty-four hours a day, an option to send an e-mail or use a web page, and a detachable, pre-addressed postcard with boxes in which to check off preferences. Providing these opportunities at a minimum will give consumers more realistic opt-out rights by allowing each consumer to exercise her rights in the manner most practicable for her

3. The Agencies should prescribe definitions for key words such as "affiliate," "nonaffiliated third party," and "nonpublic personal information" (or simply "private information"). Definitions should use bullet points with clear, short sentences and, where relevant, they should include not just examples, but the number of institutions that they embrace. Furthermore, financial institutions should be required to use the defined terms. We suggest the following examples:

AFFILIATE:

- "Affiliate" means any company that SJBank owns or that owns SJBank.
- Our affiliates include banks, credit card companies, and life insurance companies such as SJ Online, SJCard and SJ Mutual Life.
- We have 5 affiliates.

NON-AFFILIATE:

- "Non-affiliate" means any other company.
- We currently share consumer information with 12 non-affiliates.

PRIVATE INFORMATION:

- "Private information" means personal information about you that is not available to the public.
- Examples of private information are: your social security number, your credit limit, your account balance, and, if they are not listed in public directories, your address and phone number

CONCLUSION

Because the GLBA is ineffective when consumers cannot exercise their rights, we ask the Agencies to promulgate new regulations requiring financial institutions to provide notices that consumers can understand and opt-out mechanisms they can use.

Respectfully submitted,

David Arkush*
David C. Vladeck
Public Citizen Litigation Group
1600 20th Street, N.W.
Washington, D.C. 20009
(202) 588-1000

* David Arkush is currently a third-year student at Harvard Law School.

PETITIONERS

Ralph Nader
Consumer Advocate
P O Box 19312
Washington, D.C 20036

Public Citizen
1600 20th Street, N.W.
Washington, D.C. 20009

Consumer Federation of America
Travis Plunkett, Legislative Director
1424 16th Street, N.W. Suite 604
Washington, D.C. 20036

Consumers Union
Frank Torres, Legislative Counsel
1666 Connecticut Avenue, N.W., Suite 310
Washington, D.C. 20009-1039

Electronic Privacy Information Center
Marc Rotenberg, Executive Director
Chris Hoofnagle, Legislative Counsel
1718 Connecticut Ave., N.W. Suite 200
Washington, D.C. 20009

Remar Sutton
Consumer Advocate
185 Beverly Road, Suite 3
Atlanta, GA 30309

Center for Media Education
Gabriela Schneider, Senior Policy Analyst
2120 L Street, N.W. Suite 200
Washington, D.C. 20037

Commercial Alert
Gary Ruskin, Executive Director
2226 SE 55th Avenue
Portland, OR 97215

Computer Professionals for Social
Responsibility
Coralee Whitcomb, Director
555 Waverly Street
Palo Alto, California 94302

Consumer Action
Ken McEldowney, Executive Director
717 Market Street, Suite 310
San Francisco, CA 94103

Consumer Project on Technology
James Love, Director
P.O. Box 19367
Washington, D.C. 20036

Consumer Task Force on Auto Issues
J.C. Pierce, Director
185 Beverly Road, Suite 3
Atlanta, GA 30309

Essential Information
1530 P Street, N.W.
Washington, D.C. 20005

JunkBusters Corp.
Jason Catlett, Director
P.O. Box 7034
Green Brook, NJ 08812

National Consumers League
Susan Grant, VP for Public Policy
1701 K Street N.W. Suite 1200
Washington, D.C. 20006

Net Action
Audrie Krause, Executive Director
601 Van Ness Avenue, Suite 631
San Francisco, CA 94102

Privacy Rights Clearinghouse
Beth Givens, Director
Tena Friery, Research Director
1717 Kettner Avenue, Suite 105
San Diego, CA 92101

U.S. Public Interest Research Group
Ed Mierzwinski, Consumer Program Dir.
218 D Street, S.E.
Washington, D.C. 20003

FIA.org

By Electronic Mail

January 22, 2020

Mr. Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581

Re: Petition for Rulemaking under Commodity Futures Trading Commission Rule 13.1 – Codification of No-Action Position under CFTC Letter No. 19-17

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**"),[1] on behalf of its member firms that are registered with the Commodity Futures Trading Commission ("**Commission**" or "**CFTC**") as futures commission merchants ("**FCMs**"), and ICE Clear U.S.[2] ("**ICUS**" and together with FIA, the "**Petitioners**"), respectfully submit this petition for rulemaking ("**Petition**") under Commission Rule 13.1.[3] As

[1] FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington DC. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission as futures commission merchants.

[2] ICUS is registered with the Commission as a derivatives clearing organization ("**DCO**"). As such, it is required to comply with the provisions of Part 39 of the Commission's rules, including Rule 39.13(g)(8), discussed below, in connection with clearing futures, options on futures and cleared swaps on behalf of customers of its FCM clearing members.

[3] Commission Rule 13.1 authorizes any person to "file a petition with the Secretariat of the Commission for the issuance, amendment or repeal of a rule of general application." The petition must "set forth the text of any proposed rule or amendment" and "further state the nature of the petitioner's interest and may state arguments in support of the issuance, amendment or repeal of the rule."

explained in detail below, the Petition seeks to amend Commission Rule 1.56[4] and Rule 1.11[5] to codify, with certain exceptions, the terms and conditions of the no-action position adopted by the Division of Clearing and Risk ("**DCR**") and the Division of Swap Dealer and Intermediary Oversight ("**DSIO**" and, together with DCR, the "**Divisions**") in CFTC Letter No. 19-17 (the "**Proposed Amendment**").[6] Adoption of the Proposed Amendment would authorize FCMs and DCOs to continue to treat separate accounts of a customer as accounts of separate entities for purposes of Rule 39.13(g)(8)(iii) following expiration of the time-limited relief set out in CFTC Letter No. 19-17, *i.e.*, June 30, 2021.[7]

Background

From time-to-time, an FCM may enter into a customer agreement with certain beneficial owners, pursuant to which the FCM agrees to treat separate accounts established by or on behalf of the same beneficial owner as if they were separate legal entities. The reasons why a beneficial owner may request separate treatment for its accounts vary but may include, for example:

- A commercial enterprise, such as an agricultural producer or a petroleum refiner, may obtain financing from a lender that may, in connection with such financing, require the commercial enterprise to hedge the transaction. The lender will be given a subordinated security interest in the hedge account and the right to assert control over the positions and collateral in the account in the event that the commercial breaches its obligations to the lender. However, the lender neither wants nor has a legal right to any assets held in other accounts that the commercial enterprise may establish with the FCM.

[4] Rule 1.56(b) prohibits an FCM from representing in any way that it will: (i) guarantee a customer or noncustomer against loss; (ii) limit the loss of such customer or noncustomer; or (iii) not call for or attempt to collect margin. 17 CFR § 1.56(b) (2019).

[5] Rule 1.11 sets forth the Commission's risk management program for FCMs in substantial detail for the purpose of assuring that each FCM has in place appropriate policies and procedures to monitor and manage the risks associated with the activities of the FCM in its capacity as such. 17 CFR § 1.11 (2019).

[6] The text of the Proposed Amendment is set out in Appendix A to this Petition and a comparison of the proposed rules against the current rules appears as Appendix B. As noted, the purpose of the Proposed Amendment requested by this Petition is to codify, with certain exceptions, the terms and conditions set out in Letter No. 19-17. Concurrently with the filing of this Petition, the Petitioners have filed for the Commission's consideration a separate petition for rulemaking proposing further amendments to Commission Rules 1.56 and 1.11, which would modify the strict prohibitions in Rule 1.56(b), subject to enhanced risk management requirements set out in Rule 1.11, as proposed to be amended. We have separated the proposals to assure the Commission flexibility in its consideration of each.

[7] Commission Rule 39.13(g)(8)(iii) provides that each DCO must "require its clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in a customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products and swap portfolios held in such customer's account which are cleared by the derivatives clearing organization." 17 CFR § 39.13(g)(8)(iii) (2019).

- An institutional customer, such as a pension fund or mutual fund, may allocate assets to investment managers pursuant to investment management agreements ("**IMAs**") that contractually obligate each investment manager to invest the customer's assets under management in accordance with an agreed trading strategy, independent of the trading that may be undertaken for the customer by the same or other investment managers acting on behalf of other accounts of such customer.[8]

As the Commission is aware, in May 2019, the Joint Audit Committee ("**JAC**") issued two Regulatory Alerts: (i) Regulatory Alert 19-02, Combining Accounts for Margin Purposes; and (ii) Regulatory Alert 19-03, CFTC Regulation 1.56(b) Prohibition of Guarantee against Loss.

In Regulatory Alert 19-02, the JAC reminded FCMs that, when determining an account's margin funds available for disbursement, all accounts of the same beneficial owner within the same regulatory account classification must be combined, even if under different control.[9] Although not specifically referenced in Regulatory Alert 19-02, the Chicago Mercantile Exchange ("**CME**") elsewhere made clear its view that the regulatory alert is consistent with the provisions of Commission Rule 39.13(g)(8)(iii).[10]

In Regulatory Alert 19-03, the JAC expressed the view that so-called limited recourse and nonrecourse clauses "are not in compliance with industry regulations and are not permitted in any agreement between an FCM and its customers and noncustomers." The JAC added: "For clarity, in the case of a separate account of a beneficial owner managed by an asset manager, the FCM must have at all times the absolute right to look to funds in all accounts of the beneficial owner even accounts that are under different control, as well as the right to call the underlying beneficial owner for funds even if beyond the amount the beneficial owner has allocated to the asset manager(s)."

By letter to the Divisions dated June 26, 2019, FIA requested relief from aspects of Regulatory Alert 19-02 and Regulatory Alert 19-03, explaining that the policies set out in these regulatory alerts had a direct and adverse effect the ability of FCMs to maintain separate accounts for the

[8] Commission rules reflect this understanding. For example, Rule 1.33(d) requires an FCM to furnish to an account controller a copy of each monthly statement and confirmation provided to the client for that account; Part 150 provides an exemption from aggregating positions for independently controlled accounts of eligible entities.

[9] For purposes of Regulatory Alert 19-02 and 19-03 and this Petition, we understand that the term "beneficial owner" means the individual or legal entity identified on the books and records of the FCM carrying the account as the account's direct owner, *i.e.*, the FCM's customer. The term is not intended to mean the individuals or other legal entities that directly or indirectly own the legal entity that is the FCM's customer.

[10] *See* Letter from Sunil Cutinho, President, CME Clearing, to Brian A. Bussey Director, DCR, and Matthew B. Kulkin, Director, DSIO, dated June 14, 2019.

benefit of their customers.[11] On July 10, 2019, in response in part to FIA's letter, the Divisions issued CFTC Letter No. 19-17.

With respect to Regulatory Alert 19-03, the Divisions effectively confirmed the JAC's interpretation that limited recourse or non-recourse clauses would violate Commission Rule 1.56. The Divisions also noted that, in the event of a shortfall in any customer account, "the FCM must retain the ability to ultimately look to funds in other accounts of the beneficial owner, including accounts that may be under different control, as well as the right to call the beneficial owner for additional funds."

With respect to Regulatory Alert 19-02, the Divisions adopted a no-action position authorizing a DCO to allow an FCM to treat the separate accounts of a customer as accounts of separate entities for purposes of Rule 39.13(g)(8)(iii) "where the FCM clearing member's written internal controls and procedures require it to, and it in fact does, comply with the terms and conditions" set out in the letter. Significantly, as noted above, the no-action relief is time limited and extends only until June 30, 2021.

Basis for Petition

In adopting the no-action position with regard to Commission Rule 39.13(g)(8)(iii), the Divisions set a two-year limit "in order to provide Staff with time to recommend, and the Commission with time to determine whether to conduct, and if so, to in fact conduct, a rulemaking to implement appropriate relief on a permanent basis." We respectfully submit that such rulemaking is not only appropriate but essential to provide both FCMs and their customers with the legal certainty to which they are entitled.

Absent Commission action, the no-action relief with regard to the treatment of separate accounts under Commission Rule 39.13(g)(8)(iii) will expire and FCM clearing members will no longer be able to treat the separate accounts of a customer as accounts of separate entities. For many FCMs and their customers, the terms and conditions of the no-action position in CFTC Letter No. 19-17 present significant operational and systems challenges.[12] While these challenges may vary across FCMs, the conditions contemplate that FCMs adopt new practices for stress testing accounts,

[11] *See, e.g.*, Letter from Walt L. Lukken, President and Chief Executive Officer, FIA, to Brian A. Bussey Director, DCR, and Matthew B. Kulkin, Director, DSIO, dated June 26, 2019

[12] In this regard, we note that FIA earlier submitted a letter requesting additional time in which to comply with the terms and conditions of CFTC Letter No. 19-17. *See* Letter from Walt L. Lukken, President and Chief Executive Officer, FIA, to Brian A. Bussey Director, DCR, and Matthew B. Kulkin, Director, DSIO, dated July 24, 2019. It is unclear whether the *Statement by the Directors of the Division of Clearing and Risk and the Division of Swap Dealer and Intermediary Oversight Concerning the Treatment of Separate Accounts of the Same Beneficial Owner*, dated September 13, 2019, was intended to be the Divisions' response to FIA's letter.

review and possibly change margin timing expectations for non-US accounts,[13] undertake legal analysis to clarify interpretive questions, and revise their segregation calculation and recordkeeping practices. The conditions may also present time-consuming documentation changes and customer outreach.[14]

The burdens placed on such FCMs and their customers would be multiplied if the Commission were to decide not to act and not make permanent the no-action provisions of Letter No. 19-17, as proposed to be modified herein. A delay in adopting a rule may lead to the same result if, after notice and an opportunity for comment and a weighing of the costs and benefits, the Commission determines that another approach is, in fact, preferred. In either situation, FCMs and their customers would be forced to undo those changes and implement new ones in less than two years' time, which may also increase confusion for beneficial owners themselves.

Failure to adopt a rule may also affect a customer's relationships with third parties. For example, an asset manager may be less likely to use exchange-traded derivatives to hedge its customers' cash market positions if the asset manager could not have confidence that it would be able to withdraw its customers' excess margin as necessary to meet its obligations in other markets. Similarly, a bank may be less likely to provide a commercial participant with margin financing if the proceeds of its loans could be applied to meet other obligations of the participant. Institutional customers that rely on asset managers may seek to impose restrictions on such managers that would interfere with such managers' trading strategies.

FIA member firms that are FCMs (and their customers), therefore, have a direct interest in assuring that they are able to take advantage of the no-action relief beyond June 30, 2021 and are pleased to submit this Petition to facilitate the Commission's consideration of a proposed rulemaking.[15] As described below, FCMs are willing to implement many of the requirements of CFTC Letter No. 19-17 in order to extend their ability to offer separate margining to customers beyond June 30, 2021. However, having legal certainty as to the basis for doing so would help eliminate unnecessary expenditure and uncertainty in the market. Furthermore, a rulemaking would allow for an appropriate consideration of the costs and benefits of any final approach and would reduce interpretive questions.

The Proposed Amendment

As noted earlier, the Proposed Amendment would authorize FCMs to treat the separate accounts of a customer as accounts of separate entities for purposes of Rule 39.13(g)(8)(iii) by codifying,

[13] Condition 5 requires each separate account to be on a one-day margin call. Customers located outside of the US may have negotiated longer timing to take into account time zone differences and settlement practices for non-US currencies.

[14] *See* Letter from Walt L. Lukken, President and Chief Executive Office, FIA, to Joshua B. Sterling, Director, DSIO, and Sarah E. Josephson, Acting Director, DCR, dated July 24, 2019.

[15] For the avoidance of doubt, this Petition addresses only the no-action position with respect to Commission Rule 39.13(g)(8)(iii).

with certain exceptions, the terms and conditions of CFTC Letter No. 19-17. Rather than amend Rule 39.13, however, we propose amending Rule 1.56 to add a new paragraph (f), supplemented with enhanced risk management requirements at Rule 1.11(e) where Rule 1.56(f) applies.[16]

New Rule 1.56(f) would recognize the right of an FCM, subject to the conditions of Rule 1.56(f), to enter into an agreement with its customer pursuant to which: (i) notwithstanding Rule 39.13(g)(8)(iii), the FCM may allow a customer to withdraw excess funds from a separate account while there is an outstanding margin call in another separate account; and (ii) the FCM agrees that it will not (in the absence of certain specified conditions that terminate the privileges described in the Proposed Amendment) use excess funds from one account to meet an obligation in another account without the consent of the customer, provided the FCM has in place the enhanced risk management requirements set out in the Proposed Amendment.

The Proposed Amendment would further provide that the authority of the FCM to exercise the privileges described in the Proposed Amendment will terminate in the event that, with respect to the customer:

- The customer has either instituted or has instituted against it a bankruptcy proceeding; or

- The FCM is not otherwise in compliance with Rule 1.56(b).

Notably, the Proposed Amendment would also require the FCM to notify its designated self-regulatory organization ("**DSRO**") that it is entering into such agreements and would recognize that the Commission or a self-regulatory organization ("**SRO**") may, for cause and in accordance with the rules of the Commission or such SRO, as applicable, direct the FCM to cease exercising the privileges described in the amendment.[17]

The Proposed Amendment would further codify the bulk of the terms and conditions in CFTC Letter No. 19-17 in a revised Rule 1.11 by redesignating subparagraph (e)(4) as subparagraph (e)(5) and adding a new paragraph (e)(4), *Enhanced Risk Management for Separate Accounts*. New subparagraph (e)(4) reorganizes and incorporates most, but not all, of the terms and conditions in CFTC Letter No. 19-17. After analyzing all of the conditions, we suggest including in the codified version only those terms that provide actual benefit or enhancement relevant to any possible risk of separate account treatment, taking into account the burden each term imposes.

[16] Because Part 39 of the Commission's rules relate to core principles for DCOs and the relief requested here affect the obligations of FCMs, we believe it is more appropriate to place the Proposed Amendment in Rule 1.56 and Rule 1.11 rather than Part 39.

[17] The Proposed Amendment does not incorporate the definition of "ordinary course of business" set out in CFTC Letter No. 19-17. We submit that, subject to an FCM's own risk management requirements, as long as the customer timely meets its margin requirements and is not subject to a bankruptcy proceeding, an FCM should be permitted to treat the separate accounts of a customer as accounts of separate entities for purposes of Rule 39.13(g)(8)(iii).

For example, we did not include the requirement that an FCM's risk management program include stress testing and credit limits on a combined account basis as well as an individual account basis. This requirement imposes a significant systems modification burden on FCMs with limited risk management benefit. We also did not include the requirements that FCMs (i) maintain specific lists and contact information of beneficial owners of the accounts, and (ii) provide disclosure with respect to the application of the Part 190 of the Commission's rules. We believe both requirements are unnecessary.

Codification of the no-action position in CFTC Letter No. 19-17 with respect to separate accounts should not expose FCMs carrying such accounts to any additional risk. As the Divisions noted in CFTC Letter No. 19-17, the Commission's rules concerning the protection of customer funds have greatly expanded since Commission Rule 1.56(b) was promulgated. For example:

- Part 190 of the Commission's rules prescribe, among other things, the method by which the business of a commodity firm is to be conducted or liquidated following the filing of a bankruptcy petition and how customer claims are to be calculated.

- Rule 1.11 requires each FCM to develop and maintain specific risk management policies and procedures involving, among other things, the segregation and handling of customer funds. Among other requirements, each FCM must develop a process for establishing a targeted amount of residual interest that will reasonably ensure that the FCM remains in compliance with the segregated funds requirements at all times.[18]

- Rules 1.22, 22.2, and 30.7 require specific calculations regarding the requirement of residual interest in segregated, cleared swap and secured customer fund accounts to ensure that no FCM uses or permits the use of the customer funds of one customer to purchase, margin, or settle the trades, contracts, or options of another customer.[19] These rules require an FCM to compute its segregated funds balances daily and to use its own funds, *i.e.*, its residual interest, to make up any shortfalls in each customer account class.

- Part 39 of the Commission's rules establish risk management requirements for DCOs, which, in turn, require that their clearing members take certain steps to support their own risk management, thereby mitigating the risk that such members pose to the DCO and providing an extra layer of oversight.

[18] In establishing the total amount of the targeted residual interest in the segregated funds accounts, senior management must consider various factors, as applicable, relating to the nature of the FCM's business including, but not limited to, the composition of the FCM's customer base, the general creditworthiness of the customer base, the general trading activity of the customers, the types of markets and products traded by the customers, the proprietary trading of the FCM, the general volatility and liquidity of the markets and products traded by customers, the FCM's own liquidity and capital needs, and the historical trends in customer segregated fund balances, including undermargined amounts and net deficit balances in customers' accounts.

[19] 17 CFR §§ 1.22, 22.2 and 30.7.

Conclusion

For all of the above reasons, the Petitioners respectfully submit this Petition for the Commission's consideration and urge the Commission to act promptly to initiate the required procedures to promulgate the Proposed Amendment. We stand ready to assist the Commission and its staff in this effort. If the Commission has any questions or needs any additional information, please contact Allison Lurton, FIA's General Counsel and Chief Legal Officer at 202.466.5460 or alurton@fia.org.

Sincerely,

Walt L. Lukken

Walt L. Lukken
President and Chief Executive Officer of FIA

Eamonn Hahessy
General Counsel and CCO of ICE Clear U.S.

cc: Honorable Heath P. Tarbert, Chairman
Honorable Brian Quintenz, Commissioner
Honorable Rostin Benham, Commissioner
Honorable Dan Berkovitz, Commissioner

APPENDIX A

§1.11 Risk Management Program for futures commission merchants.

a. Redesignate paragraph (e)(4) as paragraph (e)(5).

b. Add a new paragraph (e)(4) to read as follows:

(4) *Enhanced Risk Management for Separate Accounts.* A futures commission merchant that maintains separate accounts as described in §1.56(f) for one or more customers must enhance its Risk Management Program to assure that each separate account is deemed a separate customer for purposes of developing and implementing its Risk Management Program to account for the additional risks of maintaining such separate accounts. Specifically, the futures commission merchant's written policies and procedures must be supplemented to:

(i) Evaluate information provided by a customer, or, as applicable, the manager of a separate account, sufficient to permit the futures commission merchant to assess the value of the assets allocated to such separate account; and

(ii) Perform stress testing and establish credit limits based on assets dedicated to such separate account, as the levels of such assets may be updated from time to time by a customer or a manager of a separate account;

(iii) Calculate the margin requirement for each separate account independently from all other separate accounts of the same customer with no offsets or spreads recognized across the separate accounts;

(iv) Assure that all calls for margin or other required deposits for any separate account of the same customer are outstanding no more than one business day, except as may result from administrative error or operational constraints;

(v) Consider a receivable from a separate account secured (a current asset) based only on the assets of that separate account;

(vi)(A) Include the margin deficiency of each separate account for purposes of its residual interest compliance calculations; and (B) cover any such margin deficiency with its own funds as applicable;

(vii)(A) Maintain a list of all separate accounts receiving such treatment indicating the customer and account numbers; and (B) record each separate account independently in the futures commission merchant's books and records; and

(ix) Provide disclosure on its website or within its disclosure document required by Regulation 1.55(i) that under Part 190 of this Chapter all separate accounts of the customer will be combined in the event of the futures commission merchant's bankruptcy.

(5) *Supervision of the Risk Management Program.* The Risk Management Program shall include a supervisory system that is reasonably designed to ensure that the policies and procedures required by this section are diligently followed.

§1.56 Prohibition of guarantees against loss.

a. Add a new paragraph (f) to read as follows:

(f)(1) Nothing in this section shall prevent a futures commission merchant that maintains two or more accounts within the same regulatory account classification (customer segregated, customer secured, cleared swaps customer, or noncustomer) for the same customer (each account hereinafter a separate account) from entering into a written agreement with the customer, pursuant to which the futures commission merchant agrees that, except as provided in paragraph (f)(2) of this section:

(i) The provisions of § 39.13(g)(8)(iii) of this Chapter to the contrary notwithstanding, the futures commission merchant may permit the customer to withdraw funds from a separate account even if the net liquidating value plus the margin deposits remaining in a customer's other accounts after such withdrawal are not sufficient to meet the customer's initial margin requirements with respect to all products and swap portfolios held in such customer's accounts that are cleared by the derivatives clearing organization; and

(ii) The futures commission merchant will not, without the prior consent of the customer, use excess customer funds from one separate account to meet any obligations in another separate account.

(2) The authority of a futures commission merchant to exercise the privileges described in paragraph (f)(1) of this section with respect to any customer will be deemed to terminate immediately in the event that:

(i) The customer has instituted, or has had instituted against it, a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights; or

(ii) The futures commission merchant is not otherwise in compliance with paragraph (b) of this section.

(3) A futures commission that intends to enter into agreements of the type authorized by paragraph (f)(1) of this section with one or more of its customers must notify its designated self-regulatory organization promptly after entering into the first such agreement.

(4) The Commission or any self-regulatory organization with authority over the futures commission merchant may, for cause and in accordance with the rules of the Commission or such self-regulatory organization, as applicable, direct the futures commission merchant to cease exercising the privileges described in paragraph (f)(1) of this section.

APPENDIX B

§1.11 Risk Management Program for futures commission merchants.

(a) *Applicability.* Nothing in this section shall apply to a futures commission merchant that does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result from soliciting or accepting orders for the purchase or sale of any commodity interest.

(b) *Definitions.* For purposes of this section:

(1) *Business unit* means any department, division, group, or personnel of a futures commission merchant or any of its affiliates, whether or not identified as such that:

(i) Engages in soliciting or in accepting orders for the purchase or sale of any commodity interest and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom; or

(ii) Otherwise handles segregated funds, including managing, investing, and overseeing the custody of segregated funds, or any documentation in connection therewith, other than for risk management purposes; and

(iii) Any personnel exercising direct supervisory authority of the performance of the activities described in paragraph (b)(1)(i) or (ii) of this section.

(2) *Customer* means a futures customer as defined in §1.3, Cleared Swaps Customer as defined in §22.1 of this chapter, and 30.7 customer as defined in §30.1 of this chapter.

(3) *Governing body* means the proprietor, if the futures commission merchant is a sole proprietorship; a general partner, if the futures commission merchant is a partnership; the board of directors if the futures commission merchant is a corporation; the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority if the futures commission merchant is a limited liability company or limited liability partnership.

(4) *Segregated funds* means money, securities, or other property held by a futures commission merchant in separate accounts pursuant to §1.20 for futures customers, pursuant to §22.2 of this chapter for Cleared Swaps Customers, and pursuant to §30.7 of this chapter for 30.7 customers.

(5) *Senior management* means, any officer or officers specifically granted the authority and responsibility to fulfill the requirements of senior management by the governing body.

(c) *Risk Management Program.* (1) Each futures commission merchant shall establish, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with the activities of the futures commission merchant as such. For purposes of this section, such policies and procedures shall be referred to collectively as a "Risk Management Program."

(2) Each futures commission merchant shall maintain written policies and procedures that describe the Risk Management Program of the futures commission merchant.

(3) The Risk Management Program and the written risk management policies and procedures, and any material changes thereto, shall be approved in writing by the governing body of the futures commission merchant.

(4) Each futures commission merchant shall furnish a copy of its written risk management policies and procedures to the Commission and its designated self-regulatory organization upon application for registration and thereafter upon request.

(d) *Risk management unit.* As part of the Risk Management Program, each futures commission merchant shall establish and maintain a risk management unit with sufficient authority; qualified personnel; and financial, operational, and other resources to carry out the risk management program established pursuant to this section. The risk management unit shall report directly to senior management and shall be independent from the business unit.

(e) *Elements of the Risk Management Program.* The Risk Management Program of each futures commission merchant shall include, at a minimum, the following elements:

(1) *Identification of risks and risk tolerance limits.* (i) The Risk Management Program shall take into account market, credit, liquidity, foreign currency, legal, operational, settlement, segregation, technological, capital, and any other applicable risks together with a description of the risk tolerance limits set by the futures commission merchant and the underlying methodology in the written policies and procedures. The risk tolerance limits shall be reviewed and approved quarterly by senior management and annually by the governing body. Exceptions to risk tolerance limits shall be subject to written policies and procedures.

(ii) The Risk Management Program shall take into account risks posed by affiliates, all lines of business of the futures commission merchant, and all other trading activity engaged in by the futures commission merchant. The Risk Management Program shall be integrated into risk management at the consolidated entity level.

(iii) The Risk Management Program shall include policies and procedures for detecting breaches of risk tolerance limits set by the futures commission merchant, and alerting supervisors within the risk management unit and senior management, as appropriate.

(2) *Periodic Risk Exposure Reports.* (i) The risk management unit of each futures commission merchant shall provide to senior management and to its governing body quarterly written reports setting forth all applicable risk exposures of the futures commission merchant; any recommended or completed changes to the Risk Management Program; the recommended time frame for implementing recommended changes; and the status of any incomplete implementation of previously recommended changes to the Risk Management Program. For purposes of this section, such reports shall be referred to as "Risk Exposure Reports." The Risk Exposure Reports also shall

be provided to the senior management and the governing body immediately upon detection of any material change in the risk exposure of the futures commission merchant.

(ii) *Furnishing to the Commission.* Each futures commission merchant shall furnish copies of its Risk Exposure Reports to the Commission within five (5) business days of providing such reports to its senior management.

(3) *Specific risk management considerations.* The Risk Management Program of each futures commission merchant shall include, but not be limited to, policies and procedures necessary to monitor and manage the following risks:

(i) *Segregation risk.* The written policies and procedures shall be reasonably designed to ensure that segregated funds are separately accounted for and segregated or secured as belonging to customers as required by the Act and Commission regulations and must, at a minimum, include or address the following:

(A) A process for the evaluation of depositories of segregated funds, including, at a minimum, documented criteria that any depository that will hold segregated funds, including an entity affiliated with the futures commission merchant, must meet, including criteria addressing the depository's capitalization, creditworthiness, operational reliability, and access to liquidity. The criteria should further consider the extent to which segregated funds are concentrated with any depository or group of depositories. The criteria also should include the availability of deposit insurance and the extent of the regulation and supervision of the depository;

(B) A program to monitor an approved depository on an ongoing basis to assess its continued satisfaction of the futures commission merchant's established criteria, including a thorough due diligence review of each depository at least annually;

(C) An account opening process for depositories, including documented authorization requirements, procedures that ensure that segregated funds are not deposited with a depository prior to the futures commission merchant receiving the acknowledgment letter required from such depository pursuant to §§1.20, and 22.2 and 30.7 of this chapter, and procedures that ensure that such account is properly titled to reflect that it is holding segregated funds pursuant to the Act and Commission regulations;

(D) A process for establishing a targeted amount of residual interest that the futures commission merchant seeks to maintain as its residual interest in the segregated funds accounts and such process must be designed to reasonably ensure that the futures commission merchant maintains the targeted residual amounts and remains in compliance with the segregated funds requirements at all times. The policies and procedures must require that senior management, in establishing the total amount of the targeted residual interest in the segregated funds accounts, perform appropriate due diligence and consider various factors, as applicable, relating to the nature of the futures commission merchant's business including, but not limited to, the composition of the futures commission merchant's customer base, the general creditworthiness of the customer base, the general trading activity of the customers, the types of markets and products traded by the customers, the proprietary trading of the futures commission merchant, the general volatility and liquidity of the markets and products traded by customers, the futures commission merchant's own liquidity and capital needs, and the historical trends in customer segregated fund balances, including undermargined amounts and net deficit balances in customers' accounts. The analysis and calculation of the targeted amount of the future commission merchant's residual interest must be described in writing with the specificity necessary to allow the Commission and the futures commission merchant's designated self-regulatory organization to duplicate the analysis and calculation and test the assumptions made by the futures commission merchant. The adequacy of the targeted residual interest and the process for establishing the targeted residual interest must be reassessed periodically by Senior Management and revised as necessary;

(E) A process for the withdrawal of cash, securities, or other property from accounts holding segregated funds, where the withdrawal is not for the purpose of payments to or on behalf of the futures commission merchant's customers. Such policies and procedures must satisfy the requirements of §1.23, §22.17 of this chapter, or §30.7 of this chapter, as applicable;

(F) A process for assessing the appropriateness of specific investments of segregated funds in permitted investments in accordance with §1.25. Such policies and procedures must take into consideration the market, credit, counterparty, operational, and liquidity risks associated with such investments, and assess whether such investments comply with the requirements in §1.25 including that the futures commission merchant manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity;

(G) Procedures requiring the appropriate separation of duties among individuals responsible for compliance with the Act and Commission regulations relating to the protection and financial reporting of segregated funds, including the separation of duties among personnel that are responsible for advising customers on trading activities, approving or overseeing cash receipts and disbursements (including investment operations), and recording and reporting financial transactions. The policies and procedures must require that any movement of funds to affiliated companies and parties are properly approved and documented;

(H) A process for the timely recording of all transactions, including transactions impacting customers' accounts, in the firm's books of record;

(I) A program for conducting annual training of all finance, treasury, operations, regulatory, compliance, settlement, and other relevant officers and employees regarding the segregation requirements for segregated funds required by the Act and regulations, the requirements for notices under §1.12, procedures for reporting suspected breaches of the policies and procedures required by this section to the chief compliance officer, without fear of retaliation, and the consequences of failing to comply with the segregation requirements of the Act and regulations; and

(J) Policies and procedures for assessing the liquidity, marketability and mark-to-market valuation of all securities or other non-cash assets held as segregated funds, including permitted investments under §1.25, to ensure that all non-cash assets held in the customer segregated accounts, both customer-owned securities and investments in accordance with §1.25, are readily marketable and highly liquid. Such policies and procedures must require daily measurement of liquidity needs with respect to customers; assessment of procedures to liquidate all non-cash collateral in a timely manner and without significant effect on price; and application of appropriate collateral haircuts that accurately reflect market and credit risk.

(ii) *Operational risk.* The Risk Management Program shall include automated financial risk management controls reasonably designed to prevent the placing of erroneous orders, including those that exceed pre-set capital, credit, or volume thresholds. The Risk Management Program shall ensure that the use of automated trading programs is subject to policies and procedures governing the use, supervision, maintenance, testing, and inspection of such programs.

(iii) *Capital risk.* The written policies and procedures shall be reasonably designed to ensure that the futures commission merchant has sufficient capital to be in compliance with the Act and the regulations, and sufficient capital and liquidity to meet the reasonably foreseeable needs of the futures commission merchant.

(4) *Enhanced Risk Management for Separate Accounts.* A futures commission merchant that maintains separate accounts as described in §1.56(f) for one or more customers must enhance its Risk Management Program to assure that each separate account is deemed a separate customer for purposes of developing and implementing its Risk Management Program to account for the additional risks of maintaining such separate accounts. Specifically, the futures commission merchant's written policies and procedures must be supplemented to:

(i) Evaluate information provided by a customer or, as applicable, the manager of a separate account, sufficient to permit the futures commission merchant to assess the value of the assets allocated to such separate account; and

(ii) Perform stress testing and establish credit limits based on assets dedicated to such separate account, as the levels of such assets may be updated from time to time by a customer or a manager of a separate account;

(iii) Calculate the margin requirement for each separate account independently from all other separate accounts of the same customer with no offsets or spreads recognized across the separate accounts;

(iv) Assure that all calls for margin or other required deposits for any separate account of the same customer are outstanding no more than one business day, except as may result from administrative error or operational constraints;

(v) Consider a receivable from a separate account secured (a current asset) based only on the assets of that separate account;

(vi)(A) Include the margin deficiency of each separate account for purposes of its residual interest compliance calculations; and (B) cover any such margin deficiency with its own funds as applicable;

(vii)(A) Maintain a list of all separate accounts receiving such treatment indicating the customer and account numbers; and (B) record each separate account independently in the futures commission merchant's books and records; and

(ix) Provide disclosure on its website or within its disclosure document required by Regulation 1.55(i) that under Part 190 of this Chapter all separate accounts of the customer will be combined in the event of the futures commission merchant's bankruptcy.

(5) *Supervision of the Risk Management Program.* The Risk Management Program shall include a supervisory system that is reasonably designed to ensure that the policies and procedures required by this section are diligently followed.

(f) *Review and testing.* (1) The Risk Management Program of each futures commission merchant shall be reviewed and tested on at least an annual basis, or upon any material change in the business of the futures commission merchant that is reasonably likely to alter the risk profile of the futures commission merchant.

(2) The annual reviews of the Risk Management Program shall include an analysis of adherence to, and the effectiveness of, the risk management policies and procedures, and any recommendations for modifications to the Risk Management Program. The annual testing shall be performed by qualified internal audit staff that are independent of the business unit, or by a qualified third party audit service reporting to staff that are independent of the business unit. The results of the annual review of the Risk Management Program shall be promptly reported to and reviewed by the chief compliance officer, senior management, and governing body of the futures commission merchant.

(3) Each futures commission merchant shall document all internal and external reviews and testing of its Risk Management Program and written risk management policies and procedures including the date of the review or test; the results; any deficiencies identified; the corrective action taken; and the date that corrective action was taken. Such documentation shall be provided to Commission staff, upon request.

(g) *Distribution of risk management policies and procedures.* The Risk Management Program shall include procedures for the timely distribution of its written risk management policies and procedures to relevant supervisory personnel. Each futures commission merchant shall maintain records of the persons to whom the risk management policies and procedures were distributed and when they were distributed.

(h) *Recordkeeping.* (1) Each futures commission merchant shall maintain copies of all written approvals required by this section.

(2) All records or reports, including, but not limited to, the written policies and procedures and any changes thereto that a futures commission merchant is required to maintain pursuant to this regulation shall be maintained in accordance with §1.31 and shall be made available promptly upon request to representatives of the Commission.

§1.56 Prohibition of guarantees against loss.

(a) [Reserved]

(b) No futures commission merchant or introducing broker may in any way represent that it will, with respect to any commodity interest in any account carried by the futures commission merchant for or on behalf of any person:

(1) Guarantee such person against loss;

(2) Limit the loss of such person; or

(3) Not call for or attempt to collect initial and maintenance margin as established by the rules of the applicable board of trade.

(c) No person may in any way represent that a futures commission merchant or introducing broker will engage in any of the acts or practices described in paragraph (b) of this section.

(d) This section shall not be construed to prevent a futures commission merchant or introducing broker from:

(1) Assuming or sharing in the losses resulting from an error or mishandling of an order; or

(2) Participating as a general partner in a commodity pool which is a limited partnership.

(e) This section shall not affect any guarantee entered into prior to January 28, 1982, but this section shall apply to any extension, modification or renewal thereof entered into after such date.

(f)(1) Nothing in this section shall prevent a futures commission merchant that maintains two or more accounts within the same regulatory account classification (customer segregated, customer secured, cleared swaps customer, or noncustomer) for the same customer (each account hereinafter a separate account) from entering into a written agreement with the customer, pursuant to which the futures commission merchant agrees that, except as provided in paragraph (f)(2) of this section:

(i) The provisions of § 39.13(g)(8)(iii) of this Chapter to the contrary notwithstanding, the futures commission merchant may permit the customer to withdraw funds from a separate account even if the net liquidating value plus the margin deposits remaining in a customer's other accounts after such withdrawal are not sufficient to meet the customer's initial margin requirements with respect to all products and swap portfolios held in such customer's accounts that are cleared by the derivatives clearing organization; and

(ii) The futures commission merchant will not, without the prior consent of the customer, use excess customer funds from one separate account to meet any obligations in another separate account.

(2) The authority of a futures commission merchant to exercise the privileges described in paragraph (f)(1) of this section with respect to any customer will be deemed to terminate immediately in the event that:

(i) The customer has instituted, or has had instituted against it, a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights; or

(ii) The futures commission merchant is not otherwise in compliance with paragraph (b) of this section.

(3) A futures commission that intends to enter into agreements of the type authorized by paragraph (f)(1) of this section with one or more of its customers must notify its designated self-regulatory organization promptly after entering into the first such agreement.

(4) The Commission or any self-regulatory organization with authority over the futures commission merchant may, for cause and in accordance with the rules of the Commission or such self-regulatory organization, as applicable, direct the futures commission merchant to cease exercising the privileges described in paragraph (f)(1) of this section.

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By Electronic Mail

January 22, 2020

Mr. Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581

Re: Petition for Rulemaking under Commodity Futures Trading Commission Rule 13.1 – Proposed Amendments to Commission Rule 1.11 and 1.56

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**"),[1] on behalf of its member firms that are registered with the Commodity Futures Trading Commission ("**Commission**" or "**CFTC**") as futures commission merchants ("**FCMs**"), and ICE Clear U.S. ("**ICUS**" and together with FIA, the "**Petitioners**"), respectfully submit this petition for rulemaking ("**Petition**") under Commission Rule 13.1.[2] This Petition seeks to amend Commission Rule 1.56[3] and Rule 1.11[4] to expressly permit allocated asset

[1] FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington DC. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission as futures commission merchants.

[2] Commission Rule 13.1 authorizes any person to "file a petition with the Secretariat of the Commission for the issuance, amendment or repeal of a rule of general application." The petition must "set forth the text of any proposed rule or amendment" and "further state the nature of the petitioner's interest and may state arguments in support of the issuance, amendment or repeal of the rule."

[3] Rule 1.56(b) prohibits an FCM from representing in any way that it will: (i) guarantee a customer or noncustomer against loss; (ii) limit the loss of such customer or noncustomer; or (iii) not call for or attempt to collect margin. 17 CFR § 1.56(b) (2019).

[4] Rule 1.11 sets forth the Commission's risk management program for FCMs in substantial detail for the purpose of assuring that each FCM has in place appropriate policies and procedures to monitor and manage the risks associated with the activities of the FCM in its capacity as such. 17 CFR § 1.11 (2019).

recourse provisions in agreements between customers and FCMs under certain circumstances, including compliance with heightened risk management procedures ("**Proposed Amendment**").[5] As explained in detail below, adoption of the Proposed Amendment would significantly enhance customer protection, clarify current industry practice and increase stability in the derivatives markets.[6]

Background

Every trading day, millions of Americans access the derivatives markets through accounts managed by fiduciaries: pension funds, mutual funds, retirement and health plans, 401k plan investment options, and other managed investments. These investors rely on fiduciaries to appropriately invest their assets for their financial security. In turn, the fiduciaries may allocate specific, dollar-limited portions of their beneficiaries' assets to investment managers pursuant to investment management agreements ("**IMAs**" and such allocated funds, "**Assets Under Management**" or "**AUM**") and investment guidelines designed to achieve returns while prudently managing investment risk. These allocations represent a significant portion of derivatives markets activity and are, therefore, important to the efficient operation of the market.

For decades, a predominant method of handling this arrangement has been contractual agreements between FCMs and investment managers that provide that, in the event of a default, the FCM has recourse to a subset of the customer's assets represented to the FCM and updated from time to time, including all of the assets allocated to that investment manager on behalf of an institutional customer (such arrangements, "**Allocated Asset Recourse**" or "**AAR**"). These contractual arrangements implement the customers' defined trading mandates that enable millions of American pensioners, retirees, and health care beneficiaries to reap the benefits of using futures to manage risk.

Allocated Asset Recourse provisions generally provide that the FCM's recourse in the event of a customer's default shall be limited to the customer assets allocated to and under management by the investment manager in its capacity as agent with authority to invest and trade on behalf of the institutional customer.[7] AAR contractual arrangements allow FCMs to carry managed accounts

[5] The text of the Proposed Amendment is set out in Appendix A to this Petition and a comparison of the proposed rules against the current rules appears as Appendix B. As noted, the purpose of the Amendment requested by this Petition is to expressly permit allocated asset recourse provisions in agreements between customers and FCMs under certain circumstances, including compliance with heightened risk management procedures. Concurrently with the filing of this Petition, the Petitioners have filed for the Commission's consideration a separate petition for rulemaking proposing further amendments to Commission Rules 1.56 and 1.11, to codify, with certain exceptions, the terms and conditions set out in CFTC Letter No. 19-17. We have separated the proposals to assure the Commission flexibility in its consideration of each.

[6] References to the derivatives markets throughout this Petition are intended to encompass all types of derivatives products, including cleared over-the-counter derivatives as well as standardized futures and options on futures contracts.

[7] Although there is no single, standard form of Allocated Asset Recourse, contract terms between an FCM and an investment manager representative of this approach are as follows:

for institutional customers. These institutional customers are generally restricted by their fiduciary obligations to their beneficiaries from exposing the entirety of their beneficiaries' assets to investment risk. Accordingly, such institutional customers generally engage multiple managers or engage a single manager to implement different strategies. To meet their own fiduciary obligations, these institutional customers may enter into IMAs that contain provisions that restrict the managers to trade (and expose to market risk) only the assets specifically allocated to the manager or strategy described in the related IMA. This is intended to prevent losses from exceeding the amount of the allocation to the investment manager. AAR provisions in FCM customer agreements allow investment managers operating under such constraints to enter the derivatives markets on behalf of their institutional customers (and the individual beneficiaries of those institutional customers) in a way that would not be possible if the agreements with FCMs provided for unlimited recourse to their institutional customers' assets (because such agreements would violate the asset owners' fiduciary obligations to those ultimate beneficiaries).

In short, AAR provisions have been a foundational component of the arrangement that allows a large segment of the investing public to access the derivatives markets, while protecting those customers' other assets. However, recent pronouncements by the Joint Audit Committee ("**JAC**") undermine that foundation.

In May 2019, the JAC issued Regulatory Alert 19-03, CFTC Regulation 1.56(b) Prohibition of Guarantee against Loss ("**Alert 19-03**"). Alert 19-03 states that AAR clauses "are not in compliance with industry regulations and are not permitted in any agreement between an FCM and its customers and noncustomers." "For clarity," Alert 19-03 continues, "in the case of a separate account of a beneficial owner managed by an asset manager, the FCM must have at all times the absolute right to look to funds in all accounts of the beneficial owner even accounts that are under different control, as well as the right to call the underlying beneficial owner for funds even if beyond the amount the beneficial owner has allocated to the asset manager(s)."

By letter to the Division of Clearing and Risk ("**DCR**") and the Division of Swap Dealer and Intermediary Oversight ("**DSIO**" and, together with DCR, the "**Divisions**") dated June 26, 2019, FIA requested relief from aspects of Alert 19-03 (and an accompanying Alert 19-02, addressed in a separate Petition filed concurrently herewith), explaining that the policies set out in the Alerts had a direct and adverse effect on the ability of FCMs to maintain separate accounts for the benefit

> FCM acknowledges and agrees that with respect to each Customer listed on Schedule A to the Agreement (as may be amended from time to time) (i) the Advisor is entering into this Agreement solely as agent on behalf of such Customer and (ii) only the assets under management by the Advisor of each such Customer listed on Schedule A, and neither the assets of the Advisor nor the assets under management of any other Customer, shall be available to meet such Customer's obligations under this Agreement. No resort to or claim upon the assets of any other Customer or the Advisor shall be made with respect to the obligations of such Customer. Nothing in this Section [__] shall be construed as a representation by the FCM that, with respect to any transaction by a Customer in any Account, FCM will (A) guarantee such Customer or such Account against loss; (B) limit the loss of such Customer or Account; or (C) not call for or attempt to collect from the Customer initial and maintenance margin as established under the rules of any applicable Exchange.

of their institutional customers.[8] In response, on July 10, 2019, the Divisions issued CFTC Letter No. 19-17, in which the Divisions expressed the view that, in the event of a shortfall in any customer account, "the FCM must retain the ability to ultimately look to funds in other accounts of the beneficial owner, including accounts that may be under different control, as well as the right to call the beneficial owner for additional funds."

While well-intentioned, the positions expressed in Alert 19-03 and CFTC Letter No. 19-17 are in tension with inescapable market realities. Participation by institutional customers in the derivatives markets has long depended on the prudent use of AAR investment arrangements, and that longstanding reliance cannot be reversed through negotiations between FCMs and their customers, or advice from professional advisors. It follows that enforcement of the JAC's interpretation of Rule 1.56 would have significant adverse effects on FCMs, their customers, and the derivatives marketplace, and result in outcomes that are inconsistent with the goals of customer protection and risk management that Rule 1.56 was designed to achieve.

By this Petition, the Petitioners respectfully request that the Commission (i) modify Rule 1.56 to expressly authorize AAR arrangements, subject to certain conditions, and (ii) modify Rule 1.11 to strengthen risk management controls around AAR arrangements.

Basis for Petition

Rule 1.56(b) prohibits an FCM from representing that it will, with respect to any commodity interest in any account carried by the FCM for or on behalf of any person: (i) guarantee such person against loss; (ii) limit the loss of such person; or (iii) not call for or attempt to collect initial and maintenance margin as established by the rules of the applicable board of trade.

Although it is our position that AAR provisions do not violate Rule 1.56(b),[9] in light of the interpretations of Rule 1.56(b) in Alert 19-03 and CFTC Letter No. 19-17, we urge the Commission to modify the language of Rule 1.56 (and Rule 1.11) to clarify that AAR provisions do not violate Rule 1.56, and to expressly authorize such arrangements, subject to certain conditions.

The Proposed Amendment is consistent with the longstanding policy objectives underlying Rule 1.56. The Commission originally proposed Rule 1.56 following the bankruptcy of an FCM (Incomco, Inc.) that had marketed guarantees against loss to its customers. The Commission noted that firms offering similar guarantees frequently engaged in patterns of fraudulent conduct (including charging "management" or "reserve" fees, often amounting to multiples of a customer's original investment) and that these firms tended to be in a "financially weakened condition."[10]

[8] *See* Letter from Walt L. Lukken, President and Chief Executive Officer, FIA, to Brian A. Bussey Director, DCR, and Matthew B. Kulkin, Director, DSIO, dated June 26, 2019

[9] Simply put, AAR is not a guarantee against loss or an undertaking to limit the loss of a customer. *See, e.g.*, note 6, *supra*. Rather, AAR is simply the contractual acknowledgment by the FCM of the constraints under which managed accounts of institutional asset owners operate.

[10] *See* 46 Fed. Reg. 11668, 11669-70 (Feb. 10, 1981).

While the concerns that motivated the adoption of Rule 1.56(b) may well have been valid more than thirty years ago, the enhancements to the customer funds protection regime that have subsequently been adopted including enhanced segregated, secured amount and cleared swaps collateral reporting and residual interest transparency and risk-based amendments to the minimum capital requirements—render those concerns largely academic in the today's highly-regulated marketplace.

As the Divisions noted in CFTC Letter No. 19-17, the Commission's regulations concerning the protection of customer funds now extend far beyond Rule 1.56. For instance, Rule 1.11 requires FCMs to develop and maintain specific risk management policies and procedures involving, among other things, the segregation and handling of customer funds; Part 190 of the Commission's rules prescribe, among other things, the method by which the business of a commodity firm is to be conducted or liquidated following the filing of a bankruptcy petition and how customer claims are to be calculated; Rules 1.22, 22.2, and 30.7 require specific calculations regarding the requirement of residual interest in segregated, cleared swap and secured customer fund accounts to ensure that no FCM uses or permits the use of the customer funds of one customer to purchase, margin, or settle the trades, contracts, or options of another customer; and Part 39 of the Commission's rules establish risk management requirements for derivatives clearing organizations ("**DCOs**"), which, in turn, require that their clearing members take certain steps to support their own risk management, thereby mitigating the risk that such members pose to the DCO.

FCMs today operate within a strong regulatory framework and are subject to both internal and external oversight. Prior to entering into an AAR arrangement with an institutional customer, an FCM may, among other things: (i) perform a credit evaluation of the institutional customer that takes into account, among other factors, that institutional customer's allocation of assets to the manager; (ii) evaluate the asset manager's trading strategy for the institutional customer; (iii) determine the appropriate margin level for the institutional customer in light of the risk presented by the foregoing; and (iv) establish risk limits for the account, consistent with its obligations under CFTC Rules 1.11 and 1.73, that are informed by this diligence process. Once the account is opened, the typical FCM will monitor trading in the account, including by means of daily stress testing, to confirm that the exposure presented by the account remains within the prescribed risk limits and that the account is being appropriately managed in light of the account's margin level and its credit profile. An FCM may periodically modify its risk management policies as to each institutional customer.

All of these practices are subject to internal and external oversight. CFTC Rule 1.11 establishes a risk management program with which FCMs must comply and which limits the risk FCMs may undertake. And FCMs are closely monitored and audited by their designated self-regulatory organizations (as well as by Commission staff). Recognizing the critical role that AAR arrangements play in facilitating participation of institutional asset owners in the derivatives markets does not create additional risks to FCMs that they are not well equipped to manage and their regulators to oversee and monitor.

Moreover, AAR arrangements are distinguishable from the practices that the CFTC was concerned about when adopting Rule 1.56. The proposing release to Rule 1.56 describes concerns about FCMs expressly agreeing not to call for additional margin to attract business, and notes that those practices were often targeted toward less sophisticated customers. In contrast, AAR provisions are typically sought by highly sophisticated market participants and often stem from existing asset allocations and account structures associated with those firms. Moreover, AAR provisions do not typically provide that the FCM will not call for additional margin. Rather the FCM typically has the authority to call for and collect any margin that is due on any positions, and will exercise its authority to call for such margin and close out accounts that fail to satisfy margin requirements. It is ultimately the aforementioned asset allocations and account structures, rather than AAR provisions, which dictate the result that such calls will be met from assets under the authority of a particular manager. When implemented under appropriate risk management procedures that limit the FCM's exposure by taking account of those constraints, they pose no risk to the FCM that it is incapable of managing, while enabling those institutional asset owners to participate in the derivatives markets.

Failure to adopt the Proposed Amendment, which would clarify the requirements of Rule 1.56 in the wake of Alert 19-03, would have profoundly adverse consequences for both FCMs and their institutional customers. Institutional asset owners, constrained by their fiduciary duties to their ultimate beneficiaries may not be able to accede to an FCM's "ultimate right" to look to funds in the beneficial owner's other accounts. Indeed it is possible that such asset owners may exit the derivatives markets and seek alternative risk management instruments in markets not subject to the CFTC's jurisdiction. Alternatively, they may continue to participate in derivatives markets, but through thinly capitalized special purpose vehicles corresponding to limited trading mandates. In the absence of the Proposed Amendments, the risk to derivatives markets structure is clear: some of the market's best credits may become its worst or leave entirely, and in that event, market liquidity and depth will contract. This stands to increase, not decrease, FCM counterparty risk and make derivatives markets less resilient, and less able to withstand financial crisis.

Institutional asset owners (*e.g.*, pension plans, mutual funds and municipalities) trading through institutional asset managers represent, on average, 25% of the holdings in the top 10 U.S.-listed futures contracts (based on COT reports of open interest in equity index and interest rate futures); in certain contracts, that figure is 40% or higher. AAR arrangements are the foundation on which that institutional market is built, and prohibiting them potentially impacts millions of investors and beneficiaries who currently depend on access to the derivatives markets to manage risk in investment portfolios that constitute a major part of America's retirement and other savings.

Lastly, authorizing AAR arrangements between FCMs and their customers under certain circumstances would be consistent with general practices beyond the derivatives marketplace. AAR is common to financial contracts (ISDAs, option agreements and securities agreements such as GMRAs and PB agreements), and are consistent with the parallel SEC rules which, like Rule 1.56, preclude guarantees against loss. Accordingly, making clear that such arrangements are permitted in the derivatives markets would generate certainty and consistency across financial contracts.

The Proposed Amendment

Revised Rule 1.56

Revised Rule 1.56 would expressly authorize AAR provisions under certain circumstances where such arrangements are appropriate and necessary in light of applicable fiduciary and other legal constraints on an institutional customer.

There are two circumstances where institutional customers are legally or contractually constrained from entering into contractual arrangements that could result in unlimited recourse:

- The first is where institutional asset owners, such as a pension fund or mutual fund (aggregating the interests and investment of millions of retail investors), allocate a specific limited subset of their capital subject to a specific investment mandate to investment managers pursuant to IMAs. The IMAs contractually obligate each investment manager to invest the institutional customer's AUM in accordance with an agreed trading strategy limited solely to the AUM. Such trading is independent of the trading that may be undertaken for the institutional customer by the same or other investment managers acting on behalf of other accounts of such customer with respect to other AUM allocations.

- The second is where commercial enterprises such as agricultural producers or petroleum refiners obtain financing from a lender that may, in connection with such financing, require the commercial enterprise to hedge the transaction. Such a hedging position is independent of the customer's general futures trading and specific only to the financing transaction.

In both circumstances, the AAR arrangement is integral to the contractual arrangements between the parties. As noted, institutional customers are operated by fiduciaries with investment mandates that constrain them from exposing the assets they manage to unlimited risk. Accordingly, institutional customers typically enter into IMAs with asset managers that restrict the asset managers' authority to the AUM. Recognizing the reality of asset managers' legal and contractual constraints, FCM customer agreements with institutional customers often mirror the restrictions set forth in IMAs and, to that end, may contain terms that limit the FCM's recourse to the assets under management by an asset manager for such customers.[11]

[11] In the case of a margin financing arrangement, for example, the lender will be given a subordinated security interest in the hedge account and the right to assert control over the positions and collateral in the account in the event that the commercial entity breaches its obligations to the lender. However, the lender neither wants nor has a legal right to any assets held in other accounts that the commercial enterprise may establish with the FCM. Similarly, the lender does not expect that the FCM would have a legal right use the assets held in the hedge account to meet the customer's obligations in other accounts. The agreements among the lender, the customer and the customer's FCM would confirm these expectations and limitations.

The commercial entities and institutional customers described above generally use the exchange-traded markets to hedge or otherwise manage the risks of their cash market activities (a fundamental purpose of the markets). Further, they are a source of significant liquidity from which all market participants benefit. Therefore, it is imperative to ensure they are not excluded entirely from the derivatives markets. Revised Rule 1.56 provides appropriate relief from any perceived restrictions of Rule 1.56, subject to appropriate terms and conditions.

Revised Rule 1.11

To further ensure that FCMs adopt appropriate risk management policies and procedures to protect FCMs and their customers from the potential risks of maintaining separate accounts, the Proposed Amendment includes revisions to Rule 1.11 in addition to Rule 1.56. Under the terms of the Proposed Amendment, an FCM that wishes to enter into Allocated Asset Recourse agreements with commercial participants and/or institutional customers must supplement their risk management policies and procedures to:

- evaluate the credit risk of each such customer, taking into account asset allocation levels provided by a commercial participant and/or institutional customer, which may be referenced in any relevant documentation with or relating to such customer (including without limitation any investment management agreement entered into by such customer with a person authorized to control trading in such customer's accounts);

- establish risk limits and margin requirements with respect to such customer that take into account the effect of such asset allocation levels, as such levels may be updated from time to time by an investment manager or institutional customer; and

- periodically monitor allocation levels applicable to such institutional customers by reviewing asset allocation levels provided by investment managers and/or institutional customers and appropriately confirming and updating risk limits and required margin amounts based on any fluctuation in such asset allocation levels.

By amending Rule 1.56 as proposed and supplementing the risk management policies of FCMs that participate in AAR arrangements with the proposed revisions to Rule 1.11, the Proposed Amendment enhances FCM risk management practices. Unlike a blanket ban on Allocated Asset Recourse provisions, the approach reflected in the Proposed Amendment recognizes the existing practical realities faced by market participants, and advances the objectives underlying Rules 1.56 and 1.11 by ultimately maximizing customer protection and limiting systemic risk.

Conclusion

For all of the above reasons, the Petitioners respectfully submit this Petition for the Commission's consideration and urge the Commission to act promptly to initiate the required procedures to promulgate the Proposed Amendment. We stand ready to assist the Commission and its staff in this effort. If the Commission has any questions or needs any additional information, please contact Allison Lurton, FIA's General Counsel and Chief Legal Officer at 202.466.5460 or alurton@fia.org.

Sincerely,

Walt L. Lukken

Walt L. Lukken
President and Chief Executive Officer of FIA

Eamonn Hehessy
General Counsel and CCO of ICE Clear U.S.

cc: Honorable Heath P. Tarbert, Chairman
Honorable Brian Quintenz, Commissioner
Honorable Rostin Benham, Commissioner
Honorable Dan Berkovitz, Commissioner

APPENDIX A

§1.11 Risk Management Program for futures commission merchants.

a. Redesignate paragraph (e)(4) as paragraph (e)(5).

b. Add a new paragraph (e)(4) to read as follows:

(4) A futures commission merchant that has contracted on a limited recourse basis as described in §1.56(f) of this chapter, must enhance its Risk Management Program to account for the additional risks of such contractual provisions. Specifically, the futures commission merchant must have written policies and procedures that require, at a minimum:

(i) evaluating the credit risk of such customer, taking into account asset allocation levels referenced in any relevant documentation with or relating to such customer (including without limitation any investment management agreement entered into by such customer with a person authorized to control trading in such customer's accounts);

(ii) establishing risk limits with respect to such customer that take into account the effect of such asset allocation levels, as such levels may be updated from time to time by an investment manager or customer; and

(iii) periodically monitoring allocation levels applicable to such customer and appropriately confirming and updating risk limits and required margin amounts based on any fluctuation in such asset allocation levels.

§1.56 Prohibition of guarantees against loss.

a. Add a new paragraph (f) to read as follows:

(f) Subject to §1.11 of this Chapter, nothing in this section shall prevent a futures commission merchant from entering in to an agreement with a customer that limits recourse to the assets under management by a person whom such customer has authorized to control trading in its account, where such limitations derive from and correspond to the legal or contractual constraints on such person's scope of authority for such customer.

APPENDIX B

§1.11 Risk Management Program for futures commission merchants.

(a) *Applicability.* Nothing in this section shall apply to a futures commission merchant that does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result from soliciting or accepting orders for the purchase or sale of any commodity interest.

(b) *Definitions.* For purposes of this section:

(1) *Business unit* means any department, division, group, or personnel of a futures commission merchant or any of its affiliates, whether or not identified as such that:

(i) Engages in soliciting or in accepting orders for the purchase or sale of any commodity interest and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom; or

(ii) Otherwise handles segregated funds, including managing, investing, and overseeing the custody of segregated funds, or any documentation in connection therewith, other than for risk management purposes; and

(iii) Any personnel exercising direct supervisory authority of the performance of the activities described in paragraph (b)(1)(i) or (ii) of this section.

(2) *Customer* means a futures customer as defined in §1.3, Cleared Swaps Customer as defined in §22.1 of this chapter, and 30.7 customer as defined in §30.1 of this chapter.

(3) *Governing body* means the proprietor, if the futures commission merchant is a sole proprietorship; a general partner, if the futures commission merchant is a partnership; the board of directors if the futures commission merchant is a corporation; the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority if the futures commission merchant is a limited liability company or limited liability partnership.

(4) *Segregated funds* means money, securities, or other property held by a futures commission merchant in separate accounts pursuant to §1.20 for futures customers, pursuant to §22.2 of this chapter for Cleared Swaps Customers, and pursuant to §30.7 of this chapter for 30.7 customers.

(5) *Senior management* means, any officer or officers specifically granted the authority and responsibility to fulfill the requirements of senior management by the governing body.

(c) *Risk Management Program.* (1) Each futures commission merchant shall establish, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with the activities of the futures commission merchant as such. For purposes of this section, such policies and procedures shall be referred to collectively as a "Risk Management Program."

(2) Each futures commission merchant shall maintain written policies and procedures that describe the Risk Management Program of the futures commission merchant.

(3) The Risk Management Program and the written risk management policies and procedures, and any material changes thereto, shall be approved in writing by the governing body of the futures commission merchant.

(4) Each futures commission merchant shall furnish a copy of its written risk management policies and procedures to the Commission and its designated self-regulatory organization upon application for registration and thereafter upon request.

(d) *Risk management unit.* As part of the Risk Management Program, each futures commission merchant shall establish and maintain a risk management unit with sufficient authority; qualified personnel; and financial, operational, and other resources to carry out the risk management program established pursuant to this section. The risk management unit shall report directly to senior management and shall be independent from the business unit.

(e) *Elements of the Risk Management Program.* The Risk Management Program of each futures commission merchant shall include, at a minimum, the following elements:

(1) *Identification of risks and risk tolerance limits.* (i) The Risk Management Program shall take into account market, credit, liquidity, foreign currency, legal, operational, settlement, segregation, technological, capital, and any other applicable risks together with a description of the risk tolerance limits set by the futures commission merchant and the underlying methodology in the written policies and procedures. The risk tolerance limits shall be reviewed and approved quarterly by senior management and annually by the governing body. Exceptions to risk tolerance limits shall be subject to written policies and procedures.

(ii) The Risk Management Program shall take into account risks posed by affiliates, all lines of business of the futures commission merchant, and all other trading activity engaged in by the futures commission merchant. The Risk Management Program shall be integrated into risk management at the consolidated entity level.

(iii) The Risk Management Program shall include policies and procedures for detecting breaches of risk tolerance limits set by the futures commission merchant, and alerting supervisors within the risk management unit and senior management, as appropriate.

(2) *Periodic Risk Exposure Reports.* (i) The risk management unit of each futures commission merchant shall provide to senior management and to its governing body quarterly written reports setting forth all applicable risk exposures of the futures commission merchant; any recommended or completed changes to the Risk Management Program; the recommended time frame for implementing recommended changes; and the status of any incomplete implementation of previously recommended changes to the Risk Management Program. For purposes of this section, such reports shall be referred to as "Risk Exposure Reports." The Risk Exposure Reports also shall

be provided to the senior management and the governing body immediately upon detection of any material change in the risk exposure of the futures commission merchant.

(ii) *Furnishing to the Commission.* Each futures commission merchant shall furnish copies of its Risk Exposure Reports to the Commission within five (5) business days of providing such reports to its senior management.

(3) *Specific risk management considerations.* The Risk Management Program of each futures commission merchant shall include, but not be limited to, policies and procedures necessary to monitor and manage the following risks:

(i) *Segregation risk.* The written policies and procedures shall be reasonably designed to ensure that segregated funds are separately accounted for and segregated or secured as belonging to customers as required by the Act and Commission regulations and must, at a minimum, include or address the following:

(A) A process for the evaluation of depositories of segregated funds, including, at a minimum, documented criteria that any depository that will hold segregated funds, including an entity affiliated with the futures commission merchant, must meet, including criteria addressing the depository's capitalization, creditworthiness, operational reliability, and access to liquidity. The criteria should further consider the extent to which segregated funds are concentrated with any depository or group of depositories. The criteria also should include the availability of deposit insurance and the extent of the regulation and supervision of the depository;

(B) A program to monitor an approved depository on an ongoing basis to assess its continued satisfaction of the futures commission merchant's established criteria, including a thorough due diligence review of each depository at least annually;

(C) An account opening process for depositories, including documented authorization requirements, procedures that ensure that segregated funds are not deposited with a depository prior to the futures commission merchant receiving the acknowledgment letter required from such depository pursuant to §§1.20, and 22.2 and 30.7 of this chapter, and procedures that ensure that such account is properly titled to reflect that it is holding segregated funds pursuant to the Act and Commission regulations;

(D) A process for establishing a targeted amount of residual interest that the futures commission merchant seeks to maintain as its residual interest in the segregated funds accounts and such process must be designed to reasonably ensure that the futures commission merchant maintains the targeted residual amounts and remains in compliance with the segregated funds requirements at all times. The policies and procedures must require that senior management, in establishing the total amount of the targeted residual interest in the segregated funds accounts, perform appropriate due diligence and consider various factors, as applicable, relating to the nature of the futures commission merchant's business including, but not limited to, the composition of the futures commission merchant's customer base, the general creditworthiness of the customer base, the general trading activity of the customers, the types of markets and products traded by the customers, the proprietary trading of the futures commission merchant, the general volatility and liquidity of the markets and products traded by customers, the futures commission merchant's own liquidity and capital needs, and the historical trends in customer segregated fund balances, including undermargined amounts and net deficit balances in customers' accounts. The analysis and calculation of the targeted amount of the future commission merchant's residual interest must be described in writing with the specificity necessary to allow the Commission and the futures commission merchant's designated self-regulatory organization to duplicate the analysis and calculation and test the assumptions made by the futures commission merchant. The adequacy of the targeted residual interest and the process for establishing the targeted residual interest must be reassessed periodically by Senior Management and revised as necessary;

(E) A process for the withdrawal of cash, securities, or other property from accounts holding segregated funds, where the withdrawal is not for the purpose of payments to or on behalf of the futures commission merchant's customers. Such policies and procedures must satisfy the requirements of §1.23, §22.17 of this chapter, or §30.7 of this chapter, as applicable;

(F) A process for assessing the appropriateness of specific investments of segregated funds in permitted investments in accordance with §1.25. Such policies and procedures must take into consideration the market, credit, counterparty, operational, and liquidity risks associated with such investments, and assess whether such investments comply with the requirements in §1.25 including that the futures commission merchant manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity;

(G) Procedures requiring the appropriate separation of duties among individuals responsible for compliance with the Act and Commission regulations relating to the protection and financial reporting of segregated funds, including the separation of duties among personnel that are responsible for advising customers on trading activities, approving or overseeing cash receipts and disbursements (including investment operations), and recording and reporting financial transactions. The policies and procedures must require that any movement of funds to affiliated companies and parties are properly approved and documented;

(H) A process for the timely recording of all transactions, including transactions impacting customers' accounts, in the firm's books of record;

(I) A program for conducting annual training of all finance, treasury, operations, regulatory, compliance, settlement, and other relevant officers and employees regarding the segregation requirements for segregated funds required by the Act and regulations, the requirements for notices under §1.12, procedures for reporting suspected breaches of the policies and procedures required by this section to the chief compliance officer, without fear of retaliation, and the consequences of failing to comply with the segregation requirements of the Act and regulations; and

(J) Policies and procedures for assessing the liquidity, marketability and mark-to-market valuation of all securities or other non-cash assets held as segregated funds, including permitted investments under §1.25, to ensure that all non-cash assets held in the customer segregated accounts, both customer-owned securities and investments in accordance with §1.25, are readily marketable and highly liquid. Such policies and procedures must require daily measurement of liquidity needs with respect to customers; assessment of procedures to liquidate all non-cash collateral in a timely manner and without significant effect on price; and application of appropriate collateral haircuts that accurately reflect market and credit risk.

(ii) *Operational risk.* The Risk Management Program shall include automated financial risk management controls reasonably designed to prevent the placing of erroneous orders, including those that exceed pre-set capital, credit, or volume thresholds. The Risk Management Program shall ensure that the use of automated trading programs is subject to policies and procedures governing the use, supervision, maintenance, testing, and inspection of such programs.

(iii) *Capital risk.* The written policies and procedures shall be reasonably designed to ensure that the futures commission merchant has sufficient capital to be in compliance with the Act and the regulations, and sufficient capital and liquidity to meet the reasonably foreseeable needs of the futures commission merchant.

(4) A futures commission merchant that has contracted on a limited recourse basis as described in §1.56(f) of this chapter, must enhance its Risk Management Program to account for the additional risks of such contractual provisions. Specifically, the futures commission merchant must have written policies and procedures that require, at a minimum:

(i) evaluating the credit risk of such customer, taking into account asset allocation levels referenced in any relevant documentation with or relating to such customer (including without limitation any investment management agreement entered into by such customer with a person authorized to control trading in such customer's accounts);

(ii) establishing risk limits with respect to such customer that take into account the effect of such asset allocation levels, as such levels may be updated from time to time by an investment manager or the customer; and

(iii) periodically monitoring allocation levels applicable to such customer and appropriately confirming and updating risk limits and required margin amounts based on any fluctuation in such asset allocation levels.

(5) *Supervision of the Risk Management Program.* The Risk Management Program shall include a supervisory system that is reasonably designed to ensure that the policies and procedures required by this section are diligently followed.

(f) *Review and testing.* (1) The Risk Management Program of each futures commission merchant shall be reviewed and tested on at least an annual basis, or upon any material change in the business of the futures commission merchant that is reasonably likely to alter the risk profile of the futures commission merchant.

(2) The annual reviews of the Risk Management Program shall include an analysis of adherence to, and the effectiveness of, the risk management policies and procedures, and any recommendations for modifications to the Risk Management Program. The annual testing shall be performed by qualified internal audit staff that are independent of the business unit, or by a qualified third party audit service reporting to staff that are independent of the business unit. The results of the annual review of the Risk Management Program shall be promptly reported to and reviewed by the chief compliance officer, senior management, and governing body of the futures commission merchant.

(3) Each futures commission merchant shall document all internal and external reviews and testing of its Risk Management Program and written risk management policies and procedures including the date of the review or test; the results; any deficiencies identified; the corrective action taken; and the date that corrective action was taken. Such documentation shall be provided to Commission staff, upon request.

(g) *Distribution of risk management policies and procedures.* The Risk Management Program shall include procedures for the timely distribution of its written risk management policies and procedures to relevant supervisory personnel. Each futures commission merchant shall maintain records of the persons to whom the risk management policies and procedures were distributed and when they were distributed.

(h) *Recordkeeping.* (1) Each futures commission merchant shall maintain copies of all written approvals required by this section.

(2) All records or reports, including, but not limited to, the written policies and procedures and any changes thereto that a futures commission merchant is required to maintain pursuant to this regulation shall be maintained in accordance with §1.31 and shall be made available promptly upon request to representatives of the Commission.

§1.56 Prohibition of guarantees against loss.

(a) [Reserved]

(b) No futures commission merchant or introducing broker may in any way represent that it will, with respect to any commodity interest in any account carried by the futures commission merchant for or on behalf of any person:

(1) Guarantee such person against loss;

(2) Limit the loss of such person; or

(3) Not call for or attempt to collect initial and maintenance margin as established by the rules of the applicable board of trade.

(c) No person may in any way represent that a futures commission merchant or introducing broker will engage in any of the acts or practices described in paragraph (b) of this section.

(d) This section shall not be construed to prevent a futures commission merchant or introducing broker from:

(1) Assuming or sharing in the losses resulting from an error or mishandling of an order; or

(2) Participating as a general partner in a commodity pool which is a limited partnership.

(e) This section shall not affect any guarantee entered into prior to January 28, 1982, but this section shall apply to any extension, modification or renewal thereof entered into after such date.

(f) Subject to §1.11 of this Chapter, nothing in this section shall prevent a futures commission merchant from entering in to an agreement with a customer that limits recourse to the assets under management by a person whom such customer has authorized to control trading in its account, where such limitations derive from and correspond to the legal or contractual constraints on such person's scope of authority for such customer.

AIMA

167 Fleet Street, London EC4A 2EA, UK
+44 (0)20 7822 8380
info@aima.org

aima.org

Mr. Christopher J. Kirkpatrick
Secretary of the Commission
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Submitted via email to ckirkpatrick@cftc.gov

February 17, 2020

Dear Mr. Kirkpatrick,

Re: Petition for Rulemaking to Harmonize Registration Exemptions for CPOs and CTAs with Registration Exemptions for Investment Advisers

The Alternative Investment Management Association Limited (AIMA)[1] ("AIMA" or the "Petitioner") respectfully petitions the Commodity Futures Trading Commission (the "Commission" or the "CFTC") under CFTC Regulation 13.1[2] to adopt (i) an exemption from registration as a commodity pool operator ("CPO") for foreign persons operating commodity pools with limited investment from U.S. Persons, similar to the "foreign private adviser" exemption in Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and Rule 202(a)(30)-1 under the Investment Advisers Act of 1940, as amended ("Advisers Act"); (ii) an exemption from registration as a CPO for foreign persons operating commodity pools with a small aggregate net asset value managed at a place of business in the United States, similar to the "private fund adviser" exemption in Title IV of the Dodd-Frank Act and Rule 203(m)-1 under the Advisers Act; and

[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 170 members that manage $400 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

[2] Commission Rule 13.1 authorizes any person to "file a petition with the Secretariat of the Commission for the issuance, amendment or repeal of a rule of general application." The petition must "set forth the text of any proposed rule or amendment" and "further state the nature of the petitioner's interest and may state arguments in support of the issuance, amendment or repeal of the rule."

(iii) corresponding exemptions from registration as a commodity trading advisor ("CTA") for advisers to such commodity pools.[3] The Petitioner would be happy to consult with Staff on the regulatory approaches that would best promote market stability and regulatory consistency. Absent Commission action in this area, discordant and conflicting regulatory regimes may lead to a fracturing of the marketplace and significant regulatory uncertainty.

The text of the proposed rule amendments is set forth in Appendix A to this letter.

I. Nature of Petitioner's Interest

The Petitioner represents a significant segment of the global investment management industry. For purposes of this petition, the Petitioner represents managers, investment advisers, and subadvisers to many types of pooled investment vehicles and separate accounts, including hedge funds, many of which trade commodity interests. As a result of the changes to the Part 4 regulations adopted by the Commission in 2012[4] and the adoption of a broad definition of the types of swaps subject to Commission regulation,[5] many of these managers, investment advisers, and subadvisers registered as CPOs and/or CTAs as of January 1, 2013. Accordingly, as a CPO or CTA, the managers, investment advisers, and subadvisers are subject to compliance with the applicable provisions of the Commodity Exchange Act ("CEA") and the Commission's regulations thereunder. The compliance obligations for the managers, investment advisers, and subadvisers apply even where the majority of investors qualify as non-U.S. Persons, as defined in Regulation 4.7(a)(1)(iv), and there are a limited number of U.S.-based investors.[6] Similarly, the compliance obligations apply for managers, investment advisers, and subadvisers where they advise limited amounts of assets attributable to U.S. clients.

Following passage of the Dodd-Frank Act and the Commission's rescission of CFTC Regulation 4.13(a)(4) in 2012, there was and continues to be a significant disparity with respect to the regulation of investment advisers by the SEC and CPOs and CTAs by the Commission. Accordingly, the Petitioner believes that the Commission should take action to harmonize Commission registration exemptions for CPOs and CTAs with registration exemptions for investment advisers under the Advisers Act. Therefore, the Petitioner respectfully requests, on behalf of its members, that the Commission (i) adopt exemptions from registration as a CPO similar to the foreign private

[3] This petition updates a previous petition submitted to the Commission on June 22, 2017. The Petitioner is no longer seeking the reinstatement of CFTC Regulation 4.13(a)(4) but is respectfully requesting that the Commission adopt other measures to promote regulatory consistency.

[4] *See* Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 11252 (Feb. 24, 2012) ("Rescission Release"), amended by Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 17328 (Mar. 26, 2012).

[5] Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48208 (Aug. 13, 2012).

[6] The regulatory disparity with respect to the regulation of investment advisers, CPOs, and CTAs by the SEC and the Commission imposes a particularly high regulatory burden for multi-manager funds because the entire fund complex may become subject to regulation by the Commission simply because a single subadviser has an office in the United States or has relatively limited investment from U.S. Persons.

adviser and private fund adviser exemptions under the Advisers Act, and (ii) adopt corresponding exemptions from registration as a CTA.

II. Proposed Harmonization of CFTC Registration Exemptions for CPOs and CTAs with Registration Exemptions for Investment Advisers Under the Advisers Act

During the past several years, there have been significant changes made with respect to the regulation of registered investment advisers, CPOs, and CTAs. In short, the cumulative result of such regulatory changes is that there is now a notable disparity between the approaches taken by the Commission and the SEC, particularly with respect to the extraterritorial reach of their respective jurisdiction.

Prior to the passage of Title IV of the Dodd-Frank Act, there was a parity of regulatory outcomes between the Commission and the SEC regarding domestic and foreign entities that performed the same types of services for private funds. With regard to the Commission, domestic and foreign managers operating commodity pools previously relied on the exemption from registration as a CPO provided by CFTC Regulation 4.13(a)(4), as long as the commodity pools they operated offered interests only to natural person investors that were "qualified eligible persons" ("QEPs"), as defined in CFTC Regulation 4.7(a)(2), and non-natural person investors (i.e., institutional investors) that were either QEPs or "accredited investors," as defined in Rule 501(a) of Regulation D under the Securities Act of 1933, as amended ("Securities Act").[7] Similarly, advisers to commodity pools often previously relied on the exemption from registration as a CTA provided by CFTC Regulation 4.14(a)(8)(i)(D), as long as the person's commodity interest trading advice was directed solely to, and for the sole use of, an exempt CPO under CFTC Regulation 4.13(a)(4). With regard to the SEC, in the past, both domestic and foreign managers who served as investment advisers to private funds often relied on the exemption from registration as an investment adviser provided by Section 203(b)(3) of the Advisers Act, as long as such investment advisers (i) had fewer than 15 clients in the preceding 12 months, (ii) did not generally hold themselves out to the public in the United States as an investment adviser, and (iii) did not act as an investment adviser to a registered investment company or business development company.

Passage of the Dodd-Frank Act ushered in a new regulatory regime. Because the Dodd-Frank Act repealed the exemption under Section 203(b)(3) of the Advisers Act, this now required, as a practical matter, all but the smallest domestic fund managers to register as investment advisers or to rely on an alternate exemption. As described further below, Title IV of the Dodd-Frank Act also imposed new limits on the extraterritorial reach of the SEC's jurisdiction by creating new exemptions designed to exclude certain foreign investment advisers from the registration requirements under the Advisers Act: (1) the foreign private adviser exemption, which is codified in Section 203(b)(3) of the Advisers Act and Rule 202(a)(30)-1 thereunder; and (2) the private fund adviser exemption, which is codified in Section 203(m) of the Advisers Act and Rule 203(m)-1 thereunder.[8]

[7] Under CFTC Regulation 4.7(a)(2)(xi), the definition of QEP expressly includes non-United States persons.

[8] Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under

In addition to those changes affecting investment adviser registration under the Advisers Act, the Dodd-Frank Act also broadened the definitions of CPO and CTA to include swaps as a form of "commodity interest." This substantially increased the number of advisers who would fall within the expanded definitions of CPO and CTA and, therefore, would either need to register as a CPO or CTA or rely on an appropriate exemption. Consequently, the existence in a non-U.S. fund (organized outside of the United States under non-U.S. law) that trades commodity interests of a single U.S. investor would require the manager or adviser of that non-U.S. fund to register as a CPO and/or CTA or to claim an exemption if the fund engages in a single swap transaction.

Further, on February 8, 2012, the Commission rescinded CFTC Regulation 4.13(a)(4).[9] This had the effect of requiring certain previously exempt managers of commodity pools either to register as CPOs or to claim an alternate exemption. In the proposing release, the Commission noted that the rescission of CFTC Regulation 4.13(a)(4), among other amendments, was intended to "limit regulatory arbitrage through harmonization"[10] and to "encourage more congruent and consistent regulation of similarly-situated entities among Federal financial regulatory agencies."[11] However, the practical effect of the rescission was to expand greatly the extraterritorial jurisdictional reach of the Commission, such that it is now substantially broader than that of the SEC, especially vis-à-vis non-U.S. firms. In particular, those non-U.S. CPOs—which the Dodd-Frank Act specifically exempted from registration under U.S. securities laws—are now subject to the jurisdiction of the Commission for their commodity interest activities in managing what are, in many cases, the same private funds that are relevant for purposes of determining their eligibility for the private fund adviser and foreign private adviser exemptions. This is the case even where non-U.S. CPOs operate pools that engage in a greater amount of securities activity than commodity interest trading.

The rescission of CFTC Regulation 4.13(a)(4) also had the effect of imposing the burdens and costs of an additional registration regime on domestic and foreign investment advisers that are registered with the SEC. It is inefficient and burdensome for dual-registered firms to have to comply with two similar but slightly different regulatory regimes, and we believe the duplication is an unnecessary use of resources.

The Petitioner notes that Commission Chairman Heath P. Tarbert, consistent with the Trump administration's policy pronouncements,[12] has expressed an interest in reducing the operational

Management, and Foreign Private Advisers, Advisers Act Rel. No. IA-3222 (Jun. 22, 2011), http://www.sec.gov/rules/final/2011/ia-3222.pdf ("Exemptions Release").

[9] *See* Rescission Release, *supra* note 4. Further, the Commission also made a corresponding revision to CFTC Regulation 4.14(a)(8)(i)(D), which prevented certain advisers to commodity pools that had been exempt from registration as a CTA from continuing to rely on that exemption. *See id.*, *supra* note 4, at 11284–85.

[10] Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976, 7986 (Feb. 11, 2011) ("Harmonization Release").

[11] *See id.* at 7978.

[12] The Trump administration has issued two executive orders aimed at alleviating unnecessary costs and burdens of government regulations. *See* Exec. Order, Reducing Regulation and Controlling Regulatory Costs (Jan. 30, 2017), https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling; Exec. Order, Enforcing the Regulatory Reform Agenda (Feb. 24, 2017), https://www.whitehouse.gov/wp-

and compliance costs for market participants.[13] The Petitioner further agrees with the Commission's previously stated goal to seek "congruent and consistent regulation of similarly-situated entities among Federal financial regulatory agencies."[14]

As a result, the Petitioner believes that these objectives would best be achieved by (i) adopting exemptions from registration as a CPO similar to the foreign private adviser and private fund adviser exemptions under the Advisers Act, and (ii) adopting corresponding exemptions from registration as a CTA. Finally, because the CEA makes a distinction for regulatory purposes between the operator of a commodity pool and the adviser to such pool (whereas the Advisers Act makes no such distinction), the Petitioner requests that the Commission adopt both CPO and CTA exemptions, as described further below. The Petitioner also respectfully requests that the Commission adopt a corresponding exemption from registration as a CTA by revising CFTC Regulation 4.14(a)(8)(i)(D), which is included in Appendix A. As a policy matter, to the extent that a CPO of a commodity pool is exempt, then any subadviser to that commodity pool should also be exempt.

Background

In 2011, the SEC adopted Rule 202(a)(30)-1 under Section 203(b)(3) of the Advisers Act (i.e., the foreign private adviser exemption), which excluded certain foreign investment advisers from the registration requirements under the Advisers Act.[15] To rely on the foreign private adviser exemption, an adviser must:

(i) have no place of business in the United States;

(ii) have, in total, fewer than 15 U.S. clients (e.g., managed accounts or pooled investment vehicles), including U.S. investors in private funds advised by the investment adviser;

(iii) have less than $25 million in aggregate assets under management that are attributable to clients in the United States and U.S. investors in private funds advised by the investment adviser; and

(iv) neither hold itself out generally to the public in the United States as an investment adviser nor act as an investment adviser to any registered investment company or business development company.[16]

At the same time, the SEC also adopted Rule 203(m)-1 under Section 203(m) of the Advisers Act (i.e., the private fund adviser exemption), which excluded advisers to private funds that manage a

content/uploads/2018/06/EO13777_EnforcingRegulatoryReformAgenda.pdf.

[13] Chairman Heath P. Tarbert, Statement of Chairman Heath Tarbert in Support of the Cross-Border Swaps Proposal (Dec. 18, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement121819#_ftn8.

[14] Harmonization Release, *supra* note 10, at 7978.

[15] *See* Exemptions Release, *supra* note 8.

[16] *See* 15 U.S.C. § 80b–2(a)(30).

limited amount of assets domestically from the registration requirements under the Advisers Act.[17] To rely on the private fund adviser exemption, an adviser must:

(i) act solely as an adviser to private funds; and

(i) have less than $150 million in assets under management in the United States.[18]

Further, a non-U.S. manager (i.e., with a principal office and place of business outside the United States) is not subject to the registration requirements of the Advisers Act if such manager:

(ii) has no client that is a U.S. Person other than a private fund; and

(iii) all assets managed at a place of business in the United States are solely attributable to private fund assets valued at less than $150 million.[19]

Supporting Arguments

As reflected in the Dodd-Frank Act, Congress has recognized that certain managers—on the basis of their place of business, type of funds advised, or amount of assets under management—simply do not warrant triggering the investment adviser registration requirement and, by extension, regulation by the SEC. The foreign private adviser exemption demonstrates that, as a policy matter, certain foreign investment advisers with only a small number of U.S. clients or investors who have invested only a small amount of assets have too insignificant a nexus to the United States to merit extension of the SEC's jurisdictional and regulatory reach. Similarly, the private fund adviser exemption embodies a policy-based decision that advisers solely to qualifying private funds and that manage a relatively limited amount of assets should not be required to register with the SEC as investment advisers.

The Petitioner believes that the same regulatory principles and logic should apply to non-U.S. CPOs and CTAs in the context of regulation by the Commission. The Commission's jurisdiction should be similarly limited with respect to non-U.S. CPOs and CTAs, and the exemptions proposed herein should have the same practical effect for firms. Given the Commission's expressed desire for regulatory consistency, the Petitioner requests that the Commission take action to harmonize CFTC registration exemptions for non-U.S. CPOs and CTAs with the foreign private adviser and private fund adviser registration exemptions under the Advisers Act.

With regard to the proposed exemptions from CPO and CTA registration, the Petitioner has provided draft text in Appendix A. As applicable, the suggested language closely mirrors the relevant sections of the corresponding rules under the Advisers Act, but it makes minor adjustments to accommodate the differences between investment advisers and CPOs and CTAs, as well as the differences between the Advisers Act and the CEA.[20] To ensure consistency with the

[17] *See* Exemptions Release, *supra* note 8.

[18] *See* 15 U.S.C. § 80b–3(m).

[19] *See* 17 C.F.R. § 275.203(m)-1(b).

[20] For example, we have deleted the requirement found in Rule 202(a)(30)-1 under the Advisers Act that the person not

foreign private adviser exemption and the private fund adviser exemption, the Petitioner believes that it is necessary, for purposes of the proposed exemptions, to use definitions of certain terms (such as "place of business," "investor," and "in the United States") identical to those under the Advisers Act (including the interpretations the SEC has given to such terms).

Moreover, the SEC has taken certain interpretive positions that further define certain circumstances in which a person who otherwise meets the definitions of "U.S. Person" and "in the United States" (as defined generally by reference to Regulation S under the Securities Act) nevertheless need not be counted as such for purposes of determining compliance with, among other things, the foreign private adviser and private fund adviser exemptions. These include circumstances in which the investor: (1) was not a U.S. Person or in the United States at the time of any investment in the securities of the issuer but subsequently becomes a U.S. Person or is in the United States due to the relocation of the investor,[21] or (2) purchased securities issued by the issuer in an offshore secondary market transaction consistent with Regulation S and not involving the issuer or its agents, affiliates, or intermediaries.[22] The Petitioner believes that, by incorporating the SEC's well-understood and long-utilized positions, the proposed exemptions will be easy to understand and implement. Further, consistency will not introduce additional and potentially conflicting interpretations of the definition of a U.S. Person and will assure that there is a consistent extraterritorial application of the requirements. In our view, it would be beneficial for the industry to be able to apply the same methodology for counting inadvertent U.S. investors in order to qualify for both SEC and Commission exemptions, rather than having to comply with divergent standards.

Finally, the Petitioner also believes that, as is the case for the foreign private adviser exemption, this exemption as applied to CPOs should be self-executing.

Requested Relief

The Petitioner hereby respectfully requests that the Commission adopt exemptions from CPO registration for non-U.S. firms similar to the foreign private adviser and private fund adviser exemptions under the Advisers Act (the full text of which can be found in Appendix A), as well as corresponding exemptions from CTA registration.

III. Conclusion

Following passage of the Dodd-Frank Act and the Commission's rescission of CFTC Regulation 4.13(a)(4), there is now a significant disparity with respect to the regulation of investment advisers, CPOs, and CTAs by the SEC and the Commission, respectively. Accordingly, the Petitioner believes that the Commission should take action to harmonize Commission registration exemptions for CPOs and CTAs with registration exemptions for investment advisers under the Advisers Act. Therefore, the Petitioner requests, on behalf of its members, that the Commission (i) adopt

advise a registered investment company or business development company.

[21] *See* Exemptions Release, *supra* note 8, at 117–18.

[22] *See* Investment Funds Institute of Canada, SEC No-Action Letter (pub. avail. Mar. 4, 1996).

exemptions from registration as a CPO similar to the foreign private adviser and private fund adviser exemptions under the Advisers Act, and (ii) adopt corresponding exemptions from registration as a CTA.

The Petitioner would welcome the opportunity to consult with Staff on the regulatory approaches that would best promote liquidity, market stability, and regulatory consistency. Absent Commission action in this area, the conflicting regulatory regimes will continue to fracture the marketplace and propagate significant regulatory uncertainty.

* * * *

We sincerely appreciate the Commission's willingness to address the industry's concerns. If you have questions or require further information, please contact Jiří Król of AIMA at +44 (0)20 7822 8380 or our outside counsel at K&L Gates LLP, Cary J. Meer, at (202) 778-9107 or Stephen M. Humenik, at (202) 778-9477.

Respectfully submitted,

Jiří Król
Deputy CEO, Global Head of Government Affairs
AIMA

cc: The Honorable Chairman Heath P. Tarbert
The Honorable Commissioner Brian D. Quintenz
The Honorable Commissioner Rostin Behnam
The Honorable Commissioner Dawn DeBerry Stump
The Honorable Commissioner Dan M. Berkovitz
Joshua B. Sterling, Director
Frank Fisanich, Chief Counsel
Amanda Olear, Acting Deputy Director, Registration and Compliance
Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission
Regina Thoele, Senior Vice President, Compliance, National Futures Association

APPENDIX A

Text of Proposed Rule Amendments

Additions to current regulations in ***bold italics and underlined***. Deletions in ~~strikethrough~~.

Section 4.13 is amended by redesignating paragraph (a)(6) as (a)(8) and, as redesignated, revising it, adding new paragraphs (a)(6), and (a)(7), revising paragraphs (b)(1) introductory text, (b)(1)(ii), (e)(2) introductory text, (e)(2)(i) introductory text and (e)(2)(iii), and adding paragraph (g), as follows:

§ 4.13 Exemption from registration as a commodity pool operator.

(a) *** * ***

(6) That person is a "foreign commodity pool operator," as defined herein.

(7) That person is a commodity pool operator with its principal office and place of business outside the United States if: (1) the commodity pool operator does not serve as a commodity pool operator to any United States person other than a commodity pool that is a private fund, and (2) the net asset value of all commodity pools that are private funds managed by the commodity pool operator at a place of business in the United States are solely attributable to commodity pools that are private funds, the total value of which are less than $150,000,000; provided that the commodity pool operator has filed notice of its intent to rely on this provision in accordance with paragraph (b) of this section and maintains records in accordance with paragraph (c)(1) of this section.

~~(6)~~ ***(8)***

(i) Eligibility for exemption under paragraph (a)(1), (a)(2), (a)(3), ~~or (a)(4)~~***, or (a)(7)*** of this section is subject to the person furnishing in written communication physically delivered or delivered through electronic transmission to each prospective participant in the pool:

(A) A statement that the person is exempt from registration with the Commission as a commodity pool operator and that therefore, unlike a registered commodity pool operator, it is not required to deliver a Disclosure Document and a certified annual report to participants in the pool; and

(B) A description of the criteria pursuant to which it qualifies for such exemption from registration.

(ii) The person must make these disclosures by no later than the time it delivers a subscription agreement for the pool to a prospective participant in the pool.

(b)(1) Any person who desires to claim the relief from registration provided *in paragraphs (a)(1), (a)(2), (a)(3) or (a)(7) of* ~~by~~ this section must file electronically a notice of exemption from commodity pool operator registration with the National Futures Association through its electronic exemption filing system. The notice must:

(i) * * *

(ii) Contain the section number pursuant to which the operator is filing the notice (i.e., § 4.13(a)(1), (2), ~~or~~ (3) *or (7))* and represent that the pool will be operated in accordance with the criteria of that paragraph; and

* * * * *

(e) * * *

(2) If a person operates one or more commodity pools described in paragraph (a)(3) of this section, and one or more commodity pools for which it must be, and is, registered as a commodity pool operator, *or if the person will be eligible to deregister as a commodity pool operator because, after complying with the requirements set forth below, it will be able to rely on registration exemptions for all of the pools that it operates,* the person is exempt from the requirements applicable to a registered commodity pool operator with respect to *such* ~~the~~ pool or pools ~~described in paragraph (a)(3) of this section~~; Provided, That the person:

(i) Furnishes in written communication physically delivered or delivered through electronic transmission to each prospective participant in a pool described in paragraph (a)(3) of this section that it operates:

* * * * *

(iii) Provides each existing participant in a pool that the person elects to operate as described in paragraph (a)(3), *(a)(6) or (a)(7)* of this section a right to redeem the participant's interest in the pool, and informs each such participant of that right no later than the time the person commences to operate the pool as described in paragraph (a)(3), *(a)(6) or (a)(7)* of this section.

* * * * *

(g) Definitions applicable to this section.

(1) The term "foreign commodity pool operator" means any commodity pool operator who:

(i) Has no place of business in the United States;

(ii) Serves as commodity pool operator for, in total, fewer than 15 commodity pools that are private funds established in the United States under U.S. law (including for this purpose investors in the United States in non-United States commodity pools that are private funds), in each case operated by the commodity pool operator;

(iii) Serves as commodity pool operator for commodity pools that are private funds established in the United States under U.S. law (including for this purpose investors in the United States in non-United States commodity pools that are private funds), in each case operated by the commodity pool operator, with an aggregate net asset value attributable to such commodity pools that are private funds (and investors in the case of non-United States commodity pools that are private funds) of less than $25,000,000, or such higher amount as the Securities and Exchange Commission may, by rule, deem appropriate in accordance with the purposes of Section 203(b)(3) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–3 (b)(3)); and

(iv) Does not hold itself out generally to the public in the United States as a commodity pool operator.

(2) The term "private fund" has the same meanings as in Section 202 of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–2) and regulations of the Securities and Exchange Commission thereunder.

(3) The terms "place of business," "investor" and "in the United States" shall have the meanings associated with such terms for purposes of Section 202(a)(30) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–2(a)(30)) and regulations of the Securities and Exchange Commission thereunder.

(4) The terms "place of business," "principal office and place of business," "United States" and "United States person" shall have the meanings associated with such terms for purposes of Section 203(m) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–3(m)) and regulations of the Securities and Exchange Commission thereunder.

(5) Notwithstanding paragraphs (g)(3) and (4) of this section, the following persons do not need to be counted as "United States persons" or as being "in the United States" with respect to a particular commodity pool that is a private fund:

(i) Any person who is a "United States person" or "in the United States" who acquired securities issued by a commodity pool by way of an offshore secondary market transaction not involving the commodity pool or its agents, affiliates or intermediaries; and

(ii) Any person who is not a United States person or in the United States each time such person acquires securities issued by the commodity pool.

Section 4.14 is amended by revising paragraphs (a)(8)(i)(D), (a)(8)(iii)(A) introductory text, (a)(8)(iii)(A)(*2*), and (a)(8)(iv) introductory text, adding paragraphs (a)(11), (a)(12), revising paragraph (c)(2) and adding paragraph (d), as follows:

§ 4.14 Exemption from registration as a commodity trading advisor.

(a)* * *

(8)* * *

(i)* * *

(D) A commodity pool operator who has claimed an exemption from registration under § 4.13(a)(3)*, or 4.13(a)(7)*, or, if registered as a commodity pool operator, who may treat each pool it operates that meets the criteria of § 4.13(a)(3)*, or 4.13(a)(7)* as if it were not so registered.

*** * ***

(iii)(A) A person who desires to claim the relief from registration provided by this §4.14(a)(8) *or by § 4.14(a)(12)* must file electronically a notice of exemption from commodity trading advisor registration with the National Futures Association through its electronic exemption filing system. The notice must:

*** * * * ***

(*2*) Contain the section number pursuant to which the advisor is filing the notice (i.e., under §4.14(a)(8)(i) *or § 4.14(a)(12)*) and represent that it will provide commodity interest advice to its clients in accordance with the criteria of that paragraph or paragraphs; and

* * *

(iv) Each person who has filed a notice of registration exemption under this §4.14(a)(8) *or § 4.14(a)(12)* must:

* * *

(11) The person is a "foreign commodity trading advisor," as defined herein.

(12) The person is a commodity trading advisor with its principal office and place of business outside the United States if: (1) the commodity trading advisor does not serve as a commodity trading advisor to any United States person other than a commodity pool that is a private fund, and (2) the net asset value of all commodity pools that are private funds advised by the commodity trading advisor at a place of business in the United States are solely attributable to commodity pools that are private funds, the total value of which are less than $150,000,000; provided that the commodity trading advisor has filed notice of its intent to rely on this provision in accordance with

paragraph (a)(8)(iii) of this section and maintains records in accordance with paragraph (a)(8)((iv) of this section;.

* * * * *

(c) ***

(2) If a person provides commodity interest trading advice to a client described in paragraph (a) of this section and to a client for which it must be, and is, registered as a commodity trading advisor, *or if the person will be eligible to deregister as a commodity trading advisor because, after complying with the requirements set forth below, it will be able to rely on registration exemptions for all of the accounts to which it provides commodity interest trading advice,* the person is exempt from the requirements applicable to a registered commodity trading advisor with respect to the clients so described; Provided, That the person furnishes in writing to each prospective client described in paragraph (a) of this section a statement that it will provide commodity interest trading advice to the client as if it was exempt from registration as a commodity trading advisor; Provided Further, That the person provides to each existing client described in paragraph (a) of this section a right to terminate its advisory agreement, and informs such client of that right no later than the time the person commences to provide commodity interest trading advice to the client as if the person was exempt from registration.

(d) Definitions applicable to this section.

(1) The term "foreign commodity trading advisor" means any commodity trading advisor who:

(i) Has no place of business in the United States;

(ii) Serves as commodity trading advisor to, in total, fewer than 15 commodity pools that are private funds established in the United States under U.S. law (including for this purpose investors in the United States in non-United States commodity pools that are private funds) and other U.S. commodity interest trading account clients;

(iii) Serves as commodity trading advisor to commodity pools that are private funds established in the United States under U.S. law (including for this purpose investors in the United States in non-United States commodity pools that are private funds and other U.S. commodity interest trading account clients with an aggregate net asset value attributable to such commodity pools that are private funds (and investors in the case of non-United States commodity pools that are private funds) and other U.S. commodity interest trading account clients of less than $25,000,000, or such higher amount as the Securities and Exchange Commission may, by rule, deem appropriate in accordance with the purposes of Section 203(b)(3) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–3 (b)(3)); and

(iv) *Does not hold itself out generally to the public in the United States as a commodity trading advisor.*

(2) The term "private fund" has the same meanings as in Section 202 of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–2) and regulations of the Securities and Exchange Commission thereunder.

(3) The terms "place of business," "investor" and "in the United States" shall have the meanings associated with such terms for purposes of Section 202(a)(30) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–2(a)(30)) and regulations of the Securities and Exchange Commission thereunder.

(4) The terms "place of business," "principal office and place of business," "United States" and "United States person" shall have the meanings associated with such terms for purposes of Section 203(m) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–3(m)) and regulations of the Securities and Exchange Commission thereunder.

(5) Notwithstanding paragraphs (d)(3) and (4) of this section, the following persons do not need to be counted as "United States persons" or as being "in the United States" with respect to a particular commodity pool that is a private fund or account:

(i) *Any person who is a "United States person" or "in the United States" who acquired securities issued by a commodity pool by way of an offshore secondary market transaction not involving the commodity pool or its agents, affiliates or intermediaries; and*

Any person who is not a United States person or in the United States each time such person acquires securities issued by the commodity pool or contributes further assets to such account.

HAUN

October 31, 2022

Christopher J. Kirkpatrick
Secretariat
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Petition for Rulemaking — DAO-Participant Liability

Dear Mr. Kirkpatrick:

Haun Ventures respectfully petitions the U.S. Commodity Futures Trading Commission ("**CFTC**" or the "**Commission**") to initiate a rulemaking process and promulgate a regulation to provide clarity and certainty related to the obligations of individuals participating in a decentralized autonomous organization ("**DAO**"). *See* 5 U.S.C. § 553(e); 17 C.F.R. § 13.1.

DAOs are a democratized governance structure for technology development that we expect will be a critical component of the next generation of innovation. On September 22, 2022, however, the Commission entered an order and commenced an enforcement action that threatens their continued vitality. Specifically, the Commission determined that anyone who votes using their tokens—evidently at any point and on any matter—becomes a "member" of the DAO and is thereby jointly and severally liable for any future unlawful actions by the DAO. *See In re bZeroX, LLC*, CFTC No. 22-31, slip op. at 9–11 (Sep. 22, 2022); Complaint, *CFTC v. Ooki DAO*, No. 3:22-cv-05416 (N.D. Cal. Sep. 22, 2022).

Haun Ventures shares the CFTC's interest in preventing technology from being used for unlawful purposes. However, the approach taken by the Commission risks serious damage to American competitiveness and innovation, and it creates perverse disincentives for responsible actors to participate in good governance over key protocols. While the Commission's joint-and-several liability theory is immediately problematic in that it would punish DAO participants in a manner not licensed by law, even more worrisome is the shadow this action has already cast over the nascent web3 ecosystem. Tokenholders' fear of participating in DAOs due to the CFTC's aggressive approach to DAO-participant liability could severely restrict this nascent but flourishing technological innovation in the United States.

Haun Ventures therefore urges the Commission to propose for notice-and-comment a regulation that defines the scope of liability for DAO participants and that sensibly limits that liability to those who actively engage in or facilitate illegal activity.

I. Background

The Commission's actions come at a critical inflection point. The original success of the internet was contingent upon open, standardized, community-developed protocols. More recently, though, we have seen the emergence of centralized gatekeepers—behemoth, closed platforms that exploit individuals' data for commercial purposes. The results of a poll we recently commissioned of voters in swing states suggests that average Americans overwhelmingly want to see a better vision for technology in society than the broken status quo.[1]

We believe that a group of emerging technologies based on cutting-edge cryptography, commonly referred to as web3, could provide this better vision.[2]

DAOs play a critical role in web3 development.[3] A DAO consists of digital asset holders who vote their tokens to democratically govern communities or software protocols using blockchain-based rules.[4] This "unique governance mechanism" invites "anyone to contribute" to a project, which enables "maximum alignment with an organization's community of users."[5] Similarly, by "hand[ing] over decision-making and execution powers to [the] community at every level," DAOs "unlock[] a net new value proposition that wasn't previously possible."[6] And, even though the concept is still in its infancy, DAOs have already embarked on a wide range of projects aimed at furthering the common good, with uses as varied as building tools to support access to justice, raising money for the Ukrainian war effort, and improving the financial security of individuals worldwide.[7]

While DAO governance varies from project to project, the rules of a DAO are typically laid out in smart contracts, which are self-executing and publicly auditable code.[8] Once the DAO is launched, any community participant can submit a proposal at any time. Proposals can range from technical upgrades to treasury allocations or any other actions that concern the project. After a proposal is made, community participants may cast their votes (though no one is required to vote their tokens on any particular proposal). If the proposal achieves some predefined level of consensus, it is then accepted, implemented, and enforced by smart contracts. The process is typically quite transparent and auditable: "[t]he details of each proposal are readily available, voting history is continuously recorded, and even the voting records of particular token holders can be observed."[9]

[1] *See* Chris Lehane & Tomicah Tillemann, *The Web3 Voter*, Haun Ventures (Sep. 29, 2022), https://mirror.xyz/haunventures.eth/DtYIt_vAijoqRV41SMNAcu6kwCAM8Mc_p8GsjFTfP6o (detailing the findings of a poll showing, among other things, that "over 90% of voters express support for an internet that is community owned, community governed, and gives people greater control over their information").

[2] *See, e.g.*, Howard Wu, *How the Coming Privacy Layer Will Fix the Broken Web*, Future (June 15, 2021), https://future.com/a-privacy-layer-for-the-web-can-change-everything/.

[3] *See, e.g.*, Emilia La Capra, *What is the role of a decentralized autonomous organization in Web3?*, CoinTelegraph (Feb. 26, 2022), https://cointelegraph.com/explained/what-is-the-role-of-a-decentralized-autonomous-organization-in-web3 ("The network design of DAOs perfectly combines with the foundation of Web3, fueling a new creator economy and the future of work.").

[4] *See Decentralized autonomous organizations*, Ethereum https://ethereum.org/en/dao/ (last visited Oct. 15, 2022); Paul Kim, *Decentralized autonomous organizations (DAOs) are non-hierarchical communities operating on blockchain technology*, Business Insider (Jul. 22, 2022), https://www.businessinsider.com/personal-finance/what-is-a-dao.

[5] Chris Ahn, *Business-Governance Fit*, Haun Ventures (July 28, 2022), https://mirror.xyz/haunventures.eth/renjKDhQY8gXsPWUlhVzZ4z1yqVYEbTJZgWdE1T9o9U.

[6] *Id.*

[7] *See LexDAO,* DAO Central, https://daocentral.com/dao/lex (last visited Oct. 17, 2022) (building tools that support access to justice); Daniel Roberts, *What DAOs Can Do: $6.75M in Ethereum for Ukraine,* Decrypt (Mar. 5, 2022), https://decrypt.co/94386/ukraine-dao-millions-in-ethereum-shows-what-dao-can-do (raising crypto donations for the Ukrainian war effort against Russia); *The Maker Protocol: MakerDAO's Multi-Collateral Dai (MCD) System* https://makerdao.com/en/whitepaper/ (last visited Oct. 17, 2022) (using stablecoin to empower individuals without bank access or in countries with unstable currencies achieve financial security).

[8] David Shuttleworth, *What Is A DAO And How Do They Work?*, Consensys (Oct. 7, 2021), https://consensys.net/blog/blockchain-explained/what-is-a-dao-and-how-do-they-work/.

[9] *Id.*

The Commission's recent enforcement action concerns a particular DAO named Ooki DAO. In 2019, bZeroX, LLC designed and deployed a blockchain-based protocol that allowed for accepting orders for and facilitating margined and leveraged retail commodity transactions. bZeroX eventually decided to transfer control of the protocol to Ooki DAO. This transfer was done in an effort to "insulate the [Protocol] from regulatory oversight and accountability for compliance with U.S. law." Complaint, *supra* at 14. Last month, the CFTC responded by bringing a civil action against Ooki DAO in federal court. The agency sought to enjoin the DAO from engaging in any "commodity-related activity," and furthermore asked for the court to issue "civil monetary penalties" against it. *Id.* at 4.

In an accompanying consent order issued against bZeroX and its two founders, the Commission expressed its views that (1) Ooki DAO is an "unincorporated association," (2) the founders had become "members" of the association simply by voting their tokens, (3) Ooki DAO had violated the Commodity Exchange Act ("**CEA**") and a CFTC regulation, and (4) the founders, as voting members of Ooki DAO, were "personally liable" for the violations. *See In re bZeroX, LLC*, slip op. at 9–11. In reaching that conclusion, the Commission relied on a state-common-law doctrine providing that members of a for-profit unincorporated association are jointly and severally liable for the debts of that association. *See id.* at 11 (collecting cases). The Commission noted that it "d[id] not take a position . . . as to the appropriate monetary sanctions against the Ooki DAO" more generally, as its Order concerned the founders only. *Id.* at 11 n.12. But the Order's logic and the Commission's recent enforcement action suggest that it views the other voting members of the DAO as similarly liable for Ooki DAO's unlawful acts. *See* Complaint, *supra* at 17 ("The Ooki DAO is an unincorporated association comprised of Ooki Token holders who have voted those tokens to govern the Ooki Protocol.").

Commissioner Mersinger issued a dissenting statement. *See* Press Release, CFTC, *Dissenting Statement of Commissioner Summer K. Mersinger* (Sep. 22, 2022).[10] There, she made clear that she "d[id] not condone individuals or entities blatantly violating the CEA or [the CFTC's] rules." *Id.* And she took no issue with the agency's filing of an enforcement action against an unincorporated association generally. *See id.* But Commissioner Mersinger believed that the Commission "cannot arbitrarily decide who is accountable for those violations based on an unsupported legal theory amounting to regulation by enforcement." *Id.* She explained that the Commission's order (1) "fail[ed] to rely on any legal authority in the CEA" or "case law relevant to this type of action," (2) "arbitrarily define[d] the Ooki DAO unincorporated association in a manner that unfairly picks winners and losers," (3) "constitute[d] blatant 'regulation by enforcement' by setting policy based on new definitions and standards never before articulated by the Commission or its staff," and (4) ignored an alternative, aiding-and-abetting theory of liability "that is specifically authorized by Congress" and that could have been used to hold the founders liable. *Id.*; *see* 7 U.S.C. § 13c(a).

The CFTC's actions against Ooki DAO sent shockwaves through the web3 community.[11] Based on the Commission's sweeping approach to liability, individuals quite reasonably fear that the mere

[10] *Available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/mersingerstatement092222.

[11] *See, e.g.*, Olga Kharif & Allyson Versprille, *Crypto DAOs and Their Token Holders Aren't Safe from the CFTC*, Bloomberg (Sep. 23, 2022), https://www.bloomberg.com/news/articles/2022-09-23/are-crypto-daos-and-governance-token-holders-safe-from-the-cftc; Owen Fernau, *CFTC Action Against DAO Outrages Crypto and One of Its Own Commissioners*, The Defiant (Sep. 22, 2022), https://thedefiant.io/cftc-sues-dao; Guillermo Jimenez & Jason Nelson, *CFTC Sues a DAO, Raising Legal Questions for DeFi Founders and Users*, Decrypt (Sep. 23, 2022), https://decrypt.co/110407/cftc-ooki-dao-bzx-lawsuit-legal-questions-defi; Jana S. Farmer & John Cahill, *DAOs: A game changer in need of new rules*, Reuters (Oct. 7, 2022), https://www.reuters.com/legal/legalindustry/daos-game-changer-need-new-rules-2022-10-07/.

act of voting on a single proposal could place them on the hook for whatever the DAO may do. That has produced an instant chilling effect on DAO participation. After all, if a DAO stumbles into unforeseen legal trouble, then, based on the Order's rationale, individuals who voted their tokens on matters entirely unrelated to the activity in question could be held liable as members of the organization. The Commission's theory might extend to those who sold their tokens prior to the unlawful activity, or even to those who actively voted *against* the unlawful activity.[12]

A rulemaking is desperately needed to quell these concerns, gather insight from the community, and align the Commission's approach with that authorized by the CEA.

II. Statement of Interest

Founded by former prosecutor Kathryn Haun in 2022, Haun Ventures is a venture capital firm with $1.5 billion in assets under management, dedicated to making investments in web3 companies and projects. We are committed to helping builders work towards a web3 ecosystem that future generations will admire. Beyond providing capital to projects, Haun Ventures aims to deliver system change—helping policymakers build effective incentive structures for the web that can increase trust, transparency, privacy, and opportunity.

We have a direct stake in seeing this rule promulgated. A number of our portfolio projects are connected with DAOs, and we have a financial interest in seeing these projects succeed. We believe that a necessary prerequisite is an environment in which responsible actors can participate in good governance over protocols. Such an environment is not possible if tokenholders fear participating in DAOs due to the CFTC's aggressive approach to DAO-participant liability.

Haun Ventures is thus an "interested" party with respect to the proposed rule set out in this Petition. *See* 5 U.S.C. § 553(e).

III. Legal Authority to Promulgate the Rule

Haun Ventures submits this Petition pursuant to the Administrative Procedure Act, which gives any "interested [organization] the right to petition for the issuance . . . of a rule." 5 U.S.C. §§ 551(2), 553(e); *see also* 17 C.F.R. § 13.1. Congress gave the Commission the authority "to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of [the CEA]." 7 U.S.C. § 12a(5). Pursuant to that "broad grant of power," *CFTC v. Schor*, 478 U.S. 833, 843 (1986), the Commission can and should adopt the following proposed rule in accordance with the rulemaking requirements set out in 5 U.S.C. § 553.

IV. Text of the Proposed Rule

The Commission should amend 17 C.F.R. § 1.3 to include the following definition:

> *Decentralized Autonomous Organization ("DAO").* This term refers to an organization—
>
> > (1) the governance of which is primarily determined using software to allow for decision-making via a set of smart contracts; and

[12] *See In re bZeroX, LLC*, slip op. at 10 ("Once an Ooki Token holder votes his or her Ooki Tokens to affect the outcome of an Ooki DAO governance vote, that person has voluntarily participated in the group formed to promote the common objective of governing the Ooki Protocol and is thus a member of the Ooki DAO unincorporated association.").

(2) that is not economically or operationally controlled by any single person, entity, or group of persons or entities under common control.

For the purposes of this definition—

> The term "smart contract" means self-executing code, script, or programming language that executes defined rules when deployed to a digital ledger or database which is chronological, consensus-based, decentralized, and cryptographically-verified in nature.

The Commission should also propose for notice and comment, and then promulgate, the following rule that clarifies the scope of DAO-participant liability:

17 C.F.R. § ___ Liability for a Decentralized Autonomous Organization's Violations

(a) ***Purpose.*** DAOs represent a novel structure for the development and governance of, and oversight over, new technologies. Although a DAO's participants are not entirely immune from liability should the DAO violate any of the provisions of the Commodity Exchange Act or any of the rules or regulations in this chapter, it is the intent of the Commission to limit individual liability to those who actively engage in or facilitate such violations.

(b) ***DAOs As "Persons."*** A DAO is considered a "person" as defined in § 1a(38) of the Commodity Exchange Act if it amounts to an association of individuals who have combined for a common cause.

(c) ***Limitations of Liability for DAO Participants.*** No person will be held liable or otherwise responsible for a DAO's violations of the Commodity Exchange Act or any of the rules or regulations in this chapter unless the person has—

> (1) Willfully caused the DAO to commit such violation;
>
> (2) Willfully aided, abetted, counseled, commanded, induced, or procured the commission of such violation; or
>
> (3) Acted in combination or concert with another person for the purpose of having the DAO commit such violation.

(d) ***Illustrations.*** The following are representative examples of persons who would not be held liable or otherwise responsible for a DAO's violations. These examples are illustrative only and are not meant to be exhaustive.

> (1) A person owns governance tokens in a DAO but never uses those tokens to vote on any governance proposal. The person is not liable for the DAO's violations by virtue of owning the governance tokens.
>
> (2) A person owns governance tokens in a DAO and uses them to vote only once on a name-change proposal. Later, it is discovered that the DAO violates one of the Commission's regulations. The person is not liable based on her vote in a matter unrelated to the illegal activity.

> (3) A person owns governance tokens in a DAO and actively votes those tokens on all proposals. He later ceases all voting activity and sells all of his governance tokens. At the time of sale, the DAO has done nothing unlawful, but the Commission subsequently passes a regulation that renders the DAO not in compliance with the law. The person is not liable based on his prior voting activity.
>
> (4) A person owns governance tokens in a DAO and actively votes those tokens on all proposals. A third party submits a proposal that would have the DAO engage in activity that violates the Commodity Exchange Act. The person votes her tokens against the third party's proposal, but it ultimately passes. The person is not liable based on her vote against the unlawful activity. (Nor would she be liable if she had abstained from voting.)
>
> (5) A person owns governance tokens in a DAO and delegates his right to vote on all proposals to a third party. The person takes no action to aid, abet, counsel, command, induce, or procure the commission of a violation by the third party to violate the Commodity Exchange Act. The third party votes the delegated tokens in favor of a proposal that would result in a violation of the Commodity Exchange Act. The person is not liable based on his delegation of tokens to the third party.

V. Reasons to Promulgate the Rule

Haun Ventures believes that the proposed rule would be in the public interest, first because it would provide clear notice to the participants of a DAO concerning when their actions might expose them to potential liability, and second because the legal position relied upon in the Commission's recent order presents both legal and pragmatic issues. The Commission should accordingly promulgate the proposed rule to restore public confidence that the CFTC will work with interested parties to develop a regulatory regime that is suitably tailored for critical emerging technologies.

A. The Commission's Approach is Unlawful

The proposed rule is preferable to the Commission's current approach because the current approach goes beyond the text of the CEA. As Commissioner Mersinger explained, "[t]here is no provision in the CEA that holds members of a for-profit unincorporated association personally liable for violations of the CEA or CFTC rules committed by the association based solely on their status as members of that association." *Dissenting Statement*, *supra*. And the Commission's role is not to expand liability by administrative fiat; that job belongs to Congress. *See Cent. Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 176–77 (1994) (determining the scope of liability based on statutory text); *Pinter v. Dahl*, 486 U.S. 622, 653 (1988) (same).

Congress has authorized liability for CEA violations in just five circumstances, which are sufficiently comprehensive to capture individuals who participate in a DAO and who actively engage in or facilitate unlawful activity. But the CEA does not support imposing penalties against individuals who participate in a DAO and who simply vote their tokens in matters that do not further unlawful activity. The five circumstances are as follows.

First, one "who commits, or who willfully aids, abets, counsels, commands, induces, or procures the commission" of a violation can be held liable. 7 U.S.C. § 13c(a). But a person who votes her tokens on matters unrelated to a DAO's illegal activity (or who votes against that illegal activity) does not herself commit a violation. Nor does she willfully aid or abet a violation in any way. After all, as courts and the Commission have held, "a specific unlawful intent to further the underlying violation is necessary before one can be found liable for aiding and abetting." *Gracey v. J.P. Morgan Chase & Co. (In re Amaranth Nat. Gas Commodities Litig.)*, 730 F.3d 170, 181 (2d Cir. 2013) (quoting *In re Richardson Secs.*, CFTC No. 78-10, 1981 WL 26081, at *5 (Jan. 27, 1981)); *see also, e.g., Damato v. Hermanson*, 153 F.3d 464, 472–73 (7th Cir. 1998). It is "not sufficient" that one is "[m]erely associat[ed]" with the violator. *Richardson*, CFTC No. 78-10, 1981 WL 26081, at *6 (first alteration in original) (quoting *Snyder v. United States*, 448 F.2d 716, 718 (8th Cir. 1971)).

Second, the CEA imposes liability against those "who act[] in combination or concert with" others "in [a] violation" of the Act or the Commission's rules. 7 U.S.C. § 13c(a). That similarly requires a guilty mens rea—specifically, an "agreement of two or more persons in a common plan or enterprise" to commit the violation. *Jeffers v. United States*, 432 U.S. 137, 148 n.14 (1977) (defining "concert"); *see also* Black's Law Dictionary 323 (10th ed. 2014) (defining "combination" as similar to a conspiracy); *Combination*, Wolters Kluwer Bouvier Law Dictionary Desk Edition (2012) ("By combination is understood, in a bad sense, a union of men for the purpose of violating the law."). Such an agreement to violate the law is lacking when a person votes her tokens on matters unrelated to a DAO's illegal activity—or, again, when she votes against such measures.

Third, one "who willfully causes an act to be done or omitted which if directly performed or omitted . . . would be a violation . . . may be held responsible for such violation." 7 U.S.C. § 13c(a). Clearly, the mere act of voting one's tokens on matters unrelated to illegal activity does not "willfully cause[]" that activity; nor does voting against it. *See Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 57 (2007) (requiring a showing of "knowledge" or, in some circumstances, "reckless[ness]," before concluding that one has acted "willfully").

Fourth, a "principal" can be held liable for the acts of its "agent" under the CEA. 7 U.S.C. § 2(a)(1)(B). But under no reasonable construction can a DAO that acts illegally be considered the "agent" of an individual who votes her tokens on matters entirely unrelated to the illegal activity. That would require a (nonsensical) showing that the DAO "act[ed] for" the innocent voter "within the scope of [the DAO's] employment or office" when it violated the law. *Id.*; *see* 17 C.F.R. § 1.2.

Fifth, and finally, one "who, directly or indirectly, controls any person who has violated" the Act or its implementing regulations "may" be held liable if the CFTC "prov[es] that the controlling person [1] did not act in good faith or [2] knowingly induced, directly or indirectly, the act or acts constituting the violation." 7 U.S.C. § 13c(b). To establish "control" for purposes of § 13c(b), "the Commission must show that the defendant 'actually exercised general control over the operation of the entity principally liable' *and* 'possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, even if such power was not exercised.'" *CFTC v. Baragosh*, 278 F.3d 319, 330 (4th Cir. 2002) (quoting *Monieson v. CFTC*, 996 F.2d 852, 859 (7th Cir. 1993)); *see also In re Johns*, CFTC No. 01-22, 2001 WL 951733 at *3 (Aug. 21, 2001). Absent ownership of a majority of a DAO's governance tokens, individual tokenholders are not likely to exercise such control over a DAO. And even then, the Commission would still have to show that the controlling tokenholder lacked good faith or knowingly induced a violation before she could be held liable.

Taking stock: the five circumstances for imposing liability in the CEA reflect a commonsense approach which enables the CFTC to punish those who actively engage in or facilitate illegal activity. These provisions can and should be used to target bad actors who leverage DAOs for unlawful means. *See Dissenting Statement, supra* (noting that "the Commission could have found [the two founders] personally liable for Ooki DAO's violations based on the aiding-and-abetting provisions" contained in 7 U.S.C. § 13c(a)). But in the CFTC's "anxiety to . . . protect[] the public," the agency "must take care not to extend the scope of the statute beyond the point where Congress indicated it would stop." *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 161 (2000) (quotation omitted). The CEA cannot be sensibly construed to permit the punishment of individuals who vote their tokens on matters unrelated to a DAO's illegal activity, or who vote against that activity.

In reaching a contrary conclusion, the CFTC's Order relied exclusively on three cases that applied state partnership law to hold individuals liable for the debts of an unincorporated association. *See In re bZeroX, LLC*, slip op. at 11 (citing *Karl Rove & Co. v. Thornburgh*, 39 F.3d 1273, 1285 (5th Cir. 1994); *Shortlidge v. Gutoski*, 484 A.2d 1083, 1086 (N.H. 1984); *Libby v. Perry*, 311 A.2d 527, 533 (Me. 1973)). None of those cases supports the Commission's sweeping approach to DAO-participant liability.

For one thing, the CEA does not provide that state partnership law should govern liability for statutory violations. As already explained, the CEA's text clearly and comprehensively sets forth who can be held responsible for violations. Those "express" provisions detailing who is legally responsible "impl[y] that there are no *other* circumstances" that would give rise to liability. *Jennings v. Rodriguez*, 138 S. Ct. 830, 844 (2018); *see* Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 107 (2012) ("The expression of one thing implies the exclusion of others[.]").

Yet even taking those state-law cases on their terms, they fail to support the Commission's approach. At common law, courts held members of for-profit unincorporated associations liable for the organization's debts in order "to protect third parties with whom the unincorporated association dealt." *Karl Rove*, 39 F.3d at 1285. There was otherwise no "judicial entity" to sue. *Id.* And because the individual members "contemplated" the potential for "profit and loss" due to their partners' dealings, it was only equitable to hold them jointly and severally liable for debts incurred in the course of the partnership's activities. *Blair v. S. Clay Mfg. Co.*, 121 S.W.2d 570, 572 (Tenn. 1938).

That rationale is fundamentally inapposite to CFTC enforcement actions. In those proceedings, the CFTC "is not simply collecting an unpaid contractual debt." *Dissenting Statement, supra*. It is instead acting to "punish" violations of the CEA, *Commodity Trend Serv., Inc. v. CFTC*, 149 F.3d 679, 688 (7th Cir. 1998), often "imposing sanctions that only the Government can impose," *Dissenting Statement, supra*. There is no sound reason—either in law or in equity—to impose such punishments against innocent DAO participants simply because they have voted their tokens. *Cf. United States v. A & P Trucking Co.*, 358 U.S. 121, 127 (1958) ("[T]he conviction of a partnership cannot be used to punish the individual partners, who might be completely free of personal guilt.").

In sum, the CEA precludes the Commission's aggressive approach to DAO-participant liability. The proposed rule, by contrast, respects and is consistent with the CEA's limitations. The Commission should thus abandon its ill-conceived enforcement approach, grant this Petition for Rulemaking, and promulgate a rule clarifying that DAO participants are not liable unless they actively engage in or facilitate illegal activity.

B. The Commission's Approach Will Produce Adverse Consequences

Beyond the legal difficulties with the Commission's approach, the practical concerns for the web3 community are equally troubling. As of this writing, there are nearly 5,000 DAOs.[13] And those DAOs—as well as the larger economy—benefit immensely from the participation of approximately 700,000 active participants, including both voters and proposal makers.[14] Yet the Commission's approach "affirmatively disincentivizes voting participation in DAO governance generally." *Dissenting Statement, supra*. That is because DAO participants must now worry that the simple act of voting their tokens on any governance matter could subject them to future liability should the DAO do something illegal. An analogy to successful collaborative projects of the past may be illustrative as to why that is so troubling: if Wikipedia contributors had been held jointly and severally liable for copyright violations in the early days of the platform, it is unlikely that it would have ever achieved sufficient uptake to become one of the largest repositories of human knowledge in history.

The sword of Damocles that now hangs over a DAO participant who votes her tokens will inevitably "have a chilling effect that discourages voting, thereby hindering good governance and the development of a culture of compliance in this setting." *Id.* Indeed, even if a voter wants to "encourage[] following the law," the risk that her vote won't ultimately carry the day might be reason enough not to vote in the first place. *Id.* And, because of that risk, the CFTC's aggressive approach could paradoxically lead to *more* illegal governance proposals passing.

And this is to say nothing of the detrimental effect it could have on existing protocols. Many protocols governed by DAOs that have already been deployed were built with minimum voting thresholds. To the extent that tokenholders are unable or unwilling to vote, these protocols could be stuck in stasis—unable to change their parameters or, worse, unable to patch vulnerabilities that have been identified, thereby exposing them to attack.

The chilling effect poses significant threats to the stability and future of all DAOs. By its own terms, the Order only explicitly extends liability to voting members of "for-profit" DAOs. *In re bZeroX, LLC*, slip op. at 11. But imposing what amounts to strict liability in those circumstances for the acts of others is itself problematic, and it raises a host of other questions too. For instance, will participants in "non-profit" DAOs similarly be held liable if the organization stumbles into legal trouble? If not, what is the dividing line between a "for-profit" and a "non-profit" DAO? Is it enough that governance tokens can be bought and sold for a profit? Or must a DAO "[seek] to be characterized as a non-profit organization in [a] federal or state registration or tax filing" to avoid subjecting its voting participants to joint and several liability? *Id.* The Commission's approach is painfully opaque and utterly divorced from the text of the CEA, which contains no dividing line based on for-profit status. Then there are the inevitable questions as to which DAO voting participants the CFTC will target. Does it matter if a

[13] *See Organizations*, DeepDAO, https://deepdao.io/organizations (last visited Oct. 26, 2022).

[14] *Id.*

tokenholder voted exclusively on matters unrelated to illegal activity? Is a tokenholder shielded from liability for organizational acts committed after the sale of her tokens, or does she remain a DAO participant by virtue of having voted in the past? What if a DAO participant votes against illegal activity but her vote does not ultimately tip the scales—is she too liable?

All these questions underscore the need for the CFTC to articulate clear, prospective rules that participants may abide by—and to do so quickly to mitigate the risk of crippling the responsible development of web3's architecture. The proposed rule meets these ends, offering a clear, sensible, and lawful approach to DAO-participant liability.

Should the Commission refuse to engage in rulemaking here, the negative effects would extend well beyond DAOs. Indeed, the CFTC's enforcement action "is the latest example of why an 'enforcement only' approach to web3 is bad for the rule of law, bad for the US economy, and bad for national security."[15]

Consider, first, the rule of law. The American people are "entitled to rely on the law as written." *Bostock v. Clayton County*, 140 S. Ct. 1731, 1749 (2020). And yet, until the CFTC issued its order, the web3 community had no notice—from any written law—that the simple act of voting their tokens could expose them to significant personal liability. *See Dissenting Statement*, *supra*. The problem does not stop with the CFTC's enforcement action against Ooki DAO. Those from all corners of the community now have reason to fear that similar, notice-less enforcement actions will be the CFTC's preferred approach for dealing with novel digital-asset-related issues moving forward. Such an oblique and aggressive enforcement strategy dissuades people from joining or participating in projects. To alleviate these concerns, it would be helpful for the Commission to fortify its commitment to engaging with the private sector[16] and to provide certainty about what the rules are with respect to the new universe of technologies embodied in web3.

In addition, if the CFTC "adopt[s] an enforcement-only approach as opposed to an enlightened partnership" with the web3 community, that will "push[] th[e] next generation of developers to go off-shore." Lehane & Tilleman, *supra* note 15. That, too, is a major problem. But this rulemaking would provide the government with an opportunity to stave off those consequences. By engaging in a collaborative rulemaking effort with interested parties to create a fair, sensible regulatory framework—one that punishes wrongdoing while fostering and incentivizing responsible development—the CFTC will show that it is willing to consider these novel and complex issues from every angle. That will help the country keep pace with technological developments so that the U.S. is positioned to attract the economic drivers of the future and not have them leave the country.

An enforcement-only approach—and its concomitant chilling effects on the web3 community—will risk the country's national security too. *Id.* This much is clear: the infrastructure of the internet is going to change. And that change "is going to take place amidst the global fight between democracies and autocracies." *Id*. As a result, the United States needs to

[15] Chris Lehane & Tomicah Tillemann, *CFTC, DAOs, and Why Regulation by Enforcement is Bad for the U.S.*, Haun Ventures (Sep. 28, 2022), https://mirror.xyz/haunventures.eth/o9BLyEU-88SljwYLVYOy1BUrLH_-1iXnC2P87X8fAto. The CFTC is not alone. In a similar haste to punish those who abuse blockchain technology, the Office of Foreign Assets Control ("**OFAC**") broadly sanctioned "Tornado Cash," a virtual currency mixer that relies on open-source code to protect financial privacy in Ethereum transactions. In doing so, however, OFAC appears to have overstepped its statutory authority—and it may have violated innocent Americans' constitutional rights along the way. *See* Katie Haun & James Rathmell, *OFAC Cannot Shut Down Open-Source Software*, Haun Ventures (Oct. 18, 2022), https://mirror.xyz/haunventures.eth/ITTj2t5XoTYLH-3bRrlVtg1joGSN89-wddRYbCkekPM.

[16] *See, e.g.*, Press Release, CFTC, *Chairman Benham Announces Technology and Customer Outreach Organization* (July 26, 2022), *available at* https://www.cftc.gov/PressRoom/PressReleases/8563-22; Press Release, CFTC, *CFTC Launches LabCFTC as Major Fintech Initiative* (May 17, 2017), *available at* https://www.cftc.gov/PressRoom/PressReleases/7558-17.

foster a regulatory environment that does not hamstring developers who are looking to build web3 responsibly. If the United States does not lead in supporting the developers for this next generation of the internet, it is going to cede its ability to shape what the future of the internet looks like.

In short, Haun Ventures respects the Commission's aims in seeking to crack down on any who seek to abuse technology for unlawful ends. But the CFTC also needs to consider the costs before adopting an overly aggressive stance that both chills lawful DAO participation and subjects innocent voters to liability. Rulemaking provides a prime opportunity to fully consider the complex issues at hand and "promote responsible innovation" in this novel policy arena. 7 U.S.C. § 5(b).

C. Rulemaking Will Benefit the Commission and Interested Parties

Beyond the issue of DAO-participant liability, Haun Ventures submits that the Commission ought to prioritize proactive rulemaking as the primary means for adapting its regime to emerging technologies of all stripes, including those underpinning web3.

Rulemaking "fosters logical and thorough consideration of policy," as well as administrative legitimacy. Lisa Schultz Bressman, *Beyond Accountability: Arbitrariness and Legitimacy in the Administrative State*, 78 N.Y.U. L. Rev. 460, 542, 546 (2003). Utilizing rulemaking procedures "opens up the process of agency policy innovation to a broad range of criticism, advice and data that is ordinarily less likely to be forthcoming in adjudication." *Nat'l Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 683 (D.C. Cir. 1973). And "the legislative form of rules may allow for a better-crafted decision, with exceptions when appropriate." Jack M. Beermann, *Inside Administrative Law* 179 (2011). The Commission's Ooki DAO Order, by contrast, shows why adjudication may not work effectively as a means for adapting old laws to new technologies. Without the benefit of public input, the Commission has articulated an unduly broad and sweeping approach to DAO-participant liability that we believe to be contrary to law, uncertain in scope, and unwise. Rulemaking would give the Commission the opportunity to hear from all interested parties before doubling down on this course.

Proceeding by rulemaking also has the advantage of "promot[ing] fairness values." Keith Werhan, *Principles of Administrative Law* 196 (3d ed. 2019). Unlike the Commission's ad hoc, regulation-by-enforcement approach, rulemaking "provid[es] advance notification to affected individuals" of their legal rights and obligations. *Id.* This is particularly important for those in the web3 community who operate at the bleeding-edge of technology and are seeking to responsibly "advance new ideas that will serve the common good." Lehane & Tillemann, *supra* note 15. By and large, those individuals "want to follow the law and will do so." *Id.* But those laws need to be established upfront through transparent, democratic processes—lest the government stifle innovation in decentralized governance and unfairly punish those trying to lawfully build the next generation of the internet.

VI. Conclusion

DAOs represent a unique opportunity to leverage the underlying technology of web3 to open the field for a new organizational form that provides better, more democratized participation in technology development and innovation. Yet the Commission's approach to DAO-participant liability unduly, unfairly, and unlawfully chills this innovation in governance. As with almost any technology, web3 platforms can be harnessed for good and bad—and we need clear rules of the road to help promote the growth of the good and suppress the bad. The proposed rule serves both of those worthy ends. It comports with the CEA's text and purposes, enables the CFTC to target bad actors, and ensures that innocent actors are not arbitrarily swept up and held liable for a DAO's illegal activity. The Commission should therefore initiate a notice-and-comment rulemaking process and promulgate the proposed rule set forth in this Petition.

Sincerely,

James Rathmell
General Counsel, Haun Ventures

cc: Steven A. Engel, Dechert LLP

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
Facsimile: (202) 418-5521

March 18, 1998

TAC 14-1

Bradford L. Jacobowitz
Interactive Brokers LLC
465 Columbus Avenue
Valhalla, New York 10595

Dear Mr. Jacobowitz:

The Commission acknowledges receipt of your petition for amendment of Commission Rule 1.55(a)(1)(ii), submitted pursuant to Commission Rule 13.2. Your petition explains that Interactive Brokers LLC ("Interactive") is a registered futures commission merchant ("FCM") which offers customers an electronic order routing system that provides access to futures markets from a computer terminal. Interactive plans to make its system available to the public through the Internet. As part of the account opening process, Interactive would require customers to read the risk disclosure language described in Commission Rule 1.55(b). In this regard, Interactive seeks an amendment to Commission Rule 1.55(a)(1)(ii) that would enable FCMs to fulfill relevant disclosure obligations by receiving from their customers an acknowledgment of the required risk disclosure statement "with an electronic signature via the Internet rather than an ink signature via traditional mail."

Consistent with the requirements of Rule 13.2, I have referred the matter to the Commission for appropriate action. After the Commission has conferred with its staff about the issues raised in your petition, I will notify you of any action that the Commission takes to resolve those issues.

Thank you for your interest in this aspect of the Commission's regulatory program. If you need further information about the status of your petition, please contact Ed Case of the Division of Trading and Markets at (202) 418-5150.

Sincerely yours,

Jean A Webb

Jean A. Webb
Secretary of the Commission

1998C/39

INTERACTIVE BROKERS LLC
SUTTON PARK NORTH
465 COLUMBUS AVENUE
VALHALLA, NEW YORK 10595

COMMODITY FUTURES [illegible]
FEB 9 [illegible] PM '98

Bradford L. Jacobowitz
General Counsel
Tel.: (914) 749-5863
Fax: (914) 749-5835

February 6, 1998

FEB 10 12 03 PM '98

Via Federal Express
Jean A. Webb
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Dear Ms. Webb:

This petition for a proposed rule change to Commodity Futures Trading Commission (the "Commission" or "CFTC") Rule 1.55(a)(1)(ii) is filed by Interactive Brokers LLC ("Interactive" or "Petitioner") pursuant to 17 CFR 13.2. The proposed rule would enable a futures commission merchant ("FCM") to open a commodity account by receiving from its customer the Risk Disclosure statement required by CFTC Rule 1.55(a)(1)(ii) with an electronic signature via the Internet rather an ink signature via traditional mail.

Nature of Petitioner's Interest

Interactive is an FCM registered with the Commission. Interactive offers an electronic order routing system which permits users to view markets from a computer terminal (the Interactive Trader Workstation, or "ITW"). Users then submit orders from their ITW, through Interactive, and to an exchange for execution. The Interactive System maintains an audit trail which records all relevant attributes of an order and time stamps the order at various stages (including, the time the order is: (i) submitted by the user, (ii) received by Interactive, (iii) sent to an exchange for execution, (iv) received by the broker for execution, and (v) executed). The Interactive System permits Users to modify or cancel orders and the audit trail records all relevant attributes and appropriate time stamps. The audit trail also records reports of executions, cancellations and revisions.

Interactive will make its system available to the public through the Internet. As part of the account opening process, Interactive would require Users who desire to establish an account with Interactive to read the Risk Disclosure statements required by the Commission and to evidence and acknowledge that they have read and understood the Risk Disclosure statement by typing their name and the date, and clicking an "electronic button" on Interactive's Internet web page. Upon clicking the "electronic button," a message will be sent to Interactive that contains the customer's typed signature and the customer's acknowledgment that the Risk Disclosure statement has been read and understood. Interactive documents the customer's consent by electronic confirmation which is retained as part of Interactive's customer records, using methods which would meet the requirements for "Delivery of Statements" under the CFTC's June 10, 1997 Advisory ("Alternative Method of Compliance With Requirements for Deliver and Retention of Monthly, Confirmation and Purchase-and-Sale Statements").

It is the clicking of the "electronic button" which Interactive seeks to utilize in lieu of the ink signature under CFTC Rule 1.55. As the Commission has recognized, in form and substance, electronic and ink signatures are materially no different, i.e., they both provide suitable acknowledgement. Satisfaction of the Rule 1.55 requirements through developments in technology which permit an electronic acknowledgement, rather than an ink signature, is a natural step in the evolution of the use of the Internet as a safe and efficient means for the public to access markets.

Text of Rule:

CFTC Rule 1.55(a)(1) provides as follows:

> "Except as provided in §1.65, no futures commission merchant or, in the case of an introduced account, no introducing broker, may open a commodity futures account for a customer unless the futures commission merchant or introducing broker first:
>
> > (ii) receives from the customer an acknowledgment signed and dated by the customer that he received and understood the disclosure statement."

Text of Proposed Rule:

> "Except as provided in §1.65, no futures commission merchant or, in the case of an introduced account, no introducing broker, may open a commodity futures account for a customer unless the futures commission merchant or introducing broker first:
>
> > (ii) receives from the customer an acknowledgment signed manually or electronically and dated by the customer that he received and understood the disclosure statement."

Arguments:

The elements of the "signature" requirement [as set forth in CFTC Rule 1.55(a)(1)(ii)] are not set out with specificity. In the absence of a specific provision, it is generally appropriate to turn for guidance to analogous situations governed by common law and statutory law.

It is almost universally understood that a signature is any form of communicated assent which is not oral. For example, Black's Law Dictionary provides the following definition:

> "Signature: The act of putting one's names at the end of an instrument to attest its validity; the name thus written. A signature may be written by hand, printed, stamped, typewritten, engraved, photographed, or cut from one instrument and attached to another, and a signature lithographed on an instrument by a party is sufficient for the purpose of signing it; it being immaterial with what kind of instrument Maricopa County vs. Osborn, 60 Ariz. 290, 136 P.2d 270, 274. And whatever mark, symbol, or device one may choose to employ as representative of himself is sufficient." Id. at 1281-822 (Emphasis added).

The Maricopa County case referred to in Black's cites several other cases and concludes, relying on text, that "it is immaterial with what kind of an instrument a signature is made." Maricopa County vs. Osborn, supra at 136 P.2d 270. A computer would be such an instrument.

Cases have made clear that a signature may be made by typewriter. Brooklyn City R. Co. v. New York, 139 Misc. 691, 248 N.Y.S. 196 (1931). The Uniform Commercial Code defines signature in Section 3-401 to include a mark used "in lieu" of a written signature." See also UCC-1-201(39). A typed, readable, computer generated and transmitted name would be such a "mark."

The general laws of various states provide similarly for broad definitions of the term "signature" which would include one placed on a document by computer transmission. For example, New York General Construction Law provides in Section 46 as follows:

> "The term signature includes any memorandum, mark or sign, written, printed, stamped, photographs, engraved or otherwise placed upon any instrument or writing with an intent to execute or authenticate such instrument or writing."

As a matter of federal law, in Carna v. Bessemer Cement Company, 588 F. Supp. 706 (1983), the Court relied upon authority similar to that cited above to conclude that a broad rule for the effectiveness of a signature is appropriate. There, the Court interpreted the Federal Bill of Lading Act, and rejected the proposition that to "sign" means to "affix a party's actual handwritten signature." The Court held that a preprinted name was the equivalent of a signature, so long as it is intended to have the force of a "signature," so long as the appropriated intention is present. The Court relied, in part, on the Official Comments to the Uniform Commercial Code which addresses the issue and conclude that a "common sense approach" based on "commercial experience" must be used to determine what constitutes a signature. Id. at 708-09.

Common sense and commercial reality has brought commerce to the point where electronic signatures transmitted over communication systems such as the Internet have become useful and common. They are considered reliable as evidenced by the fact that they are accepted in a variety of settings, such as for:

- The electronic filing of Form 1-FR with the Commission in which a registrant may use a personal identification number ("PIN") to make an oath or affirmation attesting that the Form 1-FR being filed is true and correct and that the use of such PIN will be deemed to be the equivalent of a manual signature; see 62 CFR 45 at pages 10441-10445, March 7, 1997 (amendment to CFTC Rule 1.10(d)(4) (attached as Exhibit "A");

- Court filings (see, e.g., Administrative Order In re Electronic Filing Procedures No. 97-__, dated September __, 1997, the Hon. Charles P. Sifton, Chief Judge, United States District Court for the Eastern District of New York printed in the New York Law Journal, Tuesday, November 18, 1997) (attached as Exhibit "B");

- Filing documents with the SEC (see December 19, 1996 paper entitled, "Electronic Filing and the EDGAR System: A Regulatory Overview", prepared by James R. Budge and Ruth Armfield Sanders; see also, SEC Release Nos. 33-7472; 34-39269 (attached as Exhibit "C")) (Final Rules, effective January 1, 1998 that SEC will not accept any paper filing that is required to be filed electronically, unless it satisfies the requirements for a temporary or continuing hardship exemption);

- The filing of tax returns with the Internal Revenue Service (see e.g., IRS Form 8453-OL, "U.S. Individual Income Tax Declaration for On-Line Filing"); and,

- In the banking industry, signatures and the transfer of funds (see, 17 CFR § 232.302.

So long as appropriate procedures are in place, we submit that an appropriately interpreted CFTC Rule 1.55(c) permits signatures on Risk Disclosure Statements by a party typing his or her name and the date on a computer and transmitting it over the Internet along with an acknowledgement similar to the following:

> BY TYPING MY SIGNATURE AND SENDING IT VIA THE INTERNET, I ACKNOWLEDGE THAT I HAVE READ AND UNDERSTAND THE FOREGOING DOCUMENT [THE RISK DISCLOSURE STATEMENT]; THAT I INTEND IT TO BE RELIED ON BY THE RECIPIENT; THAT I INTEND TO BE BOUND THEREBY; AND THAT I UNDERSTAND AND AGREE THAT MY ELECTRONIC SIGNATURE IS THE EQUIVALENT OF A MANUAL WRITTEN SIGNATURE.

The Commission has also endorsed the use of electronic signatures in its June 10, 1997 Advisory ("Alternative Method of Compliance With Requirements for Deliver and Retention of Monthly, Confirmation and Purchase-and-Sale Statements"). In section II ("Delivery of Statements"), the Commission recognized that there may be alternative methods to receive a customer's informed consent to receive statements electronically, and advised that "[f]or customers who constitute 'eligible customers', as defined herein, the FCM may obtain the customer's informed consent orally, by means of electronic media or through hard copy documentation including the customer's signature."

We respectfully submit that consistent with the Commission's endorsement of an electronic acknowledgement from customers with respect to the delivery of statements in electronic form, Rule 1.55(a) would permit FCM's to receive from their customers an electronic acknowledgement, in lieu of a hard copy signature, that such customer has received, read and understands the Risk Disclosure Statement. Simply stated, the receipt of an electronic acknowledgement provides the same assurance as an ink-signed document, and it benefits the marketplace if appropriate technology is used to take advantage of the resulting efficiencies.

Conclusion

It is our belief that permitting FCM's to satisfy their obligations pursuant to CFTC Rule 1.55 by receiving an electronic acknowledgement from customers that such customers have received, read and understand the required Risk Disclosure statements is an acceptable alternative and provides FCM's and the public with the benefits of expedience, reduced paperwork and lower expense without the risk that such customers have not been adequately apprised of the risks of trading.

Respectfully,

Bradford L. Jacobowitz

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
Facsimile: (202) 418-5521

October 11, 2001

Arthur F. Bell, Jr.
Arthur F. Bell, Jr. & Associates, L.L.C.
Suite 200, 201 International Circle
Hunt Valley, Maryland 21030

Re: Petition for Rulemaking -- CFTC Rule 4.22(c)(2)(ii) and Part 160

Dear Mr. Bell:

This letter acknowledges your letter to John C. Lawton and Jean A. Webb, dated August 17, 2001. Because that letter is also titled a "Petition Under 17 CFR Part 13", it is governed by Rule 13.2, which governs petitions for issuance, amendment, or repeal of a rule.[1]

Your petition suggests that there is a conflict between CFTC Rule 4.22(c)(2)(ii), which requires that operators of capital account commodity pools include in an annual report to each participant the total value of the participant's interest in the pool as of the pool's two preceding fiscal year end dates, and the Commission's recently promulgated rules concerning disclosure by futures firms of nonpublic personal information about their customers. For the reasons set forth below, the Commission disagrees and, accordingly, denies your petition for rulemaking. However, as discussed below, the Commission believes that rulemaking is unnecessary because it agrees with your alternative request for confirmation that capital account balances of pool participants may be presented without identifying participants by name.

A. The Commission's Consumer Privacy Rules

The consumer privacy legislation, as originally adopted (Section 509(3)(B) of Title V of the Gramm-Leach-Bliley Act, hereafter "GLB"), specifically excluded "persons or entities" subject to Commission jurisdiction from the coverage of GLB. This exclusion was eliminated with the enactment of the Commodity Futures Modernization Act of 2000 ("CFMA") on December 21, 2000.[2] Under Section 124 of the CFMA, Congress amended the Commodity Exchange Act ("CEA") to add a new Section 5g to the CEA to include the Commission and certain financial institutions subject to its jurisdiction within the coverage of Title V of GLB. That section of the CFMA makes the Commission a "federal functional regulator" for purposes

[1] 17 C.F.R. §13.2 (2001).

[2] Pub L. No. 106-554, 114 Stat. 2763 (2000), amending 7 U.S.C. §1 et seq.

of Title V and mandates that it promulgate consumer privacy rules for certain entities subject to its jurisdiction. These entities are: (1) futures commission merchants ("FCMs"), (2) commodity trading advisors ("CTAs"), (3) commodity pool operators ("CPOs"), and (4) introducing brokers ("IBs").

On April 27, 2001, the Commission published final rules relating to consumer privacy, which are modeled upon the rules published by the other federal functional regulators,[3] with a compliance date of March 31, 2002.[4] As you know, the Commission's rules prohibit FCMs, CTAs, CPOs, and IBs from disclosing nonpublic personal information about consumers to unaffiliated third parties unless they provide consumers with a mechanism to object to such disclosure, or the disclosure fits within one of the exceptions to the "opt-out" requirement.

B. Rule 4.22(c)(2)(ii)

Rule 4.22(c)(2)(ii) requires CPOs to provide separately, to each participant of a pool, a statement of the participant's interest in the pool. In a capital account pool, a participant's interest equals the value of the participant's capital account. Additionally, CPOs are also required to provide to the Commission and the National Futures Association ("NFA") a summary schedule listing the value of each participant's capital account, the sum of which should equal the net asset value reported on the pool's balance sheet. Rule 4.22(c)(2)(ii) does not require CPOs to identify by name each pool participant on the summary schedule and the Commission and NFA accept coded participant information. Many CPOs prepare the schedule by referring to their participants as "Partner A, B, C," etc. or "Partner 1, 2, 3," etc. CPOs are not required to report to pool participants information about fellow participants' balances.

The Commission requires that the summary schedule of participants' interests be subjected to the same audit procedures as the rest of the pool's financial statements. This means that an auditor will review the summary schedule to ensure that net income or losses of the pool and any special allocations are applied to participants appropriately.

C. Conclusion

The Commission's conclusion is that Rule 4.22(c)(2)(ii) permits various ways for CPOs to report the status of capital accounts, many of which ensure the privacy of participants' interests. Thus, CPOs should be able to comply with Rule 4.22(c)(2)(ii) without violating Commission rules concerning disclosure of customer information under Part 160.

[3] The other federal functional regulators under GLB are: the federal banking agencies (Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision); the National Credit Union Administration; the Securities and Exchange Commission; and the Federal Trade Commission.

[4] 66 Fed. Reg. 21,235 (April 27, 2001). The final rules will be published as 17 C.F.R. Part 160.

If you have any additional questions or concerns, please contact Susan Elliott, an attorney in the Division of Trading and Markets, at (202) 418-5464.

Very truly yours,

Catherine D. Dixon

Catherine D. Dixon
Assistant Secretary of the Commission

cc: Ronald Carletta, Supervisory Auditor, New York Regional Office
Gregory C. Prusik, Vice-President for Compliance and Registration, NFA

20010216

ARTHUR F. BELL, JR. & ASSOCIATES, L.L.C.

RECEIVED
C.F.T.C.

2001 AUG 27 PM 1:00

OFC. OF THE SECRETARIAT

Certified Public Accountants

(410) 821-8000

FAX (410) 321-8359

Member:

American Institute of Certified Public Accountants

SEC Practice Section

Maryland Association of Certified Public Accountants

Suite 200

201 International Circle

Hunt Valley, Maryland 21030

August 17, 2001

Mr. John C. Lawton
Acting Director
Division of Trading and Markets
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Ms. Jean A. Webb
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Conflict between CFTC Regulation 4.22(c)(2)(ii) and Section 5g of the Commodity Exchange Act, the Gramm-Leach-Bliley Act of 1999 and CFTC Rule 17 CFR Part 160, *Privacy of Consumer Financial Information*; Petition Under 17 CFR Part 13

Dear Mr. Lawton and Ms. Webb,

Arthur F. Bell, Jr. & Associates, L.L.C. is a Certified Public Accounting firm serving the futures industry for approximately twenty years. The firm has over two hundred clients involved in derivative and equity trading as Commodity Trading Advisors, Commodity Pool Operators, Futures Commission Merchants, Introducing Brokers, Registered Investment Advisers and similar capacities. Members of the firm are involved in numerous industry committees, and Mr. Bell is a member and former Director of the Managed Funds Association (MFA), a member of MFA Government Relations Committee, Futures Industry Association (FIA), National Futures Association (NFA) Special Committee, the CFTC Global Markets Advisory Committee, and various other similar industry groups. The firm's experience and industry involvement are the basis for substantial interest in the relationship among the Gramm-Leach-Bliley Act of 1999 (GLB Act), CFTC's 17 CFR Part 160 and CFTC Regulation 4.22(c)(2)(ii).

The Commodity Futures Modernization Act of 2000 added Section 5g to the Commodity Exchange Act. Section 5g requires the CFTC to prescribe regulations under Title V of the GLB Act. Title V of the GLB Act governs the privacy of consumer's financial information and imposes limits on the disclosure of such information by "institutions" that provide financial products or services to individuals for their personal (i.e., non-business) use. Section 5g requires the CFTC to adopt rules regarding the privacy of nonpublic personal information. As a result, the CFTC adopted 17 CFR Part 160, *Privacy of Consumer Financial Information*. The rule became effective June 21, 2001, with mandatory compliance required by March 31, 2002.

17 CFR Part 160 requires, among other things, that institutions, including commodity pool operators, develop privacy policies with respect to consumer nonpublic information and to provide periodic notices to all customers which describe the institution's polices and procedures with respect to safeguarding and disclosure of such nonpublic personal information. Nonpublic personal information includes "personally identifiable financial information" that is provided by a client or that results from any transaction or service performed for the client (e.g., an investor's capital account balance).

CFTC Regulation 4.22(c) requires that each commodity pool operator registered under the Commodity Exchange Act must distribute an Annual Report to each participant in each pool that it operates. Under Regulation 4.22(c)(2), the Annual Report must contain the net asset value per outstanding participation unit in the pool as of the end of each of the pool's two preceding years (Regulation 4.22(c)(2)(i) which is applicable to unit based pools) or the total value of the participant's interest or share in the pool as of the end of each of the pool's two preceding fiscal years (Regulation 4.22(c)(2)(ii) which is applicable to capital account commodity pools).

The requirements of Regulation 4.22(c)(2) in Annual Reports are typically met in one of two ways, depending on the structure of the commodity pool. Commodity pool operators typically comply with the requirement of Regulation 4.22(c)(2)(i) for unit based pools by presenting, as part of the Annual Report, the net asset value per outstanding participation unit in the pool as of the end of the current year and for each of the pool's two preceding years. Commodity pool operators typically comply with the requirement of Regulation 4.22(c)(2)(ii) for capital account pools by presenting, as part of the Annual Report, a supplemental financial information schedule listing, by partner or member identification number, each participant's capital account balance as of the end of the current and prior two fiscal years.

Conflict Between Regulation 4.22(c)(2)(ii) and GLB Act and CFTC's 17 CFR Part 160

As previously noted, partner or member capital account balances are considered "nonpublic personal financial information" under the GLB Act. Under the GLB Act, the commodity pool operator is not permitted to disclose such financial information. However, disclosure of each partner's or member's capital account balance is required to be included in the Annual Report distributed to all pool participants under CFTC Regulation 4.22(c)(2)(ii). As such, CFTC Regulation 4.22(c)(2)(ii) conflicts with the requirements of the GLB Act and the CFTC's privacy rules. Therefore, commodity pool operators of capital account commodity pools would violate the privacy provisions of the GLB Act and the CFTC's rules by complying with Regulation 4.22(c)(2)(ii).

Proposed Solution to Conflict

We would propose resolving this apparent conflict by eliminating the requirement of CFTC Regulation 4.22(c)(2)(ii) that is applicable to capital account commodity pools. The objectives of this regulation were to provide investors with some degree of confidence that their capital account balances, as reported to them by the commodity pool operator in their monthly statements, reconciled to the financial statements and to their individual capital account balances presented in the supplemental financial information contained in the Annual Report. From a practical standpoint, however, this requirement provides the investors with minimal additional confidence. This is because the auditor's report on the supplemental financial information states only that the individual capital account balances of the investors are materially stated "in relation to the financial statements taken as a whole." As such, the auditor is not expressing an opinion on the accuracy of individual investor capital account balances and any inference to the contrary is erroneous. Secondly, we are not aware of any instances of fraud involving intentional understatement of certain individual capital balances with intentional overstatements of other individual capital account balances. In essence, a "fraud" where all the assets still exist. Rather, frauds typically involve the intentional overstatement of the pool's aggregate assets and net asset value.

As such, given the conflict between Regulation 4.22(c)(2)(ii) and the GLB Act and the CFTC's privacy rules, as well as the minimal degree of additional investor confidence provided by the requirements of Regulation 4.22(c)(2), we recommend the requirements of this regulation be eliminated from Regulation 4.22 and a revised Regulation 4.22(c)(2) be added which would read as follows, "If applicable, the net asset value per outstanding participation unit in the pool as of the end of the current and each of the pool's two preceding fiscal years."

Should the CFTC not agree with our proposed solution, we ask the CFTC to provide the commodity pool operator community with confirmation that, in the CFTC's opinion, simply altering or disguising the partner or member identification numbers from those used for internal accounting or income tax return reporting purposes, provides the commodity pool operator with sufficient relief such that the commodity pool operator would not, in the opinion of the CFTC, be in violation of either the GLB Act or CFTC's 17 CFR Part 160 by presenting, in a supplemental financial information schedule as part of the Annual Report of a capital account pool, the capital account balances of individual partners or members along with altered partner or member identification numbers.

Thank you for considering our comments and proposals. If you have any questions or would like to discuss them with us, please call Arthur F. Bell, Jr. or Bob Zink at (410) 821-8000.

Sincerely,

Arthur F. Bell, Jr. & Associates, L.L.C.

Arthur F. Bell, Jr. & Associates, L.L.C.

Cc: Susan Elliott, Division of Trading and Markets

20050129

NFA NATIONAL FUTURES ASSOCIATION

August 26, 2005

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OFC. OF THE SECRETARIAT

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 4.22

Dear Ms. Webb:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulations 4.22 and 4.7. NFA petitions the Commission to amend Regulations 4.22 and 4.7 to eliminate the requirement that CPOs file manually signed pool financial statements (PFS) with NFA and replace it with a requirement that CPOs electronically file these statements and affirm the content in accordance with NFA's electronic filing system. The information required by CFTC Regulation 13.2 follows:

I. Text of Proposed Rule Amendments

PART 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADISORS

§ 4.7 Exemption from certain part 4 requirements for commodity pool operators with respect to offerings to qualified eligible persons and for commodity trading advisors with respect to advising qualified eligible persons.

(b) *Relief available to commodity pool operators.*

* * *

(3) *Annual report relief.* (i) Exemption from the specific requirements of Secs. 4.22(c) and (d); *Provided*, That within 90 calendar days after the end of the exempt pool's fiscal year, the commodity pool operator files electronically with the National Futures Association and distributes to each participant in

lieu of the financial information and statements specified by those sections, an annual report for the exempt pool. The Annual Report must be electronically filed and affirmed in accordance with National Futures Association's electronic filing system and must contain ~~signed and affirmed in accordance with Sec. 4.22(b) which contains~~, at a minimum:

* * *

§ 4.22 Reporting to Pool Participants

(c) Except as provided in paragraph (c)(6) of this section, each commodity pool operator registered or required to be registered under the Act must distribute an Annual Report to each participant in each pool that it operates, and must file electronically a copy of the Report with the National Futures Association, within 90 calendar days after the end of the pool's fiscal year or the permanent cessation of trading, whichever is earlier, but in no event longer than 90 days after funds are returned to pools participants. *Provided, however,* That if during any calendar year the commodity pool operator did not operate a commodity pool, the pool operator must so notify the National Futures Association within 30 calendar days after the end of such calendar year. The Annual Report must be electronically filed and affirmed in accordance with the requirements of National Futures Association's electronic filing system ~~signed pursuant to paragraph (h) of this section~~ and must contain the following:

* * *

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. Registered CPOs are required to be Members of NFA and are regulated by NFA. NFA is interested in ensuring that CPOs are regulated in the most efficient and effective manner. NFA believes that mandatory participation in NFA's electronic filing system furthers that goal.

III. Supporting Arguments

National Futures Association implemented a voluntary pilot program for our CPO Members that allows them to file their PFSs with NFA electronically. The pilot program began with the December 31, 2004 annual reports. Since that time and through June 15, 2005, NFA has received 364 electronically filed statements (15.5% of the total statements received during that time period).[1] NFA believes that the pilot program has been successful and provides for a more efficient and effective method for filing and receiving these statements. In addition to facilitating the filing of statements with NFA, putting the statements in electronic form makes it easier for CPOs to distribute statements to participants, thereby providing limited partners with more timely information and reducing CPOs' printing and postage costs. Moreover, the electronic filing process is relatively simple. The basic requirements are a document in PDF format and an internet connection. The certified public accountants that prepare these annual reports can provide the document in PDF format and any CPO that does not have internet access in its own offices can file the document through an internet connection available in a public facility, such as most public libraries. Given the benefits associated with and the ease in accomplishing electronic filing, NFA would like to make electronic filing of pool financial statements mandatory for all pool financial statements as of December 31, 2005.

CFTC Regulations 4.7 and 4.22, however, require CPOs to file manually signed pool financial statements with NFA. As you know, in order to implement the pilot program, the CFTC provided no action relief from the manual signature filing requirement of Regulation 4.22 to those CPOs participating in the CPO electronic filing pilot program. In order to meet NFA's goal to make electronic filing mandatory for all CPO Members, NFA requests that the Commission amend Regulations 4.22 and 4.7 to impose the mandatory requirement and to eliminate the manual signature requirement.

As discussed in NFA's no action request, eliminating the manual signature requirement will not diminish the protections provided by this requirement. The

[1] Many potential users of the EasyFile system indicated that they supported the EasyFile concept but had not taken advantage of the pilot program because they did not want to take the time to learn how to use the system until they were confident it would be an ongoing option.

electronic filing system requires the CPO to read and agree to an electronic oath or affirmation at the time the CPO submits the electronic filing. Moreover, any CPO making the electronic filing will be required to maintain the financial statement with the CPO's original signature and provide it to NFA upon request.

NFA respectfully petitions the Commission to amend Regulations 4.7 and 4.22 as described above.

Very truly yours,

Thomas W. Sexton, III
Vice President and
General Counsel

(caw:petiton for rulemaking 4.22)

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521
www.cftc.gov

Office of the Secretariat

August 29, 2005

Mr. Thomas Sexton
National Futures Association
200 West Madison Street
Suite 1600
Chicago, IL 60606

Mr. Sexton:

The Office of the Secretariat has received the petition for rulemaking to amend CFTC regulation 4.22. It has been referred to the Commission for such action as it deems appropriate, we will notify the NFA of the action taken by the Commission.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

20060024

NFA NATIONAL FUTURES ASSOCIATION

November 28, 2005

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OFC. OF THE SECRETARIAT

By Overnight Mail

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend Certain CFTC Part 4 Regulations

Dear Ms. Webb:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulations 4.5, 4.7, 4.12, 4.13, 4.14 and Advisory 18-96. NFA petitions the Commission to amend these regulations to eliminate the requirement that CPO and CTA registrants and non-registrants file manually signed notices of exemption and replace it with a requirement that CPOs and CTAs file all exemption notices through NFA's electronic exemption filing system. The information required by CFTC Regulation 13.2 follows:

I. Text of Proposed Rule Amendments

Part 4- COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

* * *

§ 4.5 Exclusion from the definition of the term "commodity pool operator."

* * *

(c) Any person who desires to claim the exclusion provided by this section shall file electronically with the National Futures Association, through its electronic exemption filing system, a notice of eligibility; *Provided, however,* That a plan fiduciary who is not a named fiduciary as described in paragraph (a)(4) of this section may claim the exclusion through the notice filed by the named fiduciary.

* * *

(d)(1) Each person who has claimed an exclusion hereunder must, in the event that any of the information contained or representations made in the notice of eligibility becomes inaccurate or incomplete, ~~file a supplemental notice~~ amend the notice electronically through ~~with the~~ National Futures Association's electronic exemption filing system ~~to that effect, which, if applicable, includes such amendments~~ as may be necessary to render the notice of eligibility accurate and complete.

(2) This ~~supplemental notice~~ amendment required by paragraph (d)(1) of this section shall be filed within fifteen business days after the occurrence of such event.

* * *

(f) Any notice required to be filed hereunder must be filed by a representative duly authorized to bind the person specified in (a) of this section.

~~(1) In writing;~~

~~(2) Manually signed by a representative duly authorized to bind a person specified in paragraph of this section; and~~

~~(3) Filed with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department).~~

* * *

§ 4.7 Exemption from certain part 4 requirements for commodity pool operators with respect to offerings to qualified eligible persons and for commodity trading advisors with respect to advising qualified eligible persons.

* * *

(d) *Notice of claim for exemption.*

(1) A notice of a claim for exemption under this section must

(i) Be ~~in writing~~ filed electronically with National Futures Association through its electronic exemption filing system by a representative duly authorized to bind the commodity pool operator or commodity trading advisor.

* * *

(vi) Where the claimant is a commodity pool operator, state the closing date of the offering or that the offering will be continuous; and

~~(vii) Be manually signed by a representative duly authorized to bind the commodity pool operator or commodity trading advisor;~~

~~(viii) Be filed with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department); and~~

(~~ix~~ vii) (A)(1) Where the claimant is a commodity pool operator, except as provided in paragraph (d)(1)(iii)(A) of this section with respect to single-investor pools and in paragraph (d)(1)(ix)(A)(2) of this section, be received by the National Futures Association:

* * *

§ 4.12 Exemption from provisions of part 4.

* * *

(b)(3) Any registered commodity pool operator who desires to claim the relief available under §4.12(b) must file electronically a claim of exemption with National Futures Association through its electronic exemption filing system. ~~file a claim of exemption with the National Futures Association.~~ Such claim must:

~~(i) Be in writing;~~

~~(ii)~~ (i) Provide the name, main business address and main business telephone number of the registered commodity pool operator, or applicant for such registration, making the request;

~~(iii)~~ (ii) Provide the name of the commodity pool for which the request is being made;

~~(iv)~~ (iii) Contain representations that the pool will be operated in compliance with §4.12(b)(1)(i) and the pool operator will comply with the requirements of §4.12(b)(1)(ii);

~~(v)~~ (iv) Specify the relief sought under §4.12(b)(2); and

~~(vi)~~ (v) Be ~~manually signed~~ filed by a representative duly authorized to bind the pool operator~~; and~~

~~(vii) Be filed with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department)~~.

* * *

§ 4.13 Exemption from registration as a commodity pool operator.

* * *

(b)(1) Any person who desires to claim the relief from registration provided by this section, must file electronically a notice of exemption from commodity pool operator registration with the National Futures Association ~~(Attn: Director of Compliance)~~ through its electronic exemption filing system. ~~file a claim of exemption with the National Futures Association.~~ The notice must:

* * *

(iii) Be ~~manually signed~~ filed by a representative duly authorized to bind the person.

* * *

(4) Each person who has filed a notice of exemption from registration under this section must, in the event that any of the information contained or representations made in the notice becomes inaccurate or incomplete, ~~file a supplemental notice~~ amend the notice through ~~with the~~ National Futures Association's electronic exemption filing system ~~to that effect, which, if applicable, includes such amendments~~ as may be necessary to render the notice accurate and complete. This ~~supplemental notice~~ amendment must be filed electronically within 15 business days after the pool operator becomes aware of the occurrence of such event.

§ 4.14 Exemption from registration as a commodity trading advisor.

* * *

(a) A Person is not required to register under the Act as a commodity trading advisor if:

* * *

(8) It is a registered as an investment adviser under the Investment Advisers Act of 1940 or with the applicable securities regulatory agency of any State, or it is exempt from such registration, or it is excluded from the definition of the term "investment adviser" pursuant to the provisions of section 202(a)(2) and 202(a)(11) of the Investment Advisers Act of 1940, *Provided,* That:

* * *

(iii) (A) A person who desires to claim the relief from registration provided by this §4.14(a)(8) must file electronically a notice of exemption from commodity trading advisor registration with the National Futures Association ~~(ATTN: Director of Compliance)~~ through its electronic exemption filing system. The notice must:

* * *

(3) Be ~~manually signed~~ filed by a representative duly authorized to bind the person.

* * *

(D) Each person who has filed a notice of exemption from registration under this section must, in the event that any of the information contained or representations made in the notice becomes inaccurate or incomplete, ~~file a supplemental notice~~ amend the notice electronically through ~~with the~~ National Futures Association's electronic exemption filing system ~~to that effect, which, if applicable, includes such amendments~~ as may be necessary to render the notice accurate and complete. This ~~supplemental notice~~ amendment must be filed within 15 business days after the trading advisor becomes aware of the occurrence of such event.

* * *

Advisory Number 18-96 Offshore Commodity Pools Relief for Certain Registered CPOs From Rules 4.21, 4.22 and 4.23(a)(10) and (a)(11) and From the Location of Books and Records Requirement of Rule 4.23

C. Filing of a Notice of a Claim for Exemption

* * *

Any notice of claim for exemption filed for relief pursuant to this Advisory must:

(1) Be ~~in writing~~ filed electronically with National Futures Association through its electronic exemption filing system by a representative duly authorized to bind the person specified in Section A.

* * *

~~(6) Be signed by the CPO as follows: if a sole proprietorship, by the sole proprietor, if a partnership, by a general partners; and if a corporation, by the chief executive officer or chief financial officer; and~~

~~(7) Be filed in duplicate with the Commission and the NFA at the headquarters address set forth below:~~

~~Commodity Futures Trading Commission~~
~~(Attn: Office of the Chief Counsel)~~
~~Division of Trading and Markets~~
~~1155 21st Street, N.W.~~
~~Washington, DC 20581~~

~~National Futures Association~~
~~(Attn: Director of Compliance, Compliance Department)~~
~~200 West Madison Street~~

A notice of a claim for exemption must be filed with the ~~Division~~ National Futures Association prior to the date upon which the CPO filing such notice intends to operate pursuant to the terms of the relief available. The notice will be effective upon filing, provided that the representations set forth therein are valid and accurate. An exemption claimed hereunder will cease to be effective upon any change which would render the representations set forth in the notice of a claim for exemption inaccurate or the continuation of such representations false or misleading. Each person who has claimed relief hereunder, in the event that any of the information contained or representations made in the notice of a claim for exemption changes or becomes inaccurate or incomplete, must amend the notice electronically through ~~file a supplemental notice with the Commission~~ National Futures Association's electronic exemption filing system ~~to that effect which, if applicable, includes such amendments~~ as may be necessary to render the notice of a claim for exemption accurate and complete. Such ~~supplemental notice~~ amendment must be filed within fifteen business days after the occurrence of the relevant event.

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. In December 2002, the CFTC authorized NFA to act as the official custodian for all notices of exemption from registration and certain Part 4 requirements that are required to be filed by CPOs and CTAs. NFA is interested in ensuring that these notices of exemption are filed in the most efficient manner. We are also looking to ensure that NFA's database of these exemptions is as complete and accurate as possible. NFA believes that mandatory participation in NFA's electronic exemption filing system furthers these goals.

III. Supporting Arguments

Currently, NFA staff manually inputs and scans all exemptions filed with NFA. NFA staff also manually follows up on any notices of exemption that are not prepared in accordance with the Part 4 requirements. Although this system has worked fairly well, it requires a considerable amount of staffing resources and may be subject to data entry error. NFA believes that a mandatory electronic filing system will result in a more efficient process for those persons claiming an exemption and ensure a more accurate exemption database.

The electronic system is relatively easy to use. Registrants and non-registrants access the electronic filing system through the use of a designated login. Once in the system, registrants and non-registrants will be able to file a notice of exemption by simply selecting the appropriate exemption type and providing the required information. The system will automatically create a printer friendly version of the selected exemption notice for the filer's records. The filer will also be able to view a historical summary of all exemption notices it has filed and update its exemption information at anytime. Further, the system provides assistance to filers through a help text which outlines the specific requirements of the exemption being filed. Although an internet connection is needed to access the system, filers without internet access in their office can use any public internet site, such as those available in most public libraries.

In order to implement NFA's electronic exemption filing system the CFTC must modify its regulations to impose the mandatory filing of exemptions through NFA's electronic exemption filing system and eliminate the manual signature requirement in a number of CFTC regulations. In particular, the CFTC regulations outlined in Section I above require that all notices of exemption filed with NFA include a manual signature by a representative duly authorized to bind the filer. Advisory Number 18-96 requires the signature of the commodity pool operator and also requires that the claim for exemption be filed with the Commission.[1]

Eliminating the manual signature requirement will not diminish the protections provided by this signature. Authentication will be required to gain access to the electronic exemption filing system. Registrants will use the same authentication model they currently use for ORS and will therefore be familiar with the login procedure. A new form-based authentication model has been developed for non-registrant authentication. This authentication process must be completed before NFA issues a login id to a non-registrant. NFA has taken great care in the development of this process in order to ensure that the database of exemption notice filings will not be compromised in any way by unauthorized persons.

NFA respectfully petitions the Commission to amend Regulations 4.5, 4.7, 4.12, 4.13, 4.14, and Advisory Number 18-96 as outlined above.

NFA's electronic exemption filing system is currently capable of accepting notices and amendments. Therefore, NFA respectfully requests that during the time period the Commission is considering the proposed amendments, the Commission provide CPOs and CTAs who wish to avail themselves of the system relief from the pertinent requirements of 4.5, 4.7, 4.12, 4.13, 4.14 and Advisory Number 18-96.

Very truly yours,

Thomas W. Sexton, III
Vice President and General Counsel

(caw:webbasedexemptionrulemaking)

[1] NFA recognizes that the Commission eliminated the filing requirement with the Commission when it authorized NFA to serve as the official custodian of the notices and claims for exemption. (*See* 67 Fed. Reg. 77470 at 77472, December 18, 2002). However, for clarity purposes, NFA requests that the Commission amend the language of the Advisory to reflect that this requirement has been eliminated.

U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521
www.cftc.gov

Office of the Secretariat

November 29, 2005

Mr. Thomas W. Sexton, III
Vice President and General Counsel
National Futures Association
200 West Madison Street
Suite 1600
Chicago, IL 60606

Dear Mr. Sexton:

This is to acknowledge receipt of the petition received by the Commodity Futures Trading Commission on November 29, 2005 for Rulemaking to Amend Certain CFTC Part 4 Regulations.

This petition has been referred to the Commission for such action as the Commission deems appropriate. You will be notified of any action taken by the Commission on this matter.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

NFA NATIONAL FUTURES ASSOCIATION

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Home > News Center > **Petitions for Rulemaking**

Petitions for Rulemaking

2010 | 2009 | 2008 | 2007 | 2006 | 2005

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March 06, 2009
Via E-mail (Dstawick@cftc.gov) and Regular Mail

Mr. David A. Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Withdrawal of February 9, 2006 Petitions for Rulemaking

Dear Mr. Stawick:

On February 9, 2006, National Futures Association (NFA) filed two petitions for rulemaking with the Commodity Futures Trading Commission ("CFTC" or "Commission"). One petition asked the Commission to amend CFTC Regulation 4.7, and the other asked the Commission to amend CFTC Regulations 4.7, 4.13, and 4.22.

NFA hereby withdraws the two February 9, 2006 petitions for rulemaking in light of the Commission's proposed rules regarding Commodity Pool Operator Periodic Account Statements and Annual Financial Reports (74 Fed. Reg. 8220, Feb. 24, 2009). While the proposed rules do not provide all the relief NFA requested, they address several issues contained in NFA's petitions. Therefore, NFA's Board of Directors voted to withdraw the petitions.

Respectfully submitted,

Thomas W. Sexton
Senior Vice President and General Counsel

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20060058

NFA NATIONAL FUTURES ASSOCIATION

February 9, 2006

RECEIVED
C.F.T.C.
2006 FEB 13 PM 1: 25
OFC. OF THE SECRETARIAT

Via Overnight Delivery

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 4.7

Dear Ms. Webb:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend Commission Regulation 4.7 to modify the annual reporting and notice of exemption requirements currently imposed upon commodity pool operators. The information required by CFTC Regulation 13.2 follows.

I. Text of Proposed Rule Amendments

PART 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

* * *

§ 4.7 Exemption from certain Part 4 requirements for commodity pool operators with respect to offering to qualified eligible persons and for commodity trading advisors with respect to advising qualified eligible persons.

* * *

(b) *Relief available to commodity pool operators.*

* * *

(3) *Annual Report Relief.*

* * *

(v) During any fiscal year a commodity pool operator does not trade a commodity interest as defined in §4.10(a) in an exempt pool, the pool operator is exempt from the Annual Report requirements under paragraphs 4.22(c) and (b)(3)(i) of this section for that pool, provided the commodity pool operator, within 90 calendar days after the end of such fiscal year, files with National Futures Association a statement to that effect and notifies each of the pool's current participants that it has no Annual Report filing requirement with National Futures Association for that fiscal year because the pool traded no commodity interests.

* * *

(d) *Notice of claim for Exemption*

(1) A notice of claim for exemption under this section must:

* * *

(viii) Be filed with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department); and

(ix)(A)(1) Where the claimant is a commodity pool operator, except as provided in paragraph (d)(1)(iii)(A) of the section with respect to single investor pools and in paragraph (d)(1)(ix)(A)(2) of this section, be received by National Futures Association~~:~~ ~~(i) B~~ before the date the pool first enters into a commodity interest transaction.~~, if the relief claimed is limited to that provided under paragraph (b)(2), (3) and (4) of this section; or~~

~~(ii) Prior to any offer or sale of any participation in the exempt pool if the claimed relief includes that provided under paragraph (b)(1) of this section.~~

* * *

II. Nature of NFA's Interest

NFA is a futures association registered under Section 17 of the Commodity Exchange Act. Pursuant to a December 18, 2002 Order, the Commission authorized NFA to maintain and serve as the official custodian of commodity pool operator (CPO) Annual Reports. As a result, CPOs are required to file their Annual Reports, including those filed for pools operating under a claim for exemption under Commission Regulation 4.7, with NFA in accordance with Commission requirements. NFA is interested in ensuring that NFA's resources are properly allocated in order to regulate CPOs in the most efficient and effective manner. For the reasons explained below, NFA believes the proposed changes to Commission Regulations are designed to ensure that NFA does not expend resources in an area that does not further NFA's regulatory mission.

III. Supporting Arguments

The CFTC and NFA have worked collaboratively over the years to meet our shared mission of ensuring the integrity of the commodity futures markets. Throughout this collaboration, there has been an underlying theme of allocating the resources of our two regulatory bodies to areas where they are most needed in order to achieve this important mission. In addition to a proper allocation between NFA and the CFTC, however, it is also important for each regulatory body to properly allocate its own resources to its particular areas of responsibility.

In 2004, CFTC registered/NFA Member CPOs operated over 3,200 "commodity" funds. Although fifty percent of these funds did not trade a single futures contract in 2004, directly or indirectly, each was required to file an Annual Report (audited or unaudited) with NFA. NFA, in turn, expended over 4,700 staff hours collecting and analyzing annual financial statements filed on behalf of the 1,600 funds that did not trade any futures contracts.

Virtually all of the these 1,600 funds qualify for regulatory relief under CFTC Regulation 4.7 and their CPOs may file an uncertified financial statement for these funds. Unfortunately, collecting and analyzing uncertified financial statements consumes the same amount of staff resources as certified statements.

NFA does not believe that it is an effective use of our resources to collect and analyze financial statements for pools that did not trade any commodity interest in the preceding fiscal year and all of whose participants are qualified eligible participants under CFTC Regulation 4.7. These efforts do not further the mission of either the CFTC or NFA and actually detract from NFA's ability to focus our resources on matters involving commodity futures—where they should be utilized to ensure the integrity of those markets.

In its current form, CFTC Regulation 4.7 does not draw any distinction between those funds that traded futures, either directly or indirectly, in the prior year and those that did not. Therefore, NFA proposes that CFTC Regulation 4.7 be amended to provide that a CPO that operates a fund under a notice of exemption under Regulation 4.7 would not be required to file an Annual Report for that fund in a given year if the fund did not trade any commodity interest transactions in that year.

In lieu of the Annual Report, the CPO would be required to file a statement with NFA notifying NFA of this fact and would also be required to notify each of the pool's current participants that it is not required to file an Annual Report with NFA for the preceding fiscal year because the fund did not trade any commodity interests. NFA notes that a similar notification requirement is already in place for the disclosure relief contained in Regulation 4.7(b)(1)(i). This would be an ongoing notification requirement and would be required for each fiscal year until such time the fund either traded futures (and therefore would have to file an Annual Report) or was not otherwise subject to any Annual Report requirements. The CPO would continue to be subject to other NFA oversight for these pools, including examinations.

NFA also proposes that the timing of the notice of exemption for pools claiming relief under 4.7 be modified. Regulation 4.7(d)(1) currently requires a CPO to file the notice of exemption before the date a pool enters into any commodity interest transactions for all relief other than relief from the disclosure document requirements. For relief from the disclosure document requirements, the CPO is required to file the notice prior to any offer or sale of participation in the exempt pool. NFA does not see any current regulatory reason for this distinction. Many 4.7 exempt funds include information about commodity trading in their offering memoranda to preserve the ability to trade those interests in the future if the need arises in their trading strategies. However, prior to the time a fund that would be exempt under 4.7 actually trades a commodity interest, there is no compelling regulatory reason why the CFTC or NFA needs to be notified that the CPO is soliciting for the fund without a disclosure document. NFA can recall few, if any, regulatory actions relating to the sales practices of a 4.7 fund. Therefore, NFA recommends that Regulation 4.7 be amended to require a CPO to file the notice of exemption prior to the time the pool enters into any commodity transaction, regardless of the relief being sought.

IV. Request for No Action Relief

We recognize that, due to the requirements of the Administrative Procedures Act, proposes changes are unlikely to become effective before the 2005 Annual Reports are due. Therefore, we request that the Commission grant no-action relief to 4.7 exempt pools and CPOs that comply with the proposed requirements and include that relief in the proposing release.

NFA respectfully requests that the Commission amend Regulation 4.7 and provide temporary no-action relief as described above.

Very truly yours,

Thomas W. Sexton, III
Vice President and General Counsel

(caw: 4.7 petition for rulemaking)

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521
www.cftc.gov

Office of the Secretariat

February 14, 2006

Mr. Thomas W. Sexton, III
Vice President and General Counsel
National Futures Association
200 West Madison Street
Suite 1600
Chicago, IL 60606

Dear Mr. Sexton:

This is to acknowledge receipt of the petition received by the Commodity Futures Trading Commission on February 13, 2006 for Rulemaking to Amend CFTC Regulation 4.7.

This petition has been referred to the Commission for such action as the Commission deems appropriate. You will be notified of any action taken by the Commission on this matter.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

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Petitions for Rulemaking

2010 | 2009 | 2008 | 2007 | 2006 | 2005

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March 06, 2009
Via E-mail (Dstawick@cftc.gov) and Regular Mail

Mr. David A. Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Withdrawal of February 9, 2006 Petitions for Rulemaking

Dear Mr. Stawick:

On February 9, 2006, National Futures Association (NFA) filed two petitions for rulemaking with the Commodity Futures Trading Commission ("CFTC" or "Commission"). One petition asked the Commission to amend CFTC Regulation 4.7, and the other asked the Commission to amend CFTC Regulations 4.7, 4.13, and 4.22.

NFA hereby withdraws the two February 9, 2006 petitions for rulemaking in light of the Commission's proposed rules regarding Commodity Pool Operator Periodic Account Statements and Annual Financial Reports (74 Fed. Reg. 8220, Feb. 24, 2009). While the proposed rules do not provide all the relief NFA requested, they address several issues contained in NFA's petitions. Therefore, NFA's Board of Directors voted to withdraw the petitions.

Respectfully submitted,

Thomas W. Sexton
Senior Vice President and General Counsel

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NFA NATIONAL FUTURES ASSOCIATION

February 9, 2006

2006 FEB 10 PM 1:25
RECEIVED

Via Overnight Delivery

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulations 4.7, 4.13 and 4.22

Dear Ms. Webb:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulations 4.7, 4.13 and 4.22 to modify a number of reporting requirements currently imposed upon commodity pool operators. The information required by CFTC Regulation 13.2 follows.

I. Text of Proposed Rule Amendments

PART 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

* * *

§ 4.7 Exemption from certain part 4 requirements for commodity pool operators with respect to offerings to qualified eligible persons and for commodity trading advisors with respect to advising qualified eligible persons.

* * *

(b) *Relief available to commodity pool operators.*

* * *

(2) Periodic reporting relief. Exemption from the specific requirements of Secs. 4.22(a) and (b); *Provided,* That a statement signed and affirmed in accordance

with Sec. 4.22(h) is prepared and distributed to pool participants no less frequently than quarterly within 30 days after the end of the reporting period. This statement must indicate:

(i) The total net asset value of the exempt pool as of the ~~end~~ beginning of the reporting period;

(ii) ~~The change in net asset value from the end of the previous reporting period;~~ ~~and~~ The total amount of additions to the exempt pool during the reporting period;

(iii) The total amount of withdrawals from and redemption of participation units in the exempt pool during the reporting period;

(iv) The total net income or loss of the exempt pool during the reporting period;

(v) The total net asset value of the exempt pool as of the end of the reporting period; and

(vi)(A) The net asset value per outstanding participation unit in the exempt pool as of the end of the reporting period~~.~~, or (B) the total value of the participant's interest or share in the exempt pool as of the end of the reporting period.

* * *

(3) *Annual Report Relief.* (i) Exemption from the specific requirements of Secs. 4.22(c) and (d); *Provided*, That within 90 calendar days after the end of the exempt pool's fiscal year, the commodity pool operator electronically files with the National Futures Association and distributes to each participant in lieu of the financial information and statements specified by those sections, an Annual Report for the exempt pool, ~~signed and~~ affirmed in accordance with the requirements of National Futures Association's electronic filing system, ~~Sec. 4.22(h)~~ which contains, at a minimum:

(A) A Statement of ~~Financial Condition~~ Assets and Liabilities as of the close of the exempt pool's fiscal year ~~(elected in accordance with Sec. 4.22(g))~~;

(B) A Statements of ~~Income (Loss)~~ Operations and Changes in Net Assets for that year; and

(C) ~~Appropriate footnote disclosure and~~ Disclosure of any other material information as may be necessary to make the required report not misleading.

(ii) Such Annual Report must be presented and computed in accordance with generally accepted accounting principles consistently applied, except that footnote disclosure, a Statement of Cash Flows, and a Schedule of Investments under the American Institute of Certified Public Accountants' Statement of Position 03-4 is not required. ~~and, if certified by an independent public accountant, so certified in accordance with Sec. 1.16 as applicable.~~

(iii) Legend. (A) If a claim for exemption has been made pursuant to this section, the commodity pool operator must make a statement to that effect on the cover page of each Annual Report.

(B) If the Annual Report is not certified in accordance with Sec. 1.16 and the pool operator will not be preparing a certified Annual Report for a pool's particular fiscal year, the pool operator must ~~make a statement to that effect~~ state on the cover page of each Annual Report that the report is not certified and ~~state~~ that a certified audit will be provided upon the request of the holders of a majority of the units of participation in the pool who are unaffiliated with the commodity pool operator.

(iv) If the commodity pool operator prepares an Annual Report certified by an independent public accountant for a pool's particular fiscal year, the report must be certified in accordance with Sec. 1.16 as applicable. If the commodity pool operator files an Annual Report under section 4.7(b)(3)(i) and then prepares a certified report, it must electronically file the certified Annual Report with National Futures Association at the time it distributes the certified report to pool participants.

(v) Except as otherwise provided below, a commodity pool operator that makes a final distribution of all funds held by a pool must distribute to participants of that pool an Annual Report in conformity with subsections (b)(3)(i)(A)-(C) and (b)(3)(ii) for the fiscal year during which the pool made the final distribution of all pool funds (except that the Statement of Assets and Liabilities shall be as of the first month end after the permanent cessation of trading), and a written notice that all interests in, and assets of the pool have been redeemed, distributed or transferred on behalf of the participants and that no certified Annual Report will be prepared. The Annual Report and notice shall also be electronically filed with National Futures Association within 90 calendar days of the date of the final distribution of all funds held by the pool; *provided, however*, that a commodity pool operator must provide to participants and electronically file with National Futures Association a certified Annual Report upon receiving a request of the holders of a majority of the units of participation in the pool who are unaffiliated with the commodity pool operator.

* * *

§4.13 Exemption from registration as a commodity pool operator.

* * *

(b)(2) The person must file the notice by no later than the time it delivers a subscription agreement for the pool to a prospective participant in the pool; Provided, That where a person registered with the Commission as a commodity pool operator intends to withdraw from registration in order to claim exemption hereunder, the person must represent in the notice of exemption that it has informed ~~notify its~~ the pool's participants in writing: (i) that it intends to withdraw from registration and claim the exemption~~,~~; (ii) whether it will continue to provide an Annual Report to pool participants; (iii) that it will not file with National Futures Association an Annual Report for the fiscal year during which the notice of exemption is submitted and for all subsequent years; and (iv) that ~~it must provide~~ each ~~such~~ participant was informed of its a right to redeem its interest in the pool prior to the ~~person~~ pool operator filing a notice of exemption from registration.

* * *

(d)(1) Each person who applies for registration as a commodity pool operator subsequent to claiming relief under paragraph (a)(1) or (a)(2) of this section must include with its application the financial statements and other information required by §4.22(c)(1) through (5) for each pool that it has operated as an operator exempt from registration. That information must be presented and computed in accordance with generally accepted accounting principles consistently applied. If the person is granted registration as a commodity pool operator, it must comply with the provisions of this part with respect to each such pool.

(2) If a commodity pool operator either withdraws from registration and claims relief under paragraph (a)(3) or (a)(4) of this section or is registered as a commodity pool operator but claims an exemption under paragraph (a)(3) or (a)(4) of this section for one or more of its pools, the commodity pool operator is not required to file an Annual Report pursuant to §4.22(c) for the exempt pool for the fiscal year during which the claim for exemption is filed; provided that the operator includes the representations contained in the written notice to current participants required by (b)(2)(i)-(iv) above.

* * *

(e)(2)(ii) Complies with paragraph (c)(1) of this section; and

* * *

4.22 Reporting to Pool Participants.

(c) Except as provided in paragraph (c)(6) and (f) of this section, section 4.7(b)(3)(v) or section 4.13(d)(2), each commodity pool operator registered or required to be registered under the Act must distribute an Annual Report to each participant in each pool that it operates, and must file a copy of the Annual Report with the National Futures Association, within 90 calendar days after either the end of the pool's fiscal year or the ~~permanent cessation of trading, whichever is earlier, but in no event longer than 90 days after funds are returned to pool participants~~ date of any final distribution of all funds held by the pool, whichever occurs earliest; *Provided, however,* That if during any ~~calendar~~ fiscal year the commodity pool operator did not operate a commodity pool, the pool operator must so notify the National Futures Association within ~~30~~ 90 calendar days after the end of such ~~calendar~~ fiscal year. The Annual Report must be electronically filed and affirmed in accordance with the requirements of National Futures Association's electronic filing system ~~signed pursuant to paragraph (h) of this section~~ and must contain the following:

(1) The net asset value of the pool as of the end of the current year and ~~each of~~ the pool's ~~two~~ preceding fiscal years.

(2)(i) The net asset value per outstanding participation unit in the pool as of the end of ~~each of~~ the current year and the pool's ~~two~~ preceding fiscal years, or (ii) The total value of the participant's interest or share in the pool as of the end of ~~each of~~ the current year and the pool's ~~two~~ preceding fiscal years.

(3) A statement of ~~Financial Condition~~ Assets and Liabilities as of the ~~close~~ end of the pool's current fiscal year and preceding fiscal year.

(4) Statement of Operations ~~Income (Loss), Changes in Financial Position,~~ and Changes in Net Assets ~~Ownership Equity~~, for the period between (i) the later of: (A) the date of the most recent Statement of Assets and Liabilities ~~Financial Condition~~ delivered to National Futures Association ~~the Commission~~ pursuant to this paragraph (c)~~,~~ or (B) ~~January 1, 1979, or (C)~~ the date of the formation of the pool, and (ii) the close of the pool's fiscal year, together with Statements of Operations ~~Income (Loss)~~, ~~Changes in Financial Position,~~ and Changes in Net Assets ~~Ownership Equity~~ for the corresponding period of the pool's previous fiscal year.

* * *

(e)(1) The Statements of ~~Income (Loss)~~ Operations required by this section must itemize brokerage commissions, management fees, advisory fees, incentive fees, interest income, interest ~~and~~ expense, total realized net gain or loss from commodity interest trading, and change in unrealized net gain or loss on commodity interest positions during the pool's fiscal year. Gains and losses on commodity interests need not be itemized by commodity or by specific delivery or expiration date.

(2) Realized and unrealized gains and losses on regulated commodities transactions presented in the Statement of Operations of a commodity pool

may be combined with realized or unrealized gains and losses, respectively, from non-commodity interest trading instruments or contracts, provided that the gains and losses to be combined are part of a related trading strategy.

* * *

(f)(1)(~~i~~) In lieu of the Annual Report required under paragraph (c) of this section, a commodity pool operator that makes a final distribution of funds held by a pool may distribute to participants of that pool unaudited financial statements for the fiscal year during which the pool made the final distribution of funds; Provided, however, that the commodity pool operator must also file with National Futures Association a written notice that all interests in, and assets of, the pool have been redeemed, distributed or transferred on behalf of the participants, and that all participants have waived in writing their rights to receive an audited Annual Report. The financial statements must contain, at a minimum:

(1) A Statement of Assets and Liabilities as of the first month end after the permanent cessation of trading;

(2) Statements of Operations and Changes in Net Assets for the period from the pool's prior fiscal year end to the first month end after the permanent cessation of trading; and

(3) Disclosure of any other material information as may be necessary to make the required report not misleading; and

(f)(2) The financial statements must be presented and computed in accordance with generally accepted accounting principles consistently applied, except that footnote disclosure, a Statement of Cash Flows, and a Schedule of Investments under the American Institute of Certified Public Accountants' Statement of Position 03-4 are not required. The financial statements shall also be electronically filed with National Futures Association within 90 calendar days of the date the pool makes the final distribution of funds held by the pool, and a commodity pool operator must submit copies of the signed waivers by participants to National Futures Association upon request.

~~(f)~~(g)(1) In the event the commodity pool operator finds that it cannot distribute the Annual Report for a pool that it operates within the time specified in paragraph (c) of this section without substantial undue hardship, it may file with the National Futures Association an application for extension of time to a specified date ~~not more than 90 calendar days after the date as of which the Annual Report was to have been distributed~~. The application must be made by the pool operator and must:

* * *

(2) In the event a commodity pool operator finds that it cannot obtain information necessary to prepare an audited or unaudited Annual Report ~~certified financial statements~~ for a pool that it operates within the time specified in ~~either~~ paragraph (c) of this section, ~~or~~ §4.7(b)(3)(i) or §4.12(b)(iii)~~,~~ as a result of the pool investing in another collective investment vehicle, it may claim an extension of time under the following conditions:

(i) The commodity pool operator must, within 90 calendar days of the end of the pool's fiscal year, file a notice with National Futures Association, except as provided in paragraph ~~(f)~~(g)(2)(v) of this section.

(ii) The notice must contain the name, main business address, main telephone number, ~~and the~~ National Futures Association registration identification number of the commodity pool operator, and the name and the identification number of the commodity pool.

(iii) The notice must state the date by which the Annual Report will be distributed and filed (the "Extended Date"), which must be no more than ~~150~~ 180 calendar days after the end of the pool's fiscal year. ~~The Annual Report must be distributed and filed by the Extended Date.~~

(iv) The notice must include representations by the commodity pool operator that:

(A) The pool for which the Annual Report is being prepared has investments in one or more collective investment vehicles (the "Investments");

(B) The commodity pool operator has been informed by the certified public accountant ~~selected~~ engaged to audit the commodity pool's financial statements that specified information establishing the value of the Investments is necessary in order for the accountant to render an opinion on the commodity pool's financial statements. The notice must include the name, main business address, main telephone number, and contact person of the accountant; and

(C) The information specified by the accountant cannot be obtained in sufficient time for the Annual Report to be prepared, audited, and distributed before the Extended Date.

(v) For each fiscal year following the filing of the notice described in ~~(f)~~(g)(2)(i) of this section~~,~~ for a particular pool, it shall be presumed that the particular pool continues to invest in another collective investment vehicle and the commodity pool operator may claim the extension of time; *provided, however,* that if the particular pool is no longer investing in another collective investment vehicle, then the commodity pool operator must electronically file with National Futures Association a certified Annual Report within 90 days after the pool's fiscal year end accompanied by a notice indicating the change in the pool's status. ~~by filing a statement containing the representations specified in paragraph (f)(2)(iv) of this section, at the same time as the pool's Annual Report.~~

(vi) Any notice or statement filed pursuant to paragraph ~~(f)~~(g)(2) of this section must be signed by the commodity pool operator in accordance with paragraph ~~(h)~~(i) of this section.

(3)(i) In the event the commodity pool operator finds that it cannot distribute the Annual Report by the Extended Date set forth in subsection (g)(2) of this section, the commodity pool operator may file with National Futures Association an application for extension of time to a specified date. The application must be made by the pool operator and must:

(A) Contain the name, main business address, main telephone number, ~~and the~~ National Futures Association registration identification number of the commodity pool operator, and the name and the identification number of the commodity pool;

(B) State the reasons for the requested extension;

(C) Indicate that the inability to make a timely filing is due to circumstances beyond the control of the pool operator, if such is the case, and describe briefly the nature of such circumstances;

(D) Contain an undertaking to file the Annual Report on or before the date specified in the application; and

(E) Be filed with National Futures Association prior to the Extended Date.

(ii) For audited annual reports, the application must be accompanied by a letter from the public accountant stating:

(A) The public accountant has read the application and agrees with the representations made by the commodity pool operator; and

(B) There is no information from the part of the audit completed to date that would indicate that the commodity pool operator was or is not complying with the prohibition in §4.20(c) regarding the commingling of property of any commodity pool with the property of any other person.

(iii) Within ten calendar days after receipt of any application for an extension of time, National Futures Association shall:

(A) Notify the commodity pool operator as to whether the requested extension has been granted or denied; or

(B) Indicate to the pool operator that additional time is required to analyze the request, in which case the amount of time needed will be specified.

* * *

~~(g)~~(h)(1) A commodity pool operator may initially elect any fiscal year for a pool, but the first fiscal year may not end more than one year after the pool's formation. For purposes of this section, a pool shall be deemed to be formed as of the date the pool operator first receives funds, securities or other property for the purchase of an interest in the pool.

* * *

~~(h)~~(i)(1) Each Account Statement and Annual Report, including an Account Statement or Annual Report provided pursuant to §4.7(b) or 4.12(b), must contain an oath or affirmation that, to the best of the knowledge and belief of the individual making the oath or affirmation, the information contained in the document is accurate and complete; *Provided, however,* That it shall be unlawful for the individual to make such oath or affirmation if the individual knows or should know that any of the information in the document is not accurate and complete.

* * *

~~(i)~~(j) The Account Statement or Annual Report may be distributed to a pool participant by means of electronic media if the participant so consents; *Provided,* That prior to the transmission of any Account Statement or Annual Report by means of electronic media, a commodity pool operator must disclose to the participant that it intends to distribute electronically the Account Statement or Annual Report or both documents, as the case may be, absent objection from the participant, which objection, if any, the participant must make no later than 10 business days following its receipt of the disclosure.

* * *

~~(j)~~(k)(1) An Account Statement or Annual Report may contain a facsimile signature, *Provided,* That:

* * *

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. Pursuant to a December 18, 2002 Order, the

Commission authorized NFA to maintain and serve as the official custodian of commodity pool operator ("CPO") Annual Reports and, therefore, CPOs are required to file their Annual Reports with NFA in accordance with Commission requirements. NFA is interested in ensuring that CPOs are regulated in the most efficient and effective manner. For the reasons explained below, NFA believes that the proposed changes to Commission Regulations will assist CPOs in complying with the Commission's filing requirements, without sacrificing any customer protections.

III. Supporting Arguments

Over the years, the Commission and NFA have experienced continuing problems with CPOs filing their pool Annual Reports late. Although there are many complicated issues associated with the late filing of these statements, one thing that is clear is that numerous CPOs find it extremely difficult to comply with the deadlines imposed in the current filing requirements. NFA believes that the bulk of the problem with late filings can be addressed through amendments to Commission rules.

In reaching this conclusion, NFA reviewed the 2004 pool statements that were filed late to determine if any patterns exist that might identify solutions to the problem. This analysis showed that most pool financial statements are received within 30 days of the deadline. However, a significant percentage of statements are over 30 days late. For 2004, 33% or 600 statements were filed more than 30 days after the filing deadline. Over ninety percent of these 600 pools were one of three types of pools – a 4.7 exempt pool, including funds of funds, a 4.13 exempt pool, or a liquidated pool. Within these three categories, 4.7 exempt pools accounted for 75% of the statements. Clearly, CPOs offering these types of pools find it difficult to comply with the current regulatory filing requirements.

NFA believes that the following proposed amendments to CFTC Regulations will make it easier for firms to comply with those requirements, without sacrificing any regulatory protections. NFA has discussed these proposed amendments with several public accounting firms, which have also found the current requirements difficult for CPOs to comply with and, therefore, indicated support for the amendments.

4.7 Exempt Pools Including Fund of Funds

CPOs offering 4.7 pools experience difficulties complying with the current requirements' deadlines because they must await valuation information from a third party regarding pool assets prior to preparing and filing statements. CPOs offering funds of funds, which have experienced tremendous growth in the last few years, encounter their own particular problems complying with the current requirements. Although Commission Regulations provide an automatic extension to CPOs offering funds of funds, which extends the due date from March 31st to May 31st and even allows for an extra 30 days to June 30 upon request, many CPOs offering these pools still file their Annual Reports late. These CPOs invest their fund in other funds and, therefore, must rely upon certified statements from these investee pools to complete their own certified statements. Additionally, to further complicate matters, these investee funds can themselves be tiered by being a fund of funds and, therefore, must await certified reports from other investee funds that may or may not have filing deadlines (e.g., off-shore or 4.13 exempt investee pools) to complete and file their own reports.

NFA believes that two issues need to be addressed relating to 4.7 pool Annual Reports. First, in the context of funds of funds, NFA believes it appropriate to amend current Regulation 4.22(f)(2) to lengthen the automatic extension for all fund of funds statements from 60 days to 90 days, with the ability to request additional time if the 90 days is not sufficient. NFA also recommends that the amount of additional time that can be requested due to circumstances beyond the CPO's control be to a specified date, and not be limited to 30 days. NFA must approve each one of these requests and we believe it will be more effective and efficient if pool operators' request the amount of time they believe they need, with NFA retaining the authority to approve or deny these requests.[1]

Lengthening the automatic extension for all fund of funds statements from 60 days to 90 days would primarily benefit single tier funds of funds and reduce the number of their statements filed late. However, this relief is limited and provides little, if any, benefit to a multi-tiered fund of funds that must await statements from its last

[1] NFA believes this logic applies equally to any pool seeking an extension of a filing deadline. Therefore, NFA recommends that 4.22 also be amended to delete the 90 day limit for extensions imposed upon non-fund of funds pools seeking a filing extension (See 4.22(g)(1) formerly 4.22(f)(1).

investee fund to prepare its own Annual Report. NFA considered whether it would be beneficial to simply propose extending the due dates for all funds of funds to 9 months to accommodate these multi-tiered funds. But because such an extension also lengthens the due dates for investee funds of funds and provides no incentive for these investee funds to complete their own financials early, NFA felt that the last pool in the chain of a multi-tiered fund of funds would be in no better position than under the current regulations. In other words, that pool is still relying upon other pools that now have more time to complete their financial reports. Therefore, to provide relief to multi-tiered fund of funds, NFA believes it is critical to provide a more flexible approach for requesting an extension due to circumstances beyond the CPO's control to a specified date beyond the 90 day automatic extension.

As previously noted, of the 600 pool statements more than 30 days late for 2004, 75% are Regulation 4.7 exempt pools and of that percentage, about 40% are fund of funds. NFA therefore believes that extending deadlines should not be the only tool utilized to address the late filing issue for 4.7 pools, including funds of funds, that must rely on others to provide valuation information. CPOs offering 4.7 pools are relieved from the obligation to file an annual certified statement pursuant to Regulation 4.22 provided the CPO, in the alternative, files and distributes an unaudited Annual Report meeting the requirements of Regulation 4.7(b)(3). Unfortunately, certain provisions of that regulation make it impractical for a CPO to file an unaudited Annual Report.

Regulation 4.7(b)(3)'s unaudited Annual Report requirements, particularly those relating to the schedule of investments and appropriate footnote disclosure, are too complicated and simply not workable. Evidence of this can be seen by the fact that for 2004 less than 7% of the over 2,100 pools exempt under Regulation 4.7 availed themselves of this alternative. In addition, most CPOs offering 4.7 pools already have a requirement pursuant to their limited partnership agreements to provide audited statements to the pool's limited partners. Because of the complexity of the current requirement, many of these CPOs would have to incur the expense of hiring a CPA to prepare the interim "simplified" unaudited statement as well as an audited statement.

Given these circumstances, NFA proposes that Regulation 4.7(b)(3) be amended to ensure that the relief contemplated provides a true alternative for CPOs. Specifically, this rule's terms should be simplified to provide an incentive for CPOs to file unaudited financial reports within 90 calendar days of a pool's fiscal year end. Although these reports should be prepared in accordance with generally accepted accounting principles, NFA's proposed amendments to Regulation 4.7(b)(3) provide additional flexibility by eliminating the requirements of footnote disclosures, a Statement of Cash Flows, and a Schedule of Investments under the American Institute of Certified Public Accountants' Statement of Position 03-4. NFA's proposed amendments also require a CPO to file a certified Annual Report with NFA when it distributes the report to pool participants. NFA recognizes that in many instances CPOs would have to do both an unaudited and audited statement but, under the proposed simplified regulatory requirement, the CPO could prepare the unaudited statement itself without incurring the cost of a CPA.

4.13 Exempt Pools

When an existing commodity pool files for an exemption under Regulation 4.13, the pool is required to file a final Annual Report pursuant to Regulation 4.22(c). Thirteen percent of the 600 statements more than 30 days late in 2004 are from existing pools filing an exemption pursuant to Regulation 4.13(a)(3) and (a)(4)'s restrictions on futures trading and investor sophistication. NFA proposes amending Regulation 4.13(d) to provide that if a CPO either withdraws from registration and claims relief under Regulation 4.13 or is registered as a CPO but claims an exemption under Regulation 4.13 for one or more of its pools, the CPO is not required to file an Annual Report pursuant to §4.22(c) for the fiscal year when the claim for exemption is filed. However, the CPO must provide a written notice to current participants that it will not file an Annual Report for that fiscal year and all subsequent fiscal years.

NFA believes that current participants in pools filing an exemption notice pursuant to Regulation 4.13 receive sufficient regulatory protections pursuant to Regulation 4.13(e)(2) prior to the exemption becoming effective and no regulatory purpose is served by requiring these CPOs to file a final Annual Report.

Liquidated Pools

Just under 5% of the 600 pools more than 30 days late in filing an Annual Report for 2004 liquidated and distributed assets to participants. CPOs are reluctant to prepare and file final certified Annual Reports pursuant to Regulation 4.22(c) for these pools because the cost involved merely dilutes the assets that would otherwise be available for distribution to participants.

Over the years, NFA has received few, if any, complaints about pools upon liquidation. Therefore, we believe that relief is warranted with regard to this issue. NFA proposes amending Commission Regulation 4.22 to permit a CPO that makes a final distribution of funds held by a pool to distribute to participants and file unaudited financial statements for the fiscal year during which the pool made the final distribution. This statements must contain, at a minimum: (1) a Statement of Assets and Liabilities as of the first month end after the permanent cessation of trading; (2) Statements of Operations and Changes in Net Assets for the period from the pool's prior fiscal year end to the first month end after the permanent cessation of trading; and (3) disclosure of any other material information. The CPO must also distribute and file with NFA a written notice that all interests in, and assets of the pool have been redeemed, distributed or transferred on behalf of the participants and that all participants have waived in writing their rights to receive an audited Annual Report.

NFA's proposal requires the financial statements to be presented and computed in accordance with generally accepted accounting principles consistently applied, except that footnote disclosure, a Statement of Cash Flows, and a Schedule of Investments under the American Institute of Certified Public Accountants' Statement of Position 03-4 are not required. The Annual Report shall be electronically filed with NFA within 90 calendar days of the date the pool makes the final distribution of funds, and a CPO must submit copies of the signed waiver by participants to NFA upon request.

Since 4.7 exempt pools are limited to qualified eligible persons, NFA proposes a slightly different requirement upon the liquidation of these pools. Specifically, NFA proposes amending Regulation 4.7 to permit a CPO that makes a final distribution of funds held by a pool to distribute to participants and file an unaudited Annual Report for the fiscal year during which the pool made the final distribution. This report would have to meet the same requirements as set forth in proposed Regulation 4.22(f) but the CPO does not have to obtain from the participants a statement that all participants have waived in writing their rights to receive an audited Annual Report. Instead, the CPO would be required to provide to participants and electronically file with NFA a certified Annual Report upon receiving a request of the holders of a majority of the units of participation in the pool who are unaffiliated with the commodity pool operator.

Additional Clarifying Points

NFA also proposes several clarifying amendments to Part 4. For example, NFA also proposes amending Regulation 4.22(c)(1) and (2) to clarify that the comparative basis for the net asset value calculations referenced therein are the pool's current year and its preceding fiscal years. The proposed amendment also delete references to the Statement of Changes in Financial Position as it no longer exists and rename various other financial statements to conform with accounting practices.

III. Request for No-Action Relief

We recognize that, due to the requirements of the Administrative Procedures Act, proposed changes are unlikely to become effective before the 2005 Annual Reports are due. Therefore, we request that the Commission grant no-action relief to pools that comply with the proposed requirements and include that relief in the proposing release.

NFA respectfully requests that the Commission amend Regulations 4.7, 4.13 and 4.22 and provide temporary no-action relief as described above.

Very truly yours,

Thomas W. Sexton, III
Vice President and General Counsel

m:\tws\petition rulemaking cpo filings rev 0106

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521
www.cftc.gov

Office of the Secretariat

February 14, 2006

Mr. Thomas W. Sexton, III
Vice President and General Counsel
National Futures Association
200 West Madison Street
Suite 1600
Chicago, IL 60606

Dear Mr. Sexton:

This is to acknowledge receipt of the petition received by the Commodity Futures Trading Commission on February 13, 2006 for Rulemaking to Amend CFTC Regulations 4.7, 4.13 and 4.22.

This petition has been referred to the Commission for such action as the Commission deems appropriate. You will be notified of any action taken by the Commission on this matter.

Sincerely,

Jean A Webb

Jean A. Webb
Secretary of the Commission

NFA NATIONAL FUTURES ASSOCIATION

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Home > News Center > **Comment Letters**

Comment Letters

2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996

Email This to a Friend

October 09, 2006
Via E-Mail (secretary@cftc.gov)

Ms. Eileen Donovan
Acting Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: RIN 3038-AC34; Proposed Amendments to Rules 1.10 and 1.31

Dear Ms. Donovan:

NFA fully supports the Commission's proposed amendments to its rules that respond to NFA's petition for rulemaking to facilitate the electronic filing of IB financial reports. These amendments will simplify the filing process and allow it to keep pace with technological changes without losing any of the protections provided by the current requirements.

We commend the Commission for its foresight in proposing additional amendments to Rule 1.10(h) to give NFA the flexibility to adopt an electronic filing requirement for IB FOCUS reports without necessitating further changes to CFTC rules. As we mentioned in our petition for rulemaking, our EasyFile system is not yet equipped to handle FOCUS reports, but we hope to add that capability in the future. The proposed amendments will expedite that process.

If you have any questions concerning this letter, please contact me at 312-781-1413 or tsexton@nfa.futures.org.

Respectfully submitted,

Thomas W. Sexton
Vice President and General Counsel

NFA is the premier independent provider of efficient and innovative regulatory programs that safeguard the integrity of the futures markets.
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NFA NATIONAL FUTURES ASSOCIATION

May 23, 2006

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C.F.T.C.
2006 MAY 24 PM 3:03
OFC. OF THE SECRETARIAT

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulations 1.10(b)(2)(iii) and 1.10(c)(2)

Dear Ms. Webb:

National Futures Association (NFA) respectfully petitions the Commission under CFTC Regulation 13.2 to amend CFTC Regulations 1.10(b)(2)(iii) and 1.10(c)(2) to eliminate the requirement that non-broker-dealer introducing brokers (IBs) file manually signed certified financial statements with NFA and replace it with a requirement that these IBs file their certified statements electronically. The information required by CFTC Regulation 13.2 follows.

I. Text of Proposed Rule Amendments

PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

* * *

§ 1.10 Financial reports of futures commission merchants and introducing brokers.

* * *

(b) *Filing of financial reports.*

* * *

(2)

* * *

(iii) A Form 1-FR-FCM or FOCUS Report required to be certified by an independent public accountant in accordance with § 1.16 ~~which is filed by a futures commission merchant, an introducing broker or an applicant for registration in either category~~, must be filed in paper form and may not be filed electronically. A Form 1-FR-IB required to be certified by an independent public accountant in accordance with § 1.16 must be electronically filed and affirmed in accordance with the requirements of National Futures Association's electronic filing system.

* * *

(c) *Where to file reports.*

* * *

(2) Any report filed pursuant to paragraph (b)(1) or (b)(4) of this section or § 1.12(a) which need not be certified in accordance with § 1.16 may be submitted to the Commission in electronic form using a Commission-assigned Personal Identification Number, and otherwise in accordance with instructions issued by the Commission, if the futures commission merchant, introducing broker, or a designated self-regulatory organization has provided the Commission with the means necessary to read and to process the information contained in such report. A Form 1-FR-IB required to be certified by an independent public accountant in accordance with § 1.16 may be submitted to the Commission in electronic form in accordance with instructions issued by the Commission, but the introducing broker must maintain a paper copy of the statement that includes the original, signed certification.

* * *

II. Nature of NFA's Interest

As you know, NFA is a futures association registered under Section 17 of the Commodity Exchange Act. IBs are required to be Members of and are regulated by NFA. Therefore, NFA is interested in ensuring that IBs are regulated in the most efficient and effective manner. NFA believes that requiring non-broker-dealer FCMs to file their Form 1-FR-IB certified financial statements electronically furthers that goal.

III. Supporting Arguments

IBs have been required to file interim financial statements electronically since January 2002, and IBs who file Form 1-FR-IBs make these filings through NFA's EasyFile system. Current CFTC rules do not, however, allow IBs to file their certified statements electronically. NFA believes that electronic filing will facilitate processing certified statements without losing any of the protections provided by CFTC and NFA rules.

Earlier this year, the Commission amended its rules to require commodity pool operators to file their annual financial reports electronically, regardless of whether those reports were certified or uncertified. NFA proposes using the same basic process for certified Form 1-FR-IB filings. In particular, the IB would upload the entire certified statement—including the financial information, footnotes, auditors' statement, and reconciliation (if necessary)—to EasyFile as a pdf document, and the IB would maintain the original signed document in its own files. Since the IB would have already entered the detailed figures from the unaudited Form 1-FR-IB into the system, the IB would not have to enter the figures from the certified statement unless that statement includes a reconciliation. If it does not include a reconciliation, the system would carry over the figures from the uncertified statement for staff's use in analyzing the certified statement.

CFTC Regulation 1.10(b)(2)(iii) currently requires IBs to file certified financial statements in paper form. Therefore, NFA requests that the Commission amend that regulation to require non-broker-dealer IBs to file their certified financial statements electronically with NFA.[1] NFA also requests that the Commission amend CFTC Regulation 1.10(c)(2) to allow electronic filings with the Commission and to require the IB to maintain the original certified statement in its files.

Eliminating the paper filing will not affect any of the protections provided by the Commission's rules. NFA will receive, in pdf format, an electronic copy of the entire certified financial report. Furthermore, the original hard copy report, with the

[1] NFA is not currently asking the Commission to apply the electronic filing requirement to broker-dealer IBs who file FOCUS Reports since EasyFile is not yet equipped to handle FOCUS Reports. We hope to add this capability in the future and will request similar changes at that time.

auditor's certification, will still exist and be available to the Commission and NFA upon request.

NFA respectfully petitions the Commission to amend Regulation 1.10(b)(2)(iii) and 1.10(c)(2) as described above.

Very truly yours,

Thomas W. Sexton, III
Vice President and
General Counsel

(kpc/committee/Petition for rulemaking, IB Certifieds)

Received
CFTC

2017 JUN 23 [illegible]

AIMA

167 Fleet Street, London EC4A 2EA, UK
+44 (0)20 7822 8380
info@aima.org

aima.org

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

23 June 2017

Dear Mr. Kirkpatrick,

Petition for Rulemaking to Harmonise Registration Exemptions for CPOs and CTAs with Registration Exemptions for Investment Advisers

The Alternative Investment Management Association[1] ("AIMA" or the "Petitioner") respectfully petitions the Commodity Futures Trading Commission (the "Commission" or the "CFTC") under CFTC Regulation 13.2 to adopt (i) an exemption from registration as a commodity pool operator ("CPO") under the Commodity Exchange Act ("CEA") that is equivalent to and incorporates the substantive requirements of former CFTC Regulation 4.13(a)(4); (ii) an exemption from registration as a CPO for foreign persons operating commodity pools with limited investment from U.S. persons, similar to the "foreign private adviser" exemption in Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and Rule 202(a)(30)-1 under the Investment Advisers Act of 1940, as amended ("Advisers Act"); (iii) an exemption from registration as a CPO for foreign persons operating commodity pools with a small aggregate net asset value managed at a place of business in the United States, similar to the "private fund adviser" exemption in Title IV of the Dodd-Frank Act and Rule 203(m)-1 under the Advisers Act; and (iv) corresponding exemptions from registration as a commodity trading advisor ("CTA") for advisers to such commodity pools. The Petitioner requests that the Commission adopt the second, third, and fourth proposed exemptions above irrespective of whether it adopts the first proposed exemption. Although the Petitioner's members' strong preference is for the Commission to reinstate CFTC Regulation 4.13(a)(4) in its entirety, the Petitioner believes that, in the alternative, it would be acceptable to its members if the Commission were to adopt an exemption substantially equivalent to former CFTC Regulation 4.13(a)(4) that imposed an additional condition

[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,800 corporate members in over 50 countries. AIMA's manager members collectively manage more than $1.8 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA proactively communicates with the media and the general public to increase awareness around the value of the industry.

requiring that managers either (i) be registered with the U.S. Securities and Exchange Commission ("SEC") as an investment adviser under the Advisers Act[2] or (ii) have no place of business in the United States. In general, the Petitioner respectfully requests that the Commission seek to harmonise Commission registration exemptions for CPOs and CTAs with registration exemptions for investment advisers under the Advisers Act.

The text of the proposed rule amendments is set forth in Appendix A to this letter.

I. Nature of Petitioner's Interest

The Petitioner represents a significant segment of the global investment management industry. For purposes of this petition, the Petitioner represents managers, investment advisers, and sub-advisers to many types of pooled investment vehicles and separate accounts, including hedge funds, many of which trade commodity interests. As a result of the changes to the Part 4 regulations adopted by the Commission in 2012[3] and the adoption of a broad definition of the types of swaps subject to Commission regulation,[4] many of these managers, investment advisers, and sub-advisers registered as CPOs and/or CTAs as of 1 January 2013. Accordingly, they are subject to compliance with the applicable provisions of the CEA and the Commission's regulations thereunder although many have limited numbers of U.S.-based investors that nevertheless do qualify as non-U.S. persons as defined in Regulation 4.7(a)(1)(iv) invested in their commodity pools or advise limited amounts of assets attributable to U.S. clients.

Following passage of the Dodd-Frank Act and the Commission's rescission of CFTC Regulation 4.13(a)(4) in 2012, there is now a significant disparity with respect to the regulation of investment advisers by the SEC and CPOs and CTAs by the Commission. Accordingly, the Petitioner believes that the Commission should take action to harmonise Commission registration exemptions for CPOs and CTAs with registration exemptions for investment advisers under the Advisers Act. Therefore, the Petitioner respectfully requests, on behalf of its members, that the Commission (i) adopt an exemption from registration as a CPO that incorporates the substantive requirements of former CFTC Regulation 4.13(a)(4), (ii) adopt exemptions from registration as a CPO similar to the foreign private adviser and private fund adviser exemptions under the Advisers Act, and (iii) adopt corresponding exemptions from registration as a CTA.

[2] This restriction is one suggested in a letter addressed to Acting Chairman Giancarlo submitted by Managed Futures Association on 6 June 2017. We support the MFA's request for relief under Regulation 4.13(a)(4) specifically, as well as in relation to the rest of the relief requested in that letter more generally.

[3] *See Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252 (24 Feb. 2012) ("Rescission Release"), amended by *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 17328 (26 Mar. 2012).

[4] *Further Definition of "Swap," "Security Based Swap," and "Security Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208 (13 Aug. 2012).

II. Proposed Harmonisation of CFTC Registration Exemptions for CPOs and CTAs with Registration Exemptions for Investment Advisers under the Advisers Act

During the past several years, there have been significant changes made with respect to the regulation of registered investment advisers, CPOs and CTAs. In short, the cumulative result of such regulatory changes is that there is now a notable disparity between the approaches taken by the Commission and the SEC, particularly with respect to the extraterritorial reach of their respective jurisdiction.

Prior to the passage of Title IV of the Dodd-Frank Act, there was a parity of regulatory outcomes between the Commission and the SEC regarding domestic and foreign entities that performed the same types of services for private funds. With regard to the Commission, domestic and foreign managers operating commodity pools often previously relied on the exemption from registration as a CPO provided by CFTC Regulation 4.13(a)(4), as long as the commodity pools they operated offered interests only to natural person investors that were "qualified eligible persons" ("QEPs"), as defined in CFTC Regulation 4.7(a)(2), and non-natural person investors (*i.e.*, institutional investors) that were either QEPs or "accredited investors," as defined in Rule 501(a) of Regulation D under the Securities Act of 1933, as amended ("Securities Act").[5] Similarly, advisers to commodity pools often previously relied on the exemption from registration as a CTA provided by CFTC Regulation 4.14(a)(8)(i)(D), as long as the person's commodity interest trading advice was directed solely to, and for the sole use of, an exempt CPO under CFTC Regulation 4.13(a)(4). With regard to the SEC, in the past, both domestic and foreign managers who served as investment advisers to private funds often relied on the exemption from registration as an investment adviser provided by Section 203(b)(3) of the Advisers Act, as long as such investment advisers (i) had fewer than 15 clients in the preceding 12 months; (ii) did not generally hold themselves out to the public in the United States as an investment adviser; and (iii) did not act as an investment adviser to a registered investment company or business development company.

Passage of the Dodd-Frank Act ushered in a new regulatory regime. Because the Dodd-Frank Act repealed the exemption under Section 203(b)(3) of the Advisers Act, this now required, as a practical matter, all but the smallest domestic fund managers to register as investment advisers or to rely on an alternate exemption. As described further below, Title IV of the Dodd-Frank Act also imposed new limits on the extraterritorial reach of the SEC's jurisdiction by creating new exemptions designed to exclude certain foreign investment advisers from the registration requirements under the Advisers Act: (1) the foreign private adviser exemption, which is codified in Section 203(b)(3) of the Advisers Act and Rule 202(a)(30)-1 thereunder, and (2) the private fund adviser exemption, which is codified in Section 203(m) of the Advisers Act and Rule 203(m)-1 thereunder.[6]

In addition to those changes affecting investment adviser registration under the Advisers Act, the Dodd-Frank Act also broadened the definitions of CPO and CTA to include swaps as a form of

[5] Under CFTC Regulation 4.7(a)(2)(xi), the definition of QEP expressly includes non-United States persons.

[6] *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Advisers Act Rel. No. IA-3222 (22 Jun. 2011), *available at* http://www.sec.gov/rules/final/2011/ia-3222.pdf ("Exemptions Release").

"commodity interest." This substantially increased the number of advisers who would fall within the expanded definitions of CPO and CTA and, therefore, would either need to register as a CPO or CTA or rely on an appropriate exemption. Consequently, the existence in a non-U.S. fund (organised outside of the United States under non-U.S. law) of a single U.S. investor would require the manager or adviser of that non-U.S. fund to register as a CPO and/or CTA or to claim an exemption if the fund engages in a single swap transaction.

Further, on 8 February 2012, the Commission rescinded CFTC Regulation 4.13(a)(4).[7] This had the effect of requiring certain previously exempt managers of commodity pools either to register as CPOs or to claim an alternate exemption. In the proposing release concerning this change, the Commission noted that the rescission of CFTC Regulation 4.13(a)(4), among other amendments, was intended to "limit regulatory arbitrage through harmonization"[8] and to "encourage more congruent and consistent regulation of similarly-situated entities among Federal financial regulatory agencies."[9] However, the actual effect of the rescission was to expand greatly the extraterritorial jurisdictional reach of the Commission, such that it is now substantially broader than that of the SEC, especially vis-à-vis non-U.S. firms. In particular, those non-U.S. CPOs — which the Dodd-Frank Act specifically exempted from registration under U.S. securities laws with regard to their securities activities through adoption of the private fund adviser and foreign private adviser exemptions from investment adviser registration — are now subject to the jurisdiction of the Commission for their commodity interest activities in managing what are, in many cases, the same private funds that are relevant for purposes of determining their eligibility for the private fund adviser and foreign private adviser exemptions. This is the case even where non-U.S. CPOs operate pools that engage in a greater amount of securities activity than commodity interest trading.

The rescission of CFTC Regulation 4.13(a)(4) also had the effect of imposing the burdens and costs of an additional registration regime on domestic and foreign investment advisers that are registered with the SEC. It is inefficient and burdensome for dual-registered firms to have to comply with two similar but slightly different regulatory regimes and we believe the duplication is an unnecessary use of resources.

The Petitioner notes that Acting Commission Chairman J. Christopher Giancarlo, consistent with the Trump Administration's policy pronouncements, has expressed a strong desire to reduce the costs

[7] *See* Rescission Release, *supra* note 3. Further, the Commission also made a corresponding revision to CFTC Regulation 4.14(a)(8)(i)(D), which prevented certain advisers to commodity pools that had been exempt from registration as a CTA from continuing to rely on that exemption. *See id., supra* note 3, at 11284-85.

[8] *Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations*, 76 Fed. Reg. 7976, 7986 (11 Feb. 2011) ("Harmonization Release").

[9] *See id.*, at 7978.

and burdens of government regulation in connection with his Project KISS initiative.[10] The Petitioner further agrees with the Commission's expressed goal to seek "congruent and consistent regulation of similarly-situated entities among Federal financial regulatory agencies." As a result, the Petitioner believes that these objectives would be best achieved by reinstating CFTC Regulation 4.13(a)(4) and harmonising Commission registration exemptions for CPOs (particularly non-U.S.-based CPOs) with registration exemptions for investment advisers under the Advisers Act, as well as by adopting corresponding exemptions for CTAs.

Finally, because the CEA makes a distinction for regulatory purposes between the operator of a commodity pool and the adviser to such pool (whereas the Advisers Act makes no such distinction), the Petitioner requests that the Commission adopt both CPO and CTA exemptions, as described further below.

A. Exemption from CPO Registration Equivalent to Rescinded CFTC Regulation 4.13(a)(4) and Corresponding CTA Exemption

Background

Under former CFTC Regulation 4.13(a)(4), general partners, managers, investment advisers, and sponsors of a private fund that traded commodity interests were each exempt from registration as a CPO if (1) all natural person investors in the fund were QEPs, and (2) all non-natural person investors in the fund were either QEPs or accredited investors. Because the definition of QEP encompasses a "qualified purchaser," as defined under Section 2(a)(51) of the Investment Company Act of 1940 ("1940 Act") and the regulations thereunder, most private funds that were operated in reliance on the exemption in Section 3(c)(7) of the 1940 Act could automatically qualify for the CFTC Regulation 4.13(a)(4) exemption. Further, because the definition of QEP under CFTC Regulation 4.7(a)(2) expressly encompasses non-United States persons, the CFTC Regulation 4.13(a)(4) exemption was particularly important for non-U.S. operators of commodity pools in which all investors were non-United States persons and for commodity pools with a mix of non-United States persons and U.S. qualified purchasers. Similarly, in the past, advisers to such commodity pools often relied on the exemption from registration as a CTA provided by CFTC Regulation 4.14(a)(8)(i)(D), as long as the person's commodity interest trading advice was directed solely to, and for the sole use of, an exempt CPO under CFTC Regulation 4.13(a)(4).

[10] The Trump Administration has issued two executive orders aimed at alleviating unnecessary costs and burdens of government regulations. *See* Exec. Order, Reducing Regulation and Controlling Regulatory Costs (30 Jan. 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling, and Exec. Order, Enforcing the Regulatory Reform Agenda (24 Feb. 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/02/24/presidential-executive-order-enforcing-regulatory-reform-agenda. *See also* "CFTC: A New Direction Forward," Acting Chairman J. Christopher Giancarlo, U.S. Commodity Futures Trading Commission (15 Mar. 2017), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20 (announcing the launch of Project KISS, representing an agency-wide review of Commission rules, regulations and practices to make them simpler, less burdensome, and less costly), and "CFTC Requests Public Input on Simplifying Rules," Release No. PR 7555-17 (3 May 2017), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7555-17 (seeking input from industry, stakeholders, and other interested parties regarding how Commission rules could be simplified and compliance burdens reduced).

Although the Dodd-Frank Act did not direct the Commission to amend or rescind the previously-adopted CPO and CTA registration exemptions and exclusions, the Commission nevertheless elected to rescind CFTC Regulation 4.13(a)(4) and to revise CFTC Regulation 4.14(a)(8)(i)(D).[11] As a result, many previously exempt managers of commodity pools have since been required either to register as CPOs or to claim an alternate exemption (*e.g.*, the CFTC Regulation 4.13(a)(3) de minimis exemption). Certain previously exempt advisers to such commodity pools have been required to undergo an identical process.

Supporting Arguments

The Petitioner believes that the Commission's adoption of an exemption from CPO registration that is equivalent to and incorporates the substantive requirements of former CFTC Regulation 4.13(a)(4), as well as a corresponding CTA exemption, would be consistent with the Commission's expressed goal regarding consistent regulation of similarly-situated entities and would ease the regulatory burden on both formerly exempt entities and on the Commission itself.

In proposing to rescind CFTC Regulation 4.13(a)(4), the Commission stated that,

> for operators of pools that are similarly situated to private funds that previously relied on the exemptions under §§ 3(c)(1) and (7) of the [1940 Act] and § 203(b)(3) of the [Advisers Act] . . . [i]t is the Commission's view that the operators of these pools should be subject to similar regulatory obligations, including proposed Form CPO-PQR, in order to provide improved transparency and increased accountability with respect to these pools.[12]

Further, the Commission also noted that the rescission of CFTC Regulation 4.13(a)(4), among other amendments, was intended to "encourage more congruent and consistent regulation of similarly-situated entities among Federal financial regulatory agencies."[13]

However, following the rescission of CFTC Regulation 4.13(a)(4), the extraterritorial jurisdictional reach of the Commission is now substantially broader than that of the SEC, especially with respect to non-U.S. firms. This regulatory disparity has resulted in an incongruous state of affairs in which certain non-U.S. CPOs and CTAs — that the Dodd-Frank Act specifically exempted with regard to their securities activities through creation of the private fund adviser and foreign private adviser exemptions — are now subject to the Commission's jurisdiction in managing what are often the same private funds that are relevant for purposes of determining their ability to rely on the private fund adviser and foreign private adviser exemptions. Accordingly, the rescission of CFTC Regulation 4.13(a)(4) and the corresponding change to CFTC Regulation 4.14(a)(8)(i)(D) have resulted in circumstances in which operators of, and advisers to, such pools are indeed not "subject to similar regulatory obligations" and are, instead, subject to divergent regulatory schemes between the

[11] *See* Rescission Release, *supra* note 3, at 11284-85.

[12] *See* Harmonization Release, *supra* note 8, at 7986.

[13] *See id.*, at 7978.

Commission and the SEC, often with respect to the same private funds, even if more securities activity than commodity interest trading is involved.

In addition, the rescission of CFTC Regulation 4.13(a)(4) and revision to CFTC Regulation 4.14(a)(8)(i)(D) have also imposed a significant burden on both managers and the Commission itself. With former CFTC Regulation 4.13(a)(4) and CFTC Regulation 4.14(a)(8)(i)(D) now unavailable, it has become more difficult for certain managers — that, again, may be exempt from registration as an investment adviser in reliance on the foreign private adviser or private fund adviser exemptions — to manage portfolio risk effectively without using instruments that would potentially subject them to registration under the CEA. If exemptions substantially similar to CFTC Regulation 4.13(a)(4) and former CFTC Regulation 4.14(a)(8)(i)(D) were not reinstated, it is possible that non-U.S. managers would increasingly preclude all U.S. investors from investing in their funds, even if such persons are sophisticated institutional investors, so as to avoid triggering the requirement to register as a CPO and becoming subject to greater regulation by the Commission as a result. In turn, such a development would further limit investor choice, to the detriment of U.S. investors more broadly.

Further, the Petitioner is not aware of regulatory problems, violations of the CEA or regulations thereunder, or investor complaints during the decade that CFTC Regulation 4.13(a)(4) and former CFTC Regulation 4.14(a)(8)(i)(D) were in effect related to this type of pool. In addition, the Petitioner notes that, if exemptions equivalent to CFTC Regulation 4.13(a)(4) and former CFTC Regulation 4.14(a)(8)(i)(D) were restored, there would still be notice filings for certain exemptions and the exempt operator and adviser would be subject to large trader reporting on behalf of the pool. The Petitioner is also not aware of the Commission finding any issues related to this type of pool being revealed by the filing of Form CPO-PQR. If the Commission had any concerns in that regard, it could presumably use its special call authority to obtain specific data.

Requested Relief

The Petitioner hereby respectfully requests that the Commission adopt an exemption equivalent to CFTC Regulation 4.13(a)(4) (the full text of which can be found in Appendix A),[14] which would exempt managers operating commodity pools from registration as a CPO as long as the commodity pools offered interests only to natural person investors that were QEPs and non-natural person investors

[14] Proposed CFTC Regulation 4.13(a)(4)(i), as found in Appendix A, has been modified slightly from the 2012 text of such section, so as to remain consistent with a no-action letter issued by the Commission's Division of Swap Dealer and Intermediary Oversight granting exemptive relief to CPOs from the requirement in CFTC Regulation 4.13(a)(3)(i) that securities be "offered and sold without marketing to the public," which had as its goal harmonization with Section 4 of the Securities Act and the regulations thereunder, as amended by the Jumpstart Our Business Startups (JOBS) Act. *See* CFTC Letter No. 14-116 (9 Sept. 2014), *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-116.pdf.

that were either QEPs or accredited investors at the time of purchase or binding commitment to purchase.[15]

Although the Petitioner's members' preference is for the Commission to reinstate CFTC Regulation 4.13(a)(4) in its entirety, the Petitioner believes that, in the alternative, it would be acceptable to its members if the Commission were to adopt an exemption substantially equivalent to former CFTC Regulation 4.13(a)(4) that imposed an additional condition requiring that managers either (i) be registered with the SEC as an investment adviser under the Advisers Act or (ii) have no place of business in the United States. The full text of such an alternative exemption can be found in Appendix B. The principal practical difference between this alternative and full reinstatement would be that domestic U.S. investment advisers that are not registered with the SEC would not qualify for relief from CFTC registration requirements under this exemption.

Further, the Petitioner also respectfully requests that the Commission adopt a corresponding exemption from registration as a CTA by revising CFTC Regulation 4.14(a)(8)(i)(D), which is included in Appendix A. As a policy matter, to the extent that a CPO of a commodity pool is exempt, then any sub-adviser to that commodity pool should also be exempt.

B. Exemptions from CPO Registration Similar to the Foreign Private Adviser and Private Fund Adviser Exemptions from Investment Adviser Registration and Corresponding CTA Exemptions

Background

In 2011, the SEC adopted Rule 202(a)(30)-1 under Section 203(b)(3) of the Advisers Act (*i.e.*, the foreign private adviser exemption), which excluded certain foreign investment advisers from the registration requirements under the Advisers Act.[16] To rely on the foreign private adviser exemption, an adviser must: (i) have no place of business in the United States; (ii) have, in total, fewer than 15 U.S. clients (*e.g.*, managed accounts or pooled investment vehicles), including U.S. investors in private funds advised by the investment adviser; (iii) have less than $25 million in aggregate assets under management that are attributable to clients in the United States and U.S. investors in private funds advised by the investment adviser; and (iv) neither hold itself out generally to the public in the United States as an investment adviser nor act as an investment adviser to any registered investment company or business development company.[17]

[15] In the event that proposed CFTC Regulation 4.13(a)(4) were reinstated, eligible managers operating commodity pools could, as a transitional measure, rely on and comply with CFTC Regulation 4.13(e)(2) to transition from operating a pool where they act in a registered capacity to one where they rely on new CFTC Regulation 4.13(a)(4). Similarly, a CTA could transition with respect to some or all of their accounts to the new exemptions the Petitioner has proposed in reliance on CFTC Regulation 4.14(c)(2). Further, provided that a CPO relies on CFTC Regulation 4.13(e)(2)(iii) or a CTA relies on CFTC Regulation 4.14(c)(2), such entity should be permitted to deregister as a CPO or CTA, as applicable, and instead be permitted to rely on the exemptions from registration for all of its pools or accounts. The Petitioner has included revised text of CFTC Regulation 4.13(e) and 4.14(c)(2) to reflect these concepts in Appendix A.

[16] *See* Exemptions Release, *supra* note 6.

[17] *See* 15 U.S.C. § 80b-2(a)(30).

At the same time, the SEC also adopted Rule 203(m)-1 under Section 203(m) of the Advisers Act (*i.e.*, the private fund adviser exemption), which excluded advisers to private funds that manage a limited amount of assets domestically from the registration requirements under the Advisers Act.[18] To rely on the private fund adviser exemption, an adviser must: (i) act solely as an adviser to private funds; and (ii) have less than $150 million in assets under management in the United States.[19] Further, a non-U.S. manager (*i.e.*, with a principal office and place of business outside the United States) is not subject to the registration requirements of the Advisers Act if such manager (i) has no client that is a U.S. person other than a private fund and (ii) all assets managed at a place of business in the United States are solely attributable to private fund assets valued at less than $150 million.[20]

Supporting Arguments

As reflected in the Dodd-Frank Act, Congress has recognised that certain managers — on the basis of their place of business, type of funds advised or amount of assets under management — simply do not warrant triggering the investment adviser registration requirement and, by extension, regulation by the SEC. The foreign private adviser exemption demonstrates that, as a policy matter, certain foreign investment advisers with only a small number of U.S. clients or investors who have invested only a small amount of assets have too insignificant a nexus to the United States to merit extension of the SEC's jurisdictional and regulatory reach. Similarly, the private fund adviser exemption embodies a policy-based decision that advisers solely to qualifying private funds and that manage a relatively limited amount of assets should not be required to register with the SEC as investment advisers.

The Petitioner believes that the same regulatory principles and logic should apply to non-U.S. CPOs and CTAs in the context of regulation by the Commission. The Commission's jurisdiction should be similarly limited with respect to non-U.S. CPOs and CTAs, and the exemptions proposed herein should have the same practical effect for firms. Given the Commission's expressed desire for regulatory consistency, the Petitioner requests that the Commission take action to harmonise CFTC registration exemptions for non U.S. CPOs and CTAs with the foreign private adviser and private fund adviser registration exemptions under the Advisers Act.

With regard to the proposed exemptions from CPO and CTA registration, the Petitioner has provided draft text in Appendix A. As applicable, the suggested language closely mirrors the relevant sections of the corresponding rules under the Advisers Act, but makes minor adjustments to accommodate the differences between investment advisers and CPOs and CTAs as well as the differences between the Advisers Act and the CEA.[21] To ensure consistency with the foreign private adviser exemption and the private fund adviser exemption, the Petitioner believes that it is necessary, for purposes of the

[18] *See* Exemptions Release, *supra* note 6.

[19] *See* 15 U.S.C. § 80b-3(m).

[20] *See* 17 CFR 275.203(m)-1(b).

[21] For example, we have deleted the requirement found in Rule 202(a)(30)-1 under the Advisers Act that the person not advise a registered investment company or business development company, since CPO registration may not be required to advise such entities (only investment adviser registration).

proposed exemptions, to use definitions of certain terms (such as "place of business," "investor," and "in the United States") identical to those under the Advisers Act (including the interpretations the SEC has given to such terms).

Moreover, the SEC has taken certain interpretive positions that further define certain circumstances in which a person who otherwise meets the definitions of "U.S. person" and "in the United States" (as defined generally by reference to Regulation S under the Securities Act) nevertheless need not be counted as such for purposes of determining compliance with, among other things, the foreign private adviser and private fund adviser exemptions. These include circumstances in which the investor: (1) was not a U.S. person or in the United States at the time of any investment in the securities of the issuer but subsequently becomes a U.S. person or is in the United States due to the relocation of the investor;[22] or (2) purchased securities issued by the issuer in an offshore secondary market transaction consistent with Regulation S and not involving the issuer or its agents, affiliates or intermediaries.[23] The Petitioner believes that, by incorporating the SEC's well-understood and long-utilised positions, the proposed exemptions will be easy to understand and implement, will not introduce additional and potentially conflicting interpretations of the definition of a U.S. person, and will assure that there is a consistent extraterritorial application of the requirements. In our view, it would be beneficial for the industry to be able to apply the same methodology for counting inadvertent U.S. investors in order to qualify for both SEC and Commission exemptions, rather than having to comply with divergent standards.

Finally, the Petitioner also believes that, as is the case for the foreign private adviser exemption, this exemption as applied to CPOs should be self-executing. Unlike the proposed reinstated CFTC Regulation 4.13(a)(4) exemption and CPO exemption similar to the private fund adviser exemption, the proposed foreign private adviser exemption would not require that a notice filing be made with the National Futures Association in order to claim that exemption.

Requested Relief

The Petitioner hereby respectfully requests that the Commission adopt exemptions from CPO registration for non-U.S. firms similar to the foreign private adviser and private fund adviser exemptions under the Advisers Act (the full text of which can be found in Appendix A), as well as corresponding exemptions from CTA registration. In particular, the Petitioner requests that the Commission adopt these exemptions irrespective of whether it elects to reinstate exemptions equivalent to CFTC Regulation 4.13(a)(4) and former CFTC Regulation 4.14(a)(8)(i)(D).

III. Conclusion

Following passage of the Dodd-Frank Act and the Commission's rescission of CFTC Regulation 4.13(a)(4), there is now a significant disparity with respect to the regulation of investment advisers, CPOs, and CTAs by the SEC and the Commission, respectively. Accordingly, the Petitioner believes

[22] *See* Exemptions Release, *supra* note 6, at 117-18.

[23] *See Investment Funds Institute of Canada*, SEC No Action Letter (pub. avail. 4 Mar. 1996).

that the Commission should take action to harmonise Commission registration exemptions for CPOs and CTAs with registration exemptions for investment advisers under the Advisers Act. Therefore, the Petitioner requests, on behalf of its members, that the Commission (i) adopt an exemption from registration as a CPO that incorporates the substantive requirements of former CFTC Regulation 4.13(a)(4), (ii) adopt exemptions from registration as a CPO for non-U.S. firms similar to the foreign private adviser and private fund adviser exemptions under the Advisers Act, and (iii) adopt corresponding exemptions for certain CTAs.

* * * *

We sincerely appreciate the Commission's willingness to address the industry's concerns. If you have questions or require further information, please contact Jiří Król of AIMA at +44 (0)20 7822 8380 or our outside counsel at K&L Gates LLP, Cary J. Meer, at (202) 778-9107.

Respectfully submitted,

Jiří Król
Deputy CEO
Head of Governmental and Regulatory Affairs
Alternative Investment Management Association

cc: The Honorable Acting Chairman J. Christopher Giancarlo
The Honorable Commissioner Sharon Bowen
Eileen T. Flaherty, Director
Frank Fisanich, Chief Counsel
Erik F. Remmler, Deputy Director, Registration and Compliance
Amanda Olear, Associate Director, Managed Funds & Financial Reviews
Michael Ehrstein, Special Counsel, Managed Funds & Financial Reviews
Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission
Regina Thoele, Senior Vice President, Compliance, National Futures Association

APPENDIX A

Text of Proposed Rule Amendments

Additions to current regulations in ***bold italics and underlined***. Deletions in ~~**strikethrough**~~.

Section 4.13 is amended by redesignating paragraph (a)(6) as (a)(8) and, as redesignated, revising it, adding new paragraphs (a)(4), (a)(6), and (a)(7), revising paragraphs (b)(1) introductory text, (b)(1)(ii), (e)(2) introductory text, (e)(2)(i) introductory text and (e)(2)(iii), and adding paragraph (g), as follows:

§ 4.13 Exemption from registration as a commodity pool operator.

(a) * * *

(4) For each pool for which the person claims exemption from registration under this paragraph (a)(4):

(i) Interests in the pool are exempt from registration under the Securities Act of 1933, as amended (15 U.S.C. § 77, et seq.), and such interests are offered and sold either (A) without marketing to the public in the United States or (B) pursuant to Section 4 of the Securities Act of 1933, as amended (15 U.S.C. § 77d), and the regulations thereunder;

(ii) The person reasonably believes, at the time of investment (or, in the case of an existing pool, at the time of conversion to a pool meeting the criteria of paragraph (a)(4) of this section), that:

(A) Each natural person participant (including such person's self-directed employee benefit plan, if any), is a "qualified eligible person," as that term is defined in §4.7(a)(2); and

(B) Each non-natural person participant is a "qualified eligible person," as that term is defined in §4.7, or an "accredited investor," as that term is defined in §230.501(a)(1)-(3), (a)(7) and (a)(8) of this title;

Provided, That nothing in paragraph (a)(4) of this section will prohibit the person from claiming an exemption under this section if it additionally operates one or more pools that meet the criteria of paragraph (a)(3) of this section.

* * * * *

(6) That person is a "foreign commodity pool operator," as defined herein.

(7) That person is a commodity pool operator with its principal office and place of business outside the United States if: (1) the commodity pool operator does not serve as a commodity pool operator to any United States person other than a commodity pool that is a private fund, and

(2) the net asset value of all commodity pools that are private funds managed by the commodity pool operator at a place of business in the United States are solely attributable to commodity pools that are private funds, the total value of which are less than $150,000,000; provided that the commodity pool operator has filed notice of its intent to rely on this provision in accordance with paragraph (b) of this section and maintains records in accordance with paragraph (c)(1) of this section.

~~(6)~~ ***(8)***

(i) Eligibility for exemption under paragraph (a)(1), (a)(2), (a)(3)***,*** ~~or~~ (a)(4)***, or (a)(7)*** of this section is subject to the person furnishing in written communication physically delivered or delivered through electronic transmission to each prospective participant in the pool:

(A) A statement that the person is exempt from registration with the Commission as a commodity pool operator and that therefore, unlike a registered commodity pool operator, it is not required to deliver a Disclosure Document and a certified annual report to participants in the pool; and

(B) A description of the criteria pursuant to which it qualifies for such exemption from registration.

(ii) The person must make these disclosures by no later than the time it delivers a subscription agreement for the pool to a prospective participant in the pool.

(b)(1) Any person who desires to claim the relief from registration provided ***in paragraphs (a)(1), (a)(2), (a)(3), (a)(4), or (a)(7) of*** ~~by~~ this section must file electronically a notice of exemption from commodity pool operator registration with the National Futures Association through its electronic exemption filing system. The notice must:

(i) * * *

(ii) Contain the section number pursuant to which the operator is filing the notice (i.e., § 4.13(a)(1), (2), ~~or~~ (3)~~)~~***, (4) or (7))*** and represent that the pool will be operated in accordance with the criteria of that paragraph; and

* * * * *

(e) * * *

(2) If a person operates one or more commodity pools described in paragraph (a)(3) ***or (a)(4)*** of this section, and one or more commodity pools for which it must be, and is, registered as a commodity pool operator, ***or if the person will be eligible to deregister as a commodity pool operator because, after complying with the requirements set forth below, it will be able to rely on***

registration exemptions for all of the pools that it operates, the person is exempt from the requirements applicable to a registered commodity pool operator with respect to ***such*** ~~the~~ pool or pools ~~described in paragraph (a)(3) of this section~~; Provided, That the person:

(i) Furnishes in written communication physically delivered or delivered through electronic transmission to each prospective participant in a pool described in paragraph (a)(3) ***or(a)(4)*** of this section that it operates:

* * * * *

(iii) Provides each existing participant in a pool that the person elects to operate as described in paragraph (a)(3), ***(a)(4), (a)(6) or (a)(7)*** of this section a right to redeem the participant's interest in the pool, and informs each such participant of that right no later than the time the person commences to operate the pool as described in paragraph (a)(3), ***(a)(4), (a)(6) or (a)(7)*** of this section.

* * * * *

(g) Definitions applicable to this section.

(1) The term "foreign commodity pool operator" means any commodity pool operator who:

(i) Has no place of business in the United States;

(ii) Serves as commodity pool operator for, in total, fewer than 15 commodity pools that are private funds established in the United States under U.S. law (including for this purpose investors in the United States in non-United States commodity pools that are private funds), in each case operated by the commodity pool operator;

(iii) Serves as commodity pool operator for commodity pools that are private funds established in the United States under U.S. law (including for this purpose investors in the United States in non-United States commodity pools that are private funds), in each case operated by the commodity pool operator, with an aggregate net asset value attributable to such commodity pools that are private funds (and investors in the case of non-United States commodity pools that are private funds) of less than $25,000,000, or such higher amount as the Securities and Exchange Commission may, by rule, deem appropriate in accordance with the purposes of Section 203(b)(3) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–3 (b)(3)); and

(iv) Does not hold itself out generally to the public in the United States as a commodity pool operator.

(2) The term "private fund" has the same meanings as in Section 202 of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b-2) and regulations of the Securities and Exchange Commission thereunder.

(3) The terms "place of business," "investor" and "in the United States" shall have the meanings associated with such terms for purposes of Section 202(a)(30) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b-2(a)(30)) and regulations of the Securities and Exchange Commission thereunder.

(4) The terms "place of business," "principal office and place of business," "United States" and "United States person" shall have the meanings associated with such terms for purposes of Section 203(m) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b-3(m)) and regulations of the Securities and Exchange Commission thereunder.

(5) Notwithstanding paragraphs (g)(3) and (4) of this section, the following persons do not need to be counted as "United States persons" or as being "in the United States" with respect to a particular commodity pool that is a private fund:

(i) Any person who is a "United States person" or "in the United States" who acquired securities issued by a commodity pool by way of an offshore secondary market transaction not involving the commodity pool or its agents, affiliates or intermediaries; and

(ii) Any person who is not a United States person or in the United States each time such person acquires securities issued by the commodity pool.

Section 4.14 is amended by revising paragraphs (a)(8)(i)(D), (a)(8)(iii)(A) introductory text, (a)(8)(iii)(A)(2), and (a)(8)(iv) introductory text, adding paragraphs (a)(11), (a)(12), revising paragraph (c)(2) and adding paragraph (d), as follows:

§ 4.14 Exemption from registration as a commodity trading advisor.

(a)* * *
(8)* * *
(i)* * *

(D) A commodity pool operator who has claimed an exemption from registration under § 4.13(a)(3)**,** ***4.13(a)(4) or 4.13(a)(7)***, or, if registered as a commodity pool operator, who may treat each pool it operates that meets the criteria of § 4.13(a)(3)***, 4.13(a)(4) or 4.13(a)(7)*** as if it were not so registered.

* * *

(iii)(A) A person who desires to claim the relief from registration provided by this §4.14(a)(8) ***or by § 4.14(a)(12)*** must file electronically a notice of exemption from commodity trading advisor registration with the National Futures Association through its electronic exemption filing system. The notice must:
* * * * *

(2) Contain the section number pursuant to which the advisor is filing the notice (i.e., under §4.14(a)(8)(i) ***or § 4.14(a)(12)***) and represent that it will provide commodity interest advice to its clients in accordance with the criteria of that paragraph or paragraphs; and

* * *

(iv) Each person who has filed a notice of registration exemption under this §4.14(a)(8) ***or § 4.14(a)(12)*** must:
* * *

(11) The person is a "foreign commodity trading advisor," as defined herein.

(12) The person is a commodity trading advisor with its principal office and place of business outside the United States if: (1) the commodity trading advisor does not serve as a commodity trading advisor to any United States person other than a commodity pool that is a private fund, and (2) the net asset value of all commodity pools that are private funds advised by the commodity trading advisor at a place of business in the United States are solely attributable to commodity pools that are private funds, the total value of which are less than $150,000,000; provided that the commodity trading advisor has filed notice of its intent to rely on this provision in accordance with paragraph (a)(8)(iii) of this section and maintains records in accordance with paragraph (a)(8)((iv) of this section;.

* * * * *
(c) ***

(2) If a person provides commodity interest trading advice to a client described in paragraph (a) of this section and to a client for which it must be, and is, registered as a commodity trading advisor, ***or if the person will be eligible to deregister as a commodity trading advisor because, after complying with the requirements set forth below, it will be able to rely on registration exemptions for all of the accounts to which it provides commodity interest trading advice,*** the person is exempt from the requirements applicable to a registered commodity trading advisor with respect to the clients so described; Provided, That the person furnishes in writing to each prospective client described in paragraph (a) of this section a statement that it will provide commodity interest trading advice to the client as if it was exempt from registration as a commodity trading advisor; Provided Further, That the person provides to each existing client described in paragraph (a) of this section a right to terminate its advisory agreement, and informs such client of that right no later than the time

the person commences to provide commodity interest trading advice to the client as if the person was exempt from registration.

(d) Definitions applicable to this section.

(1) The term "foreign commodity trading advisor" means any commodity trading advisor who:

(i) Has no place of business in the United States;

(ii) Serves as commodity trading advisor to, in total, fewer than 15 commodity pools that are private funds established in the United States under U.S. law (including for this purpose investors in the United States in non-United States commodity pools that are private funds) and other U.S. commodity interest trading account clients;

(iii) Serves as commodity trading advisor to commodity pools that are private funds established in the United States under U.S. law (including for this purpose investors in the United States in non-United States commodity pools that are private funds and other U.S. commodity interest trading account clients with an aggregate net asset value attributable to such commodity pools that are private funds (and investors in the case of non-United States commodity pools that are private funds) and other U.S. commodity interest trading account clients of less than $25,000,000, or such higher amount as the Securities and Exchange Commission may, by rule, deem appropriate in accordance with the purposes of Section 203(b)(3) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–3 (b)(3)); and

(iv) Does not hold itself out generally to the public in the United States as a commodity trading advisor.

(2) The term "private fund" has the same meanings as in Section 202 of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–2) and regulations of the Securities and Exchange Commission thereunder.

(3) The terms "place of business," "investor" and "in the United States" shall have the meanings associated with such terms for purposes of Section 202(a)(30) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–2(a)(30)) and regulations of the Securities and Exchange Commission thereunder.

(4) The terms "place of business," "principal office and place of business," "United States" and "United States person" shall have the meanings associated with such terms for purposes of Section 203(m) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–3(m)) and regulations of the Securities and Exchange Commission thereunder.

(5) Notwithstanding paragraphs (d)(3) and (4) of this section, the following persons do not need to be counted as "United States persons" or as being "in the United States" with respect to a particular commodity pool that is a private fund or account:

(i) Any person who is a "United States person" or "in the United States" who acquired securities issued by a commodity pool by way of an offshore secondary market transaction not involving the commodity pool or its agents, affiliates or intermediaries; and

(ii) Any person who is not a United States person or in the United States each time such person acquires securities issued by the commodity pool or contributes further assets to such account.

APPENDIX B

Text of Alternative Proposed Rule Amendments

Additions to current regulations in ***bold italics and underlined***. Deletions in ~~**strikethrough.**~~

Section 4.13 is amended by adding new paragraph (a)(4), as follows.

§ 4.13 Exemption from registration as a commodity pool operator.

(a) * * *

(4) For each pool for which the person claims exemption from registration under this paragraph (a)(4):

(i) Interests in the pool are exempt from registration under the Securities Act of 1933, as amended (15 U.S.C. § 77, et seq.), and such interests are offered and sold either (A) without marketing to the public in the United States or (B) pursuant to Section 4 of the Securities Act of 1933, as amended (15 U.S.C. § 77d), and the regulations thereunder;

(ii) The person reasonably believes, at the time of investment (or, in the case of an existing pool, at the time of conversion to a pool meeting the criteria of paragraph (a)(4) of this section), that:

(A) Each natural person participant (including such person's self-directed employee benefit plan, if any), is a "qualified eligible person," as that term is defined in §4.7(a)(2); and

(B) Each non-natural person participant is a "qualified eligible person," as that term is defined in §4.7, or an "accredited investor," as that term is defined in §230.501(a)(1)-(3), (a)(7) and (a)(8) of this title;

(iii) The person either:

(A) Is registered as an investment adviser pursuant to Section 203 of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b-3); or

(B) Has no place of business in the United States, as such term is defined in Section 202(a)(30) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b–2(a)(30)) and regulations of the Securities and Exchange Commission thereunder.

Provided, That nothing in paragraph (a)(4) of this section will prohibit the person from claiming an exemption under this section if it additionally operates one or more pools that meet the criteria of paragraph (a)(3) of this section.

Invesco

Invesco Capital Management LLC
3500 Lacey Road
Suite 700
Downers Grove, IL 60515

Telephone 630 933 9600
www.invesco.com

September 28, 2023

Mr. Christopher Kirkpatrick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Petition for Rulemaking under Commodity Futures Trading Commission Regulation 1.25

Dear Mr. Kirkpatrick:

Invesco Capital Management LLC ("**Invesco**" or the "**Petitioner**"), a commodity pool operator and commodity trading advisor registered with the U.S. Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") and an investment adviser registered with the U.S. Securities and Exchange Commission ("**SEC**"), respectfully submits this petition for rulemaking ("**Petition**") to amend Commission Regulation 1.25 ("**CFTC Regulation 1.25**"). As explained in detail below, the Petition seeks to amend CFTC Regulation 1.25 (the "**Amendment**") to permit futures commission merchants ("**FCMs**") and derivatives clearing organizations ("**DCOs**" and together with FCMs, "**Clearing Entities**") that satisfy the terms and conditions of CFTC Regulation 1.25, including specific conditions contained in the Amendment (such Clearing Entities being "**Eligible Entities**"), to invest customer funds in exchange-traded funds ("**ETFs**") that invest their assets only in short-term U.S. Treasury Obligations (Treasury bills, notes, or bonds with a maximum remaining term to maturity of 12 months) and cash, subject to the terms and conditions specified herein ("**Qualified Treasury ETFs**").

I. Summary of Proposed Amendment

The Petitioner is requesting the Amendment to allow Clearing Entities to invest customer funds in Qualified Treasury ETFs because the amendment will: (1) provide Clearing Entities with additional investment choices for customer funds, promote operational efficiencies and offer potentially better investment returns for Clearing Entities, and their customers, with respect to customer fund investments, and facilitate financial market innovation; (2) enable customers to receive protections under the CFTC's customer funds protection rules for an additional category of investment instrument; and (3) be consistent with, and promote, the public interest goals enumerated in the Commodity Exchange Act (the "**Act**").

Under Section 4d of the Act and CFTC Regulations 1.25, 22.2(e)(1), 22.3(d), 30.7(h), and 39.15(e), Clearing Entities are restricted in the types of instruments in which they may invest futures customer segregated funds, cleared swaps customer collateral, and the foreign futures or foreign options secured amount (collectively, "**Customer Funds**")[1] to a list of specified instruments ("**permitted investments**") that are highly liquid and are not subject to a material risk of loss of principal. Shares of ETFs are currently not included in the list of permitted investments. Invesco is the sponsor of various short-term Treasury ETFs, including the Invesco Short Term Treasury ETF ("**TBLL**"),

[1] *See* 17 C.F.R. §§ 1.3, 22.1, and 30.7 (defining futures customer funds, cleared swaps customer collateral, and the foreign futures or foreign options secured amount).

among other Qualified Treasury ETFs, and wishes to permit Eligible Clearing Entities to invest Customer Funds in TBLL, and any other Qualified Treasury ETF offered by Invesco or other sponsors that satisfies the terms and conditions specified herein. Accordingly, Invesco respectfully requests the Commission to amend CFTC Regulation 1.25 to include such Qualified Treasury ETFs in the list of permitted investments.

Invesco believes that there are significant benefits to be gained from making shares of Qualified Treasury ETFs ("**Shares**") available to Clearing Entities for investment of Customer Funds. For example, Qualified Treasury ETFs will provide Clearing Entities with a new investment option for Customer Funds without compromising the Commission's customer protection regime. This is because the Qualified Treasury ETFs are comprised of a sub-set of the same high-quality liquid instruments that are otherwise permitted under the Act and CFTC Regulation 1.25 (i.e., U.S. government securities). Moreover, the current list of permitted investments already contemplates indirect investment of Customer Funds in U.S. Treasury Obligations through an investment vehicle that invests in such securities because CFTC Regulation 1.25 allows Clearing Entities to invest Customer Funds in government money market funds. In addition, as explained below, investing in a Qualified Treasury ETF is much simpler, less burdensome, and cost-efficient for a Clearing Entity than identifying, investing in, and administering investments in individual U.S. Government Treasury securities. There is also the possibility that Qualified Treasury ETFs will provide Clearing Entities and their customers with better investment returns than direct investments in selected underlying U.S. Treasury Obligations. Finally, the design of Qualified Treasury ETFs and characteristics such as price and investment transparency and intra-day exchange trading and liquidity are additional features that help make the Shares a safe and efficient vehicle for investment by Clearing Entities of Customer Funds.

This Petition is based upon the Petitioner's experience sponsoring Qualified Treasury ETFs and its familiarity with such instruments, analysis of the Commission's protections for investment of Customer Funds by Clearing Entities, and discussions with Clearing Entities themselves. As a result of its review, the Petitioner has determined that there is considerable interest in, and support and justification for, Clearing Entities being permitted to invest Customer Funds in Qualified Treasury ETFs. Accordingly, Petitioner requests that the Commission adopt the Amendment.

II. Regulatory Background and Basis for Petition

a. Customer Protection under Section 4d and 4(b) of the Act

The Act and CFTC regulations promulgated thereunder provide a comprehensive customer protection regime with which Clearing Entities must comply. The customer protection regime applies to Customer Funds and the investments that a Clearing Entity may make with such funds. Section 4d(a)(2) of the Act provides in relevant part that futures customer segregated funds "may be invested in obligations of the United States, in general obligations of any State or of any political subdivision thereof, and in obligations fully guaranteed as to principal and interest by the United States, such investments to be made in accordance with such rules and regulations and subject to such conditions as the Commission may prescribe."[2] Similarly, Section 4d(f) governs cleared swaps customer collateral, and includes a provision regarding the investment of such collateral identical to the provision in Section 4d(a)(2), cited above.[3] The Commission's customer funds protection regime also covers the foreign futures and foreign options secured amount pursuant to its plenary authority under Section 4(b) of the Act, and the Commission's regulations limit the types

[2] 7 U.S.C. § 6d(a)(2).

[3] *Id.* § 6d(f)(4).

of investments that a Clearing Entity may make with secured amount funds to those enumerated in CFTC Regulation 1.25, as set forth below.[4]

b. Permitted Investments of Customer Funds under CFTC Regulation 1.25, 22.2(e)(1), 22.3(d), 30.7, and 39.15(e)

Pursuant to the statutory authority described above, the CFTC has promulgated Regulations 1.25, 22.2(e)(1), 22.3(d), 30.7, and 39.15(e) enumerating the types of permitted investments in which a Clearing Entity may invest Customer Funds. Specifically Clearing Entities may currently invest Customer Funds in: U.S. government securities, municipal securities, U.S. agency obligations, certificates of deposit, and commercial paper, corporate notes and bonds fully guaranteed by the U.S. under the Temporary Liquidity Guaranty Program administered by the Federal Deposit Insurance Corporation ("**FDIC**"), interests in certain government money market funds, and agreements for resale or repurchase of the foregoing instruments (i.e., repurchase agreements and reverse repurchase agreements).[5] The Commission has, from time to time, reviewed and modified the list of permitted investments. For example, the CFTC permitted Clearing Entities to enter into repurchase agreements using Customer Funds in interpretative relief that CFTC Staff issued in 1984, expanded the relief in 1993 to include reverse repurchase agreements provided that the underlying securities had a maturity of 180 days or less, and ultimately codified the relief in large part in 2000 and 2004 with amendments to CFTC Regulation 1.25.[6] In addition, CFTC Staff has issued no-action relief to a clearing house (CME Clearing) to expand the scope of permitted investments to include an interest earning facility that invested in short-term U.S. government securities.[7]

The CFTC requires that all permitted investments must satisfy specific standards, and imposes restrictions on certain types of permitted investments, that are intended to assure that the permitted investments are low risk and highly liquid, as set forth below:

- *Liquidity*. A permitted investment must be highly liquid, with the ability to be converted into cash within one business day without material discount in value.[8]
- *Time to maturity*. A permitted investment's time to maturity must not be greater than 24 months (with the exception of investments in money market funds).[9]
- *Concentration Limits*. Investments in a permitted investment are subject to specified asset-based and issuer-based concentration limits.[10] Investments in U.S. government securities, however, are not subject to these concentration limits.

[4] *Id.* § 6(b); 17 C.F.R. § 30.7(g).

[5] 17 C.F.R. § 1.25(a).

[6] CFTC Interpretative Letter 84-24 (Dec. 5, 1984); Division of Trading and Markets Financial and Segregation Interpretation No. 2-1 (Dec. 15, 1993); Rules Relating to Intermediaries of Commodity Interest Transactions, 65 Fed. Reg. 77,993 (Dec. 13, 2000) (publishing final rules); Investment of Customer Funds, 65 Fed. Reg. 82,270 (Dec. 28, 2000) (making technical corrections and accelerating effective date of final rules from February 12, 2001 to December 28, 2000); Investment of Customer Funds, 69 Fed. Reg. 6,140 (Feb. 10, 2004).

[7] CFTC Interpretative Letter No. 96-78 (Oct. 28, 1996).

[8] 17 C.F.R. § 1.25(b)(1).

[9] *Id.* § 1.25(b)(4).

[10] *Id.* § 1.25(b)(3). CFTC Regulation 1.25(b)(3)(i)(A) provides that investments in U.S. government securities "shall not be subject to a concentration limit."

- *Investments in Affiliates*. A Clearing Entity is prohibited from investing Customer Funds in obligations of an entity affiliated with such Clearing Entity. However, a Clearing Entity may invest Customer Funds in a money market fund that is affiliated with that Clearing Entity.[11]
- *Prohibitions*. In addition, a permitted investment may not:
  - contain interest-only payment features;
  - provide payments linked to a commodity, currency, reference instrument, index, or benchmark, with the exception of certain adjustable rate securities; and
  - with the exception of money market funds, contain an embedded derivative.[12]

In addition, money market funds are subject to other terms, conditions and prohibitions.[13]

Currently, Clearing Entities and other derivatives market participants, such as swap dealers and their swap counterparties, are subject to various regulatory requirements regarding the use of high-quality liquid collateral: initial margin requirements for cleared futures and swaps, both of which require an FCM to set aside a targeted residual interest amount of its own funds in the customer account, and initial margin requirements for uncleared swaps, as well as applicable Basel III liquidity coverage ratios and other regulatory capital requirements. As such, the need for high-quality liquid collateral is substantial and is exacerbated in events of stress in the financial system. In addition to the increased demand for high-quality liquid collateral for uncleared swaps and Basel III requirements, existing collateral alternatives may not be acceptable or may present operational challenges (e.g., cash is expensive to maintain on a bank's balance sheet, Clearing Entities face operational challenges in connection with rolling Treasury bills and maintaining multiple CUSIPs, and money market funds must be transferred via a transfer agent which also gives rise to operational challenges).

For the reasons stated above, the Petitioner has observed that Clearing Entities need a greater number of high-quality liquid collateral options. One way to provide these additional alternatives is through the expansion of permitted investments to include Qualified Treasury ETFs. Although Qualified Treasury ETFs are not enumerated as permitted investments, such instruments are economical equivalents to a subset of the current list of permitted investments, namely government

[11] *Id.* § 1.25(b)(5).

[12] *Id.* § 1.25(b)(2).

[13] Money market funds are subject to additional conditions; they must comply with the requirements identified above, subject to certain exceptions, as well as the following requirements: (1) the fund must be an SEC-registered investment company pursuant to the Investment Company Act of 1940 and hold itself out to investors as a money market fund in accordance with SEC Rule 2a-7; (2) the fund's sponsor must be a federally regulated financial institution, a bank, an SEC-registered investment adviser, or a domestic branch of a foreign bank insured by the FDIC; (3) with certain exceptions, the fund must be legally obligated to redeem an interest and make payment in satisfaction of the redemption by the business day following a redemption request, and a Clearing Entity must retain documentation to support compliance with this requirement; (4) the fund's net asset value must be computed by 9:00 a.m. of the business day following each business day, and be made available to the Clearing Entity by such time; (5) a Clearing Entity must maintain the confirmation relating to the purchase in its records in accordance with the CFTC's general recordkeeping rule (CFTC Regulation 1.31) and must note the ownership of fund shares (by book-entry or otherwise) in a custody account of the Clearing Entity pursuant to CFTC Regulation 1.26; (6) a Clearing Entity must obtain the acknowledgment letter (in the template form required pursuant to CFTC Regulation 1.26) from an entity that has substantial control over the fund shares purchased with customer funds and has the knowledge and authority to facilitate redemption and payment or transfer of the Customer Funds (i.e., a depository acting as custodian or the fund sponsor); (7) the agreement pursuant to which the Clearing Entity has acquired and is holding its interest in the fund must not contain a provision that prevents the pledging or transferring of shares; and (8) the fund must be a "non-electing government money market fund" that is subject to the conditions of CFTC Letter Nos. 16-68 and 16-69.[13] *See* 17 C.F.R. § 1.25(c); Division of Swap Dealer and Intermediary Oversight, CFTC, No-Action Relief, CFTC Letter No. 16-68 (Aug. 8, 2016); Division of Clearing and Risk, CFTC, Interpretation, CFTC Letter No. 16-69 (Aug. 8, 2016).

securities, and can otherwise comply with the conditions of CFTC Regulation 1.25 while providing an efficient, liquid and safe investment alternative to Clearing Entities.

III. Description of Qualified Treasury ETFs

a. Overview of ETFs

The following provides a general overview of ETFs, but it should be noted that the proposed amendment would permit a Clearing Entity to invest Customer Funds only in ETFs that are Qualified Treasury ETFs. An ETF is a type of security that is similar to a mutual fund (and may be an investment company registered under the Investment Company Act of 1940, as amended ("**Investment Company Act**")), pooling money from investors and investing these funds in stocks, bonds, short-term money market instruments, derivatives, other securities or assets, or some combination of these investment instruments (although as noted above, Qualified Treasury ETFs will invest only in short-term U.S. Treasury Obligations and cash). An ETF's shares are registered with the SEC under the Securities Act of 1933, as amended ("**Securities Act**"), regulated under the Securities Exchange Act of 1934, as amended ("**Exchange Act**"), listed on one or more national securities exchanges registered with the SEC pursuant to Section 6 of the Exchange Act, 15 U.S.C. § 78f ("**National Securities Exchange**"), and traded throughout the day like other exchange-listed securities. Unlike mutual funds, however, the price of an ETF's shares on a National Securities Exchange fluctuates throughout the day and shares may be bought and sold throughout the trading day through a National Securities Exchange (whereas mutual funds may only be bought or sold once a day after the markets close).

For further clarity, below is an explanation of: (1) other attributes of ETFs generally, such as the role of specific market participants that have entered into an agreement with the ETF ("**Authorized Participants**" or "**APs**"), the way ETF shares are offered and the secondary trading of the shares, the financial reporting requirements applicable to an ETF, and liquidity risk management program requirements applicable to most ETFs; (2) specific attributes of Qualified Treasury ETFs, such as the regulatory registration status of a Qualified Treasury ETF and eligible assets in which a Qualified Treasury ETF may invest; and (3) the conditions an Eligible Entity must satisfy to purchase Shares as an Authorized Participant.

b. Offering of ETF Shares

i. The Role of Authorized Participants

An ETF offers its Shares to Authorized Participants, who purchase and redeem blocks of a specified amount of shares (each block, a "**Creation Unit**") pursuant to the Authorized Participant Agreement ("**AP Agreement**") entered into between the ETF and each Authorized Participant. Creation Units may be created or redeemed only by Authorized Participants, who must: (1) be an SEC-registered broker-dealer or other securities market participant (such as a bank or other financial institution that is not required to register as a broker-dealer to engage in securities transactions); (2) be a full participating member of the National Securities Clearing Corporation ("**NSCC**") and the Depository Trust Company ("**DTC**"); and (3) have entered into an AP Agreement with the ETF (and potentially other parties, such as the ETF's sponsor, distributor or transfer agent).

Authorized Participants play a key role in the primary market for ETF shares because they are the only investors that are allowed to transact directly with the ETF. Authorized Participants do not receive compensation from an ETF or its sponsor and have no legal obligation to create or redeem shares. Their activity is driven either by client demand or proprietary trading activity. Authorized Participants can choose to create or redeem shares as they build positions, or they can choose to build up or unwind their ETF positions in the secondary market in their discretion. Also, Authorized

Participants create and redeem Shares in the primary market when doing so is a more effective way of managing a firm's aggregate exposure than trading in the secondary market. Some Authorized Participants are clearing brokers (rather than dealers) and receive payment for processing creations and redemptions as an agent for a wide array of market participants such as registered investment advisers and various liquidity providers, including market makers, hedge funds, and proprietary trading firms.

An AP Agreement typically will set forth the procedures for the creation and redemption of Creation Units and for the delivery of cash or securities required for such creations or redemptions, as also described in an ETF's prospectus. Generally, a Qualified Treasury ETF offers and redeems Shares with settlement on the same day (if creation or redemption orders are received before 12:00 p.m. Eastern time) or the next business day (if creation or redemption orders are received on or after 12:00 p.m. Eastern time) at the net asset value ("**NAV**") next calculated in Creation Units in exchange for the deposit or delivery of a basket of securities. In addition, a third party (for example, the ETF's administrator, such as a large institutional bank) generally calculates the ETF's NAV twice per business day at 12:00 p.m. Eastern time and at the close of regular trading (typically at 4:00 p.m. Eastern time) when the National Securities Exchange is open.

ii. Secondary (Exchange) Trading of the Shares

In addition to the availability of ETF shares being sold by the ETF to Authorized Participants through the Creation Unit order process, individual shares of ETFs may be purchased and sold on a National Securities Exchange by the general investing public through registered broker-dealers. Shares that are traded on a National Securities Exchange trade at market prices rather than NAV. Therefore, shares may trade at a premium or discount in relation an ETF's NAV. However, because Authorized Participants have the ability to arbitrage small differences between the ETF's share price on the National Securities Exchange and the NAV (e.g., the Authorized Participant can purchase shares on the National Securities Exchange at a discount and deliver them to the ETF at NAV), any premiums or discounts tend to be small. This effect is particularly true for ETFs whose underlying assets are highly liquid, such as is the case for Qualified Treasury ETFs.

c. Regulatory Requirements Applicable to ETFs, such as Qualified Treasury ETFs

i. Periodic Financial Reporting Requirements under the Investment Company Act

As an investment company registered under the Investment Company Act whose shares are registered under the Securities Act and Exchange Act, ETFs must comply with a number of financial reporting requirements, including the following reports required pursuant to the Investment Company Act: (1) annual shareholder report, including audited financial statements, filed on Form N-CSR;[14] (2) semi-annual shareholder report, including unaudited financial statements, filed on Form N-CSR;[15] (3) monthly portfolio statistics and holdings filed quarterly on Form N-PORT;[16] (4) annual census report containing financial-related information filed on Form N-CEN;[17] and

[14] 17 C.F.R. § 270.30e-1; https://www.sec.gov/files/2017-03/formn-csr.pdf. Form N-CSR is a combined reporting form that is to be used for reports of registered management investment companies under Section 30(b)(2) of the Investment Company Act and Section 13(a) or 15(d) of the Exchange Act, filed pursuant to Rule 30b2-1(a) under the Investment Company Act (17 C.F.R. § 270.30b2-1(a)).

[15] *Id.*

[16] 17 C.F.R. § 270.30b1-9; https://www.sec.gov/files/formn-port.pdf.

[17] 17 C.F.R. § 270.30a-1; https://www.sec.gov/files/formn-cen-info.pdf.

(5) periodic reports with respect to portfolio liquidity and derivatives use on Form N-RN.[18] As an Exchange Act Section 12 registrant, an ETF would be subject to financial reporting under the Exchange Act if it were not excused from these requirements by virtue of its registration under the Investment Company Act.[19]

ii. Liquidity Risk Management Program (Rule 22e-4 under the Investment Company Act)

The current formulation of SEC Rule 22e-4 under the Investment Company Act requires an open-end management investment company that is registered with the SEC, including a Qualified Treasury ETF, to adopt and implement a liquidity risk management program ("**LRMP**") that is reasonably designed to assess and manage its liquidity risks.[20] The rules define "liquidity risk" to mean "the risk that the fund could not meet requests to redeem shares issued by the fund without significant dilution of remaining investors' interests in the fund."[21]

Under the SEC's rules, an LRMP must include specific elements, including: (1) assessment, management, and periodic review of a fund's liquidity risk, with specific considerations;[22] (2) classification of the liquidity of fund portfolio investments on at least a monthly basis into one of four categories (highly liquid investments, moderately liquid investments, less liquid investments, and illiquid investments); (3) with regard to a fund that does not primarily hold assets that are highly liquid investments, determine a highly liquid investment minimum; (4) procedures related to the acquisition of illiquid investments; and (5) with regard to a fund that engages in (or reserves the right to engage in) redemptions in kind, policies and procedures regarding how and when it will engage in such redemptions in kind. When a fund's level of illiquid investments exceed 15 percent of the fund's total assets, or when a fund's highly liquid investments fall below the fund's prescribed minimum for more than a short period of time, the fund must confidentially report this information to the SEC on Form N-LIQUID.

A fund's board of trustees must have oversight over the fund's LRMP, meaning that that the board of trustees must initially approve the program itself as well as the designation of the person (or persons) responsible for administering the program and preparing a written report at least annually that satisfies the criteria in the regulation.[23] Moreover, the fund's board of trustees must perform a review of the designated person's written reports at least annually.[24] A fund also must comply with the rule's recordkeeping obligations.

d. Eligible Assets in which a Qualified Treasury ETF May Invest

Pursuant to the Amendment, the assets in which a Qualified Treasury ETF may invest would be consistent with the Act and CFTC regulations. The investment objective and strategy of a Qualified

[18] 17 C.F.R. § 270.30b1-10; https://www.sec.gov/files/formn-liquid.pdf.

[19] For example, a Qualified Treasury ETF is not subject to Forms 10-K, 10-Q, and 8-K under the Exchange Act. *See*, *e.g.*, 15 U.S.C. §§ 78m, 78n, and 78p.

[20] 17 C.F.R. § 270.22e-4.

[21] *Id.* § 270.22e-4(a)(11).

[22] For example, an ETF must consider in its assessment, management, and periodic review of its liquidity risk: "(1) The relationship between the ETF's portfolio liquidity and the way in which, and the prices and spreads at which, ETF shares trade, including, the efficiency of the arbitrage function and the level of active participation by market participants (including authorized participants); and (2) The effect of the composition of baskets on the overall liquidity of the ETF's portfolio." *Id.* 270.22e-4(b)(1)(i)(D).

[23] *Id.* 270.22e-4(b)(2).

[24] *Id.*

Treasury ETF is disclosed in its prospectus. Qualified Treasury ETFs permitted under the Amendment would be limited to those that invest in solely in: (i) highly liquid U.S. Treasury Obligations with a maturity of 12 months or less; and (ii) cash. Although ETFs that track indexes often have a policy of investing least 80 or 90 percent of the value of their assets in components of the applicable index (e.g., a short term treasury ETF may have a policy to invest at least 80% of its assets in U.S. Treasury Obligations with maturities of 12 months or less), the Petitioner believes a higher standard for Qualified Treasury ETFs (i.e., 100% of assets being invested in U.S. Treasury Obligations with maturities of 12 months or less and/or cash) is appropriate for the principles and purposes of the Amendment and CFTC Regulation 1.25.

As previously noted, Sections 4d(a) and 4d(f) of the Act explicitly permit a Clearing Entity to invest Customer Funds in obligations of the United States and CFTC Regulation 1.25 allows a Clearing Entity to invest Customer Funds in "government securities" (defined to include obligations of the United States and obligations fully guaranteed as to principal and interest by the United States). [25] The Amendment would allow Eligible Entities to invest in government securities, albeit indirectly through an investment instrument that is itself liquid and compliant with the other conditions of CFTC Regulation 1.25.

e. Clearing Entity Eligibility Requirements

To comply with the regulatory requirement that investments be "highly liquid", an investment must have the ability to be converted into cash within one business day without a material discount in value. [26] Accordingly, to ensure same day liquidity, the Petitioner proposes that a Clearing Entity must satisfy certain criteria to invest Customer Funds in a Qualified Treasury ETF. Under the Amendment, a Clearing Entity must be an Authorized Participant that has entered into an AP Agreement with a Qualified Treasury ETF, giving it the ability to transact directly with the Qualified Treasury ETF in a manner that settles same day, or have an agency agreement with an Authorized Participant.[27] In addition, the Clearing Entity must comply with the Qualified Treasury ETF's Creation Unit purchase and redemption order procedures, subject to the pricing mechanism available to an Authorized Participant and in compliance with the specified settlement methods.

i. Clearing Entity must be an Authorized Participant of a Qualified Treasury ETF (Eligible Entity)

To invest Customer Funds in Qualified Treasury ETFs, an Eligible Entity must satisfy certain criteria. It must be an Authorized Participant or have an agency agreement with an Authorized Participant that has entered into an AP Agreement with a Qualified Treasury ETF. As detailed above, an Authorized Participant must be a registered, self-clearing broker-dealer that can process all required trade submission, clearance, and settlement transactions on its own account and must be a full participating member of the NSCC and DTC. A Clearing Entity that satisfies these criteria is considered an Eligible Entity.

ii. Creation Basket and Pricing

An Eligible Entity will receive a Creation Unit in exchange for U.S. Treasury Obligations or U.S. dollars when it purchases a Creation Unit pursuant to the procedures in the AP Agreement through its agency relationship with its AP. The purchase price must be based on the Qualified Treasury

[25] 7 U.S.C. §§ 6d(a)(2), 6d(f)(4); 17 C.F.R. § 1.25(a)(1)(i).

[26] 17 C.F.R. §1.25(b)(1).

[27] While FCMs often serve as APs, this is generally not the case for DCOs. DCOs, however, often have contractual agency relationships with FCMs.

ETF's next-calculated NAV per Shares as determined in accordance with the Qualified Treasury ETF's pricing procedures adopted in accordance with the Investment Company Act.

iii. Redemption Basket and Pricing

An Eligible Entity will receive U.S. dollars when it redeems a Creation Unit, the price of which must be based on the Qualified Treasury ETF's next-calculated NAV per Share as determined in accordance with the Qualified Treasury ETF's pricing procedures adopted in accordance with the Investment Company Act.

iv. DVP Settlement Method Requirements

The AP Agreement between an Eligible Entity and a Qualified Treasury ETF must stipulate to the settlement method of Creation Units orders. Pursuant to a Delivery Versus Payment ("**DVP**") settlement, an Eligible Entity will not transfer payment or securities until it has received Shares or cash. For purchases of Creation Units, the exchange of assets must occur on a DVP basis (meaning that the Eligible Entity receives the Shares immediately prior to the receipt of payment by the Qualified Treasury ETF). For redemptions of Creation Units, the exchange of assets must occur on a DVP basis (meaning that the Eligible Entity receives U.S. dollars immediately prior to the transfer of Shares to the Qualified Treasury ETF).

IV. The Petition for Amendment Furthers Public Policy

a. The Amendment would be Consistent with the Public Interest and the Purposes of the Act

The Amendment is consistent with the public interest[28] and the customer protection regime under the Act and CFTC regulations because Qualified Treasury ETFs may only invest in instruments that are otherwise permitted investments of Customer Funds, providing a high quality, low risk and highly liquid alternative investment option for Eligible Entities seeking an alternative and efficient investment instrument for Customer Funds. The SEC oversees the offer and sale, listing, and ongoing regulatory obligations of Qualified Treasury ETFs, including periodic financial reporting and compliance with LRMP requirements, as described above. In fact, investing Customer Funds in pooled investment vehicles is already permitted under CFTC Regulation 1.25 by virtue of the regulation's enumeration of money market funds as permitted investments.

i. Qualified Treasury ETFs will Satisfy all of the Conditions Applicable to Other Permitted Investments Under Rule 1.25

Although a Qualified Treasury ETF is not currently a permitted investment enumerated in CFTC Regulation 1.25, it satisfies all of the conditions with which a permitted investment must comply. Specifically:

- *Liquidity*
    - A Qualified Treasury ETF invests only in highly liquid U.S. Treasury Obligations and cash. Therefore, it is even more liquid than other permitted investments, such as money market funds, whose underlying investments may be less liquid than those

[28] The national public interests noted in the Act include the prevention of fraud and the preservation of the financial integrity of markets, as well as the promotion of responsible economic or financial innovation and fair competition.

of a Qualified Treasury ETF. In addition, as more fully described below, the Shares may be purchased and redeemed with same-day settlement from the relevant Qualified Treasury ETF in the primary market and are traded secondarily on a National Securities Exchange. As a result, Shares should be considered highly liquid securities.

  - A Qualified Treasury ETF satisfies the requirement that a permitted investment can be converted into cash within one business day. Due to the fact that a Qualified Treasury ETF will be utilized by Eligible Entities for purposes of Customer Fund investments, it is expected that disposition of Shares will occur primarily through principal transactions of Creation Units. With respect to such redemption orders, generally a Qualified Treasury ETF will make a payment that settles on the same business day if the redemption request is received before 12:00 p.m. Eastern time and for all redemption requests received on or after 12:00 p.m. Eastern time, payment settles on T+1.
  - Consistent with the requirements of SEC Rule 22e-4 under the Investment Company Act, a Qualified Treasury ETF that is a registered open-end management investment company must have an LRMP and, pursuant to the requested relief, such program will take into consideration the liquidity needs that the Qualified Treasury ETF reasonably expects to be associated with the Creation Unit creations and redemptions, including in connection with the use of its Shares pursuant to the requested relief.
  - Qualified Treasury ETFs calculate and disseminate NAV twice daily: (1) the first NAV calculation is at 12:00 p.m. ET, and Shares settle T+0; and (2) the second NAV calculation is at the traditional end-of-day, with Shares settling at T+1. In comparison, Treasury securities settle at T+1, making Qualified Treasury ETFs an attractive investment choice for Customer Fund Investments.

- *Time to Maturity.* No Qualified Treasury ETF will hold investments with a time to maturity that is greater than 12 months.

Further, a Qualified Treasury ETF under the Amendment does not: (1) contain interest-only payment features (although it does pay a dividend); or (2) provide payments linked to a commodity, currency, reference instrument, index, or benchmark (although its value may be linked to a reference index). Moreover, an Eligible Entity is not prohibited from pledging or transferring the Shares, consistent with the regulatory requirement that an instrument must be "one that a futures commission merchant owns or has an unqualified right to pledge, [and] is not subject to any lien"[29].

ii. Expanding Permitted Investments to Include Qualified Treasury ETFs is in the Public Interest

Customers and Eligible Entities will benefit from additional permitted investment options for Customer Funds. Eligible Entities benefit by having a new investment option that reduces operational inefficiencies and promotes the safe and liquid investment of Customer Funds consistent with the Act and CFTC regulations. Eligible Entities and customers may also benefit to the extent that Qualified Treasury ETFs earn a yield greater than the return on short-term U.S. Treasury Obligations.

The expansion of permitted investments to include Qualified Treasury ETFs provides greater flexibility to Clearing Entities while maintaining the same level of protection for customers and helps reduce operational challenges that Clearing Entities currently face. For example, Qualified

[29] 17 C.F.R. § 1.25(b)(ii)(B).

Treasury ETFs help reduce operational challenges and inefficiencies associated with Eligible Entities' optimization of their investments and allocation of Customer Funds among cash, money market funds, and Treasuries. One challenge is simply the expense to maintain cash deposits on a bank's balance sheet, which also generates a low yield. Thus, Clearing Entities need to find alternative methods to minimize cash balances of Customer Funds by instead investing Customer Funds in highly liquid instruments that offer better returns than cash.

Investing Customer Funds in Treasury bills also presents operational challenges to Clearing Entities in connection with managing and reinvesting interest payments, periodically rolling positions and maintaining multiple CUSIPs, requiring a team of professionals to manage the duration, yield, and liquidity of a portfolio of Treasuries. Conversely, a Qualified Treasury ETF eliminates many of these challenges and related costs in an efficient investment vehicle. The operational efficiencies that a Qualified Treasury ETF provide allow an Eligible Entity to gain exposure to short-term U.S. Treasury Obligations without buying and selling Treasury securities on a periodic basis, such as each quarter, eliminating the costs associated with trading Treasury securities. TBLL, for example, historically has performed better than a portfolio of direct investments in U.S. Treasury Obligations, even after management fees are paid. The potential for higher yields with less involvement in the day-to-day trading make Qualified Treasury ETFs an attractive solution for responsibly investing Customer Funds.

In addition, Qualified Treasury ETFs provide exposure to Treasuries and other U.S. Treasury Obligations, which may become particularly beneficial in times of market stress when high-quality liquid collateral is scarce. An additional type of permitted investment helps diversify an Eligible Entity's portfolio of Customer Fund investments, which is restricted by issuer-based and asset-based concentration limits pursuant to CFTC Regulation 1.25.

b. The Amendment will have no Material Adverse Effect on CFTC or Contract Market Regulatory or Self-Regulatory Responsibilities

The requested relief will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act. Designated self-regulatory organizations, including designated contract markets ("**DCMs**") and the National Futures Association ("**NFA**") through delegated authority of the CFTC routinely examine FCMs for compliance with CFTC Regulation 1.25. The CFTC periodically examines DCOs for compliance with CFTC Regulation 1.25. Qualified Treasury ETFs will be subject to the existing conditions applicable to permitted investments, and specific conditions that are objectively ascertainable by the Clearing Entity, DCM, and NFA. Although the Commission, DCMs and the NFA may need to update their examination procedures to reflect the addition of a permitted investment, the same examination methodology will be involved. Thus, the Commission, NFA, and contract markets will be able to continue to discharge their regulatory responsibilities without a material adverse effect.

c. The Amendment is Pro-Competitive

The Petitioner believes that the Commission's expansion of permitted investments to include Qualified Treasury ETFs promotes financial innovation and fair competition. The Qualified Treasury ETFs are consistent with existing instruments that are considered permitted investments of Customer Funds, making them a safe investment option for Customer Funds. The expansion of permitted investments to include Qualified Treasury ETFs increases Clearing Entity investment opportunities, allowing Eligible Entities to expand the type of investments in their portfolios of Customer Fund investments while not limiting Eligible Entities' choice in Qualified Treasury ETFs. The relief sought applies not only to Invesco's Qualified Treasury ETFs but to all Qualified Treasury ETFs currently offered in the market and those that are offered in the future.

V. The Proposed Amendment

a. Amendment Sought

The Petitioner respectfully requests the Commission adopt an amendment to CFTC Regulation 1.25 to permit Qualified Treasury ETFs, subject to the conditions below (the "**Conditions**"), to be "permitted investments" of Customer Funds under CFTC Regulation 1.25. As described in detail, Qualified Treasury ETFs invest assets only in instruments that are themselves permitted investments and satisfy liquidity and other requirements applicable to permitted investments. Moreover, Qualified Treasury ETFs are subject to the SEC's regulatory regimes under the Investment Company Act, Securities Act, and Exchange Act. The Commission's expansion of the enumerated permitted investments will benefit the Clearing Entity community and customers alike without causing a material adverse effect on the CFTC or any contract market. Qualified Treasury ETFs will also benefit by the addition of an entirely new market segment that they may pursue as investors.

b. Terms and Conditions of the Amendment

In accordance with the proposed Amendment, to be considered a "permitted investment" under CFTC Regulation 1.25, a Qualified Treasury ETF must comply with the following Conditions:

1. Each Qualified Treasury ETF is and remains registered as an open-end management investment company under the Investment Company Act.
2. The Shares of each Qualified Treasury ETF is and will remain registered under the Securities Act of 1933.
3. Each Qualified Treasury ETF will be subject to periodic reporting of financial information that is required by the Exchange Act and the Investment Company Act.
4. Shares of each Qualified Treasury ETF must be listed for trading on a National Securities Exchange, without any restriction imposed on such listing or trading by that National Securities Exchange.
5. Each Qualified Treasury ETF will have in place and maintain a policy to invest, under normal circumstances, at least 100 percent of the value of its assets in U.S. Treasury Obligations with maturities of 12 months or less and cash. Each Qualified Treasury ETF must disclose its policy in its prospectus.
6. Each Qualified Treasury ETF must have implemented and must maintain a liquidity risk management program pursuant to SEC Rule 22e-4 under the Investment Company Act, 17 C.F.R. § 270.22e-4, or any future LRMP regulation.
7. Each Qualified Treasury ETF's LRMP must take into consideration the liquidity needs that the Qualified Treasury ETF reasonably expects to be associated with the creation and redemption of Share Baskets, including in connection with the use of its Shares pursuant to CFTC Regulation 1.25.
8. Each Qualified Treasury ETF must have entered into an AP Agreement with each Clearing Entity or AP agent of a Clearing Entity that seeks to use the Qualified Treasury ETF to invest Customer Funds to be an Authorized Participant of the Qualified Treasury ETF (e.g., an Eligible Entity).
9. Each AP Agreement must require the Qualified Treasury ETF to provide the Eligible Entity or its AP agent with a Creation Basket in exchange for U.S. Treasury Obligations (or U.S. Dollars), based on the Qualified Treasury ETF's NAV per share as determined in accordance with the Qualified Treasury ETF's pricing procedures adopted in accordance

with the Investment Company Act. Each AP Agreement must also require each such exchange to occur on a Delivery Versus Payment basis.

10. Each AP Agreement must require the Qualified Treasury ETF to provide the Eligible Entity with U.S. Dollars in exchange for a Redemption Basket, based on the Qualified Treasury ETF's NAV per share as determined in accordance with the Qualified Treasury ETF's pricing procedures adopted in accordance with the Investment Company Act. Each AP Agreement must also require each such exchange to occur on a Delivery Versus Payment basis.
11. Each Qualified Treasury ETF must offer a mechanism, pursuant to its procedures enumerated in the prospectus and AP Agreement, to settle primary transactions in Creation Units with Authorized Participants on the same day as the trade (T+0 settlement).

VI. Conclusion

Based on the foregoing, we respectfully request that the Commission adopt an amendment to CFTC Regulation 1.25 to permit Eligible Entities to invest Customer Funds in Qualified Treasury ETFs. The Petitioner believes that the requested Amendment is consistent with the public interest and the purposes of the Act and the Commission's rules. Such Amendment will be consistent with the objectives of preserving principal and maintaining liquidity as required under CFTC Regulation 1.25(b), while permitting Clearing Entities to manage more efficiently the investment of Customer Funds.

If you should have any questions or comments or require any further information regarding this petition for rulemaking, please do not hesitate to contact the undersigned at (630) 868-7179 or our outside counsel, Michael Philipp at (312) 324-1905 or Michael.philipp@morganlewis.com.

Sincerely,

Anna Paglia
Chief Executive Officer
Invesco Capital Management LLC

CC: Chairman Rostin Behnam
Commissioner Kristin N. Johnson
Commissioner Christy Goldsmith Romero
Commissioner Summer K. Mersinger
Commissioner Caroline D. Pham
Thomas Smith, Deputy Director, Capital, Margin & Segregation, CFTC
Adam Henkel, Head of Legal, US ETFs, Invesco
Michael Philipp, Partner, Morgan, Lewis & Bockius LLP

APPENDIX A: FORMS

CFTC FORM 102
Identification of Special Accounts, Volume Threshold Accounts, and Consolidated Accounts

NOTICE: Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act")[1] and the regulations thereunder,[2] or the filing of a report with the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

PRIVACY ACT NOTICE

The Commission's authority for soliciting this information is granted in sections 4a, 4c(b), 4g, 4i and 8 of the CEA and related regulations (*see*, e.g., 17 CFR § 17.01(b)). The information solicited from entities and individuals engaged in activities covered by the CEA is required to be provided to the CFTC, and failure to comply may result in the imposition of criminal or administrative sanctions (*see*, e.g., 7 U.S.C. sections 9 and 13a-1, and/or 18 U.S.C. 1001). The information requested is most commonly used in the Commission's market and trade practice surveillance activities to (a) provide information concerning the size and composition of the commodity ~~derivatives~~ futures markets, (b) permit the Commission to monitor and enforce speculative position limits and (c) enhance the Commission's trade surveillance data. The requested information may be used by the Commission in the conduct of investigations and litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to contract markets to meet responsibilities assigned to them by law. The information will be maintained in, and any additional disclosures will be made in accordance with, the CFTC System of Records Notices, available on www.cftc.gov.

[1] 7 U.S.C. section 1, *et seq*.

[2] Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter 1 of title 17 of the Code of Federal Regulations; 17 CFR Chapter 1 *et seq*.

APPENDIX A: FORMS

BACKGROUND & INSTRUCTIONS

17 CFR 17.01(a) requires each futures commission merchant, clearing member, or foreign broker to identify and report its special accounts to the Commission on Form 102. 17 CFR 17.01(b) requires each clearing member to identify and report its volume threshold accounts to the Commission on Form 102. ~~In addition, 17 CFR 20.5 requires each reporting entity holding or carrying a consolidated account with a reportable position to identify and report the counterparty of such account to the Commission by submitting a 102S filing.~~ As appropriate, please follow the instructions below to generate and submit the required report or filing. Unless the context requires otherwise, the terms used herein shall have the same meaning as ascribed in parts 15 to 21 of the Commission's regulations.

Complete Form 102 as follows:

General Information – Cover Sheet:	All filers.
Section 102A:	Only complete when submitting Form 102 for a special account.
Section 102B:	Only complete when submitting Form 102 for a volume threshold account.
~~Section 102S:~~	~~Only complete when submitting a 102S filing.~~
Signature/Authentication:	All filers.

Submitting Form 102: Once completed, please submit this form to the Commission pursuant to the instructions on www.cftc.gov or as otherwise directed by Commission staff. If submission attempts fail, the reporting trader shall contact the Commission at techsupport@cftc.gov for further technical support.

Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.

APPENDIX A: FORMS

General Information – Cover Sheet.

Please indicate the type of account to be reported (choose only one):

Special Account (please complete section 102A)	□
Volume Threshold Account 102 (please complete section 102B)	□
~~Consolidated Account 102S filing (please complete section 102S)~~	~~□~~

Reporting Firm Contact Information:[1]

Whether submitting Form 102 for a special account, volume threshold account, ~~or as a 102S filing for a consolidated account, ~~please provide the contact information of the reporting firm and, as applicable, indicate whether the reporting firm is a futures commission merchant, clearing member, and/or foreign broker~~, and/or swap dealer~~. In addition, provide the reporting firm's reporting firm ID.[2]

Name of Reporting Firm: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Reporting Firm Contact Name (a natural person, "Contact"):
Contact Job Title:
Contact Phone Number:[3]
Contact Email Address:
Firm Website:
Firm NFA ID (if any):
Firm Legal Entity Identifier (if any):[4]
Reporting Firm Type(s) (mark all that apply):

[1] The term "reporting firm" as used herein may refer to a futures commission merchant, clearing member, foreign broker, ~~swap dealer, ~~or other reporting entity, as appropriate.

[2] The "reporting firm ID" is an alpha-numeric identifier assigned by the Commission.

[3] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[4] Firm Legal Entity Identifier means a Legal Entity Identifier issued by an LEI issuer accredited by the Global Legal Entity Identifier Foundation (www.gleif.org). If the Firm Legal Entity Identifier is reported~~ was issued by the CICI Utility (or by any other CFTC-accepted LEI provider)~~, then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Reporting Firm, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Firm Legal Entity Identifier~~. Furthermore, in the event data collected by LEI Issuing Organizations include information that is required to be reported for ~~the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of ~~the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report data for any of the Supplemental Fields to the extent such data are collected by LEI Issuing Organizations ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Firm Legal Entity Identifier~~. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should

□ Futures commission merchant

□ Clearing member

□ Foreign broker

□ ~~Swap dealer~~

□ Other: ______________________________

Reporting Firm ID:

check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information ~~has been reported to~~ is collected by an LEI Issuing Organization ~~provider~~.

APPENDIX A: FORMS

Section 102A – Identifying and reporting *a special account.*

1. *New/Modified Indicator:*

□ Special account being reported for the first time

□ Re-submitted or modified Information for a previously reported special account

2. *Special Account Origination.*

For each special account, indicate whether the account is being reported based on ~~ownership of a reportable position,~~ control of a reportable position, both ownership and control of a reportable position, or because it is an omnibus account with a reportable position (choose only one):

~~Ownership of a reportable position[5]~~ ~~(complete questions 3, 4, 6, 9, and 10)~~	~~□~~
Control of a reportable position (complete questions 3, ~~7, 9~~6, 8, and ~~10~~9)	□
Ownership and control of a reportable position (complete questions 3, 6, ~~7, 9~~, 8, and ~~10~~9)	□
Omnibus account with a reportable position[6] (complete questions 3, 5, 7, 8, ~~9,~~ and ~~10~~9)	□

3. *Reporting number and name.*[7]

Provide the reporting number and name of the special account.

Special Account Number:
Special Account Name:

4. *House or Customer Indicator.*

If the reported special account is being reported based on ownership of a reportable position, indicate whether the special account is a house or customer account of the reporting firm:

□ HOUSE

□ CUSTOMER

[5] ~~Reporting parties are not required to submit Form 102A based solely on ownership of a reportable position at this time.~~

[6] Omnibus accounts are accounts that one futures commission merchant, clearing member or foreign broker carries for another in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm.

[7] Reporting firms shall assign a reporting number and name to each special account when it is reportable for the first time in futures or options on futures. If an account has been assigned a number and name for reporting in futures (options), use the same number and name for reporting options (futures). Such reporting number and name must not be changed or assigned to any other special account without the prior approval of the Commission.

5. *Omnibus Account Information.*

If the reported special account is an omnibus account, indicate whether the account is a house or customer omnibus account:[8]

□ HOUSE

□ CUSTOMER

~~*6. Special Account Owner(s) Contact Information.*~~

~~Provide the following information regarding the owner of this special account. Owners may be natural persons or any type of legal entity.~~

~~Indicate whether the owner is a legal entity or a natural person:~~

~~Legal entity: □~~
~~Natural person: □~~

~~***Name of Special Account Owner:*** [For each field, check box if field reported to LEI provider in lieu of reported on this form □]~~
~~***Street Address:***~~
~~***City:***~~
~~***State:***~~
~~***Country:***~~
~~***Zip/Postal Code:***~~
~~Phone Number:~~[9]
~~Email Address:~~
~~Contact Name (if owner not a natural person):~~
~~Contact Job Title:~~
~~Contact Relationship to Owner:~~
~~Contact Phone Number:~~[10]
~~Contact Email Address:~~
~~Owner Website (if any):~~[11]
~~Owner NFA ID (if any):~~
~~Owner Legal Entity Identifier (if any):~~[12]

[8] House omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.

[9] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[10] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[11] ~~The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.~~

[12] ~~If the Owner Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Special Account Owner, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the~~

6~~7~~. *Special Account Controller(s) Contact Information.*

Provide the following information regarding the controller of this special account. Controllers may be natural persons or any type of legal entity.

Indicate whether the controller is a legal entity or, if not a legal entity, a natural person:

Legal entity: □
Natural person: □

Name of Special Account Controller: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[13]
Email Address:
Contact Name (if controller not a natural person):
Contact Job Title:
Contact Relationship to Controller:
Contact Phone Number:[14]
Contact Email Address:
Controller Website (if any):[15]
Controller NFA ID (if any):
Controller Legal Entity Identifier (if any):[16]

~~reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.~~

[13] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[14] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[15] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[16] The Controller Legal Entity Identifier means a Legal Entity Identifier issued by an LEI issuer accredited by the Global Legal Entity Identifier Foundation (www.gleif.org). If the Controller Legal Entity Identifier is reported ~~was issued by the CICI Utility (or by any other CFTC-accepted LEI provider)~~, then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Special Account Controller, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Controller Legal Entity Identifier~~. Furthermore, in the event data collected by LEI Issuing Organizations include information that is required to be reported for ~~the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of~~ the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report data for any of the Supplemental Fields to the extent such data are collected by LEI Issuing Organizations ~~that were reported to the~~

7~~8~~ *Omnibus Account Originator Contact Information.*

Provide contact information for the originator of the omnibus account in this special account.

Name of Omnibus Account Originator: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[17]
Contact Name:
Contact Job Title:
Contact Relationship to Originator:
Contact Phone Number:[18]
Contact Email Address:
Originator Website (if any):[19]
Originator NFA ID (if any):
Originator Legal Entity Identifier (if any):[20]

~~CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Controller Legal Entity Identifier~~. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information is collected by ~~has been reported to an~~ LEI Issuing Organization ~~provider~~.

[17] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[18] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[19] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[20] The Originator Legal Entity Identifier means a Legal Entity Identifier issued by an LEI issuer accredited by the Global Legal Entity Identifier Foundation (www.gleif.org). If the Originator Legal Entity Identifier is reported ~~was issued by the CICI Utility (or by any other CFTC-accepted LEI provider)~~, then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Omnibus Account Originator, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier~~. Furthermore, in the event data collected by LEI Issuing Organizations include information that is required to be reported for ~~the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of~~ the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report data for any of the Supplemental Fields to the extent such data are collected by LEI Issuing Organizations ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier~~. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information is collected by ~~has been reported to an~~ LEI Issuing Organization ~~provider~~.

8~~9~~ Identification of Trading Account(s) that Comprise the Special Account.

For each special account reported by an entity acting as a *clearing member*, provide the trading account number(s), and any related short code(s), that comprise this special account. Also identify the reporting market at which each trading account number appears.

Trading Account Number:
Short Code(s):
Reporting Market:

9~~10~~. Trading Account Ownership ~~and Control~~ Information.

(i) Omnibus Account Information.

For each trading account identified in question 8~~9~~, is such account an omnibus account, or used to execute trades for an omnibus account?

□ YES

□ NO

If NO, proceed to (ii) and (iii), below. If YES, indicate whether the account is a house or customer omnibus account and provide contact information for the originator of the omnibus account:[21]

□ HOUSE

□ CUSTOMER

Name of Omnibus Account Originator: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[22]
Contact Name:
Contact Job Title:
Contact Relationship to Originator:

[21] As above, house omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.

[22] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Contact Phone Number:[23]
Contact Email Address:
Originator Website (if any):[24]
Originator NFA ID (if any):
Originator Legal Entity Identifier (if any):[25]

(ii) Trading Account Owner(s).

For each trading account identified in question 8~~9~~ that is not an omnibus account, provide the requested information for each owner ("owner"), as defined in Rule 15.00(bb).

Indicate whether the owner is a legal entity or a natural person:

Legal entity: □

Natural person: □

Name of Trading Account Owner(s): [For each field, check box if field reported to LEI provider in lieu of reported on this form □]

Follow-On Information:[26]

Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[27]
Email Address (if owner(s) a natural person):
Contact Name (provide only if owner is not a

[23] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[24] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[25] The Originator Legal Entity Identifier means a Legal Entity Identifier issued by an LEI issuer accredited by the Global Legal Entity Identifier Foundation (www.gleif.org). If the Originator Legal Entity Identifier is reported~~ was issued by the CICI Utility (or by any other CFTC-accepted LEI provider)~~, then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Omnibus Account Originator, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier~~. Furthermore, in the event data collected by LEI Issuing Organizations include information that is required to be reported for ~~the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of~~ the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report data for any of the Supplemental Fields to the extent such data are collected by LEI Issuing Organizations ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier~~. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information is collected by ~~has been reported to an~~ LEI Issuing Organization~~ provider~~.

[26] Follow-On Information may be submitted by the later date specified in § 17.02.

[27] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

natural person):

Contact Job Title:
Contact Relationship to Owner:
Contact Phone Number:[28]
Contact Email Address:

Owner Website (if any):[29]
Owner NFA ID (if any):
Owner Legal Entity Identifier (if any):[30]

~~*(iii) Trading Account Controller(s).*~~

~~For each trading account identified in question 9 that is not an omnibus account, provide the requested information for each controller ("controller"). NOTE: As defined in § 15.00, the controller identified for a trading account that comprises or pertains to a special account must be a natural person.~~

~~Name of Trading Account Controller(s):~~

~~Follow-On Information:[31]~~

~~Street Address:~~
~~City:~~
~~State:~~
~~Country:~~
~~Zip/Postal Code:~~
~~Phone Number:[32]~~
~~Name of Employer:~~
~~Employer NFA ID (if any):~~
~~Employer Legal Entity Identifier (if any):~~
~~Job Title:~~

[28] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[29] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[30] The Owner Legal Entity Identifier means a Legal Entity Identifier issued by an LEI issuer accredited by the Global Legal Entity Identifier Foundation (www.gleif.org). If the Owner Legal Entity Identifier is reported ~~was issued by the CICI Utility (or by any other CFTC-accepted LEI provider)~~, then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Trading Account Owner(s), Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier~~. Furthermore, in the event data collected by LEI Issuing Organizations include information that is required to be reported for ~~the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of~~ the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report data for any of the Supplemental Fields to the extent such data are collected by LEI Issuing Organizations ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier~~. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information is collected by ~~has been reported to an~~ LEI Issuing Organization ~~provider~~.

~~[31] Follow-On Information may be submitted by the later date specified in § 17.02.~~

~~[32] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

~~Relationship to Owner:~~
~~Email Address:~~
~~Controller NFA ID (if any):~~

10~~11~~. For Reporting Firms That Are Foreign Brokers.

If the reporting firm indicated that it is a foreign broker in the "Reporting Firm Contact Information" above, identify the reporting firm's U.S. futures commission merchant.

Name of U.S. futures commission merchant:
Street Address:
City:
State:
Country:
Zip/Postal Code:
Contact Name at U.S. futures commission merchant (a natural person, "Contact"):
Contact Job Title:
Contact Phone Number:[33]
Contact Email Address:

Section 102B – Identifying and reporting *a volume threshold account.*

1. *New/Modified Indicator:*

□ Volume threshold account being reported for the first time

□ Re-submitted or modified Information for a previously reported volume threshold account

2. *Trading Account Data for the Volume Threshold Account.*

Provide the trading account number, and any related short code(s), deemed to be a volume threshold account. Also identify the reporting market at which the volume threshold account had reportable trading volume.

Trading Account Number:
Short Code(s):
Reporting Market:

3. *Associated Special Account Number.*

If the volume threshold account has been previously identified as a trading account that comprises a special account(s) reported by a clearing member in question 8~~9~~ in section 102A of this form, provide the associated special account number(s).

[33] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

4. *Omnibus Account Information.*[34]

Is the reported volume threshold account an omnibus account, or used to execute trades for an omnibus account?

□ YES

□ NO

If NO, proceed to (5) and (6), below. If YES, indicate whether the account is a house or customer omnibus account and provide contact information for the originator of the omnibus account:[35]

□ HOUSE

□ CUSTOMER

Name of Omnibus Account Originator: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[36]
Contact Name:
    Contact Job Title:
    Contact Relationship to Originator:
    Contact Phone Number:[37]
    Contact Email Address:
Originator Website (if any):[38]
Originator NFA ID (if any):
Originator Legal Entity Identifier (if any):[39]

[34] As above, omnibus accounts are accounts that one futures commission merchant, clearing member or foreign broker carries for another in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm.

[35] As above, house omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.

[36] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[37] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[38] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[39] The Originator Legal Entity Identifier means a Legal Entity Identifier issued by an LEI issuer accredited by the Global Legal Entity Identifier Foundation (www.gleif.org). If the Originator Legal Entity Identifier is reported ~~was~~

5. *Volume Threshold Account Owner(s).*

For each volume threshold account that is not an omnibus account, provide the requested information for each owner ("owner") as defined in Rule 15.00(cc).

Indicate whether the owner is a legal entity or a natural person:

Legal entity: □

Natural person: □

Name of Volume Threshold Account Owner(s): [For each field, check box if field reported to LEI provider in lieu of reported on this form □]

Follow-On Information:[40]

Street Address: ***City:*** ***State:*** ***Country:*** ***Zip/Postal Code:*** Phone Number:[41] Email Address (if owner(s) a natural person): Contact Name (provide only if owner is not a natural person): Contact Job Title: Contact Relationship to Owner: Contact Phone Number:[42] Contact Email Address:

~~issued by the CICI Utility (or by any other CFTC-accepted LEI provider)~~, then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Omnibus Account Originator, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier~~. Furthermore, in the event data collected by LEI Issuing Organizations include information that is required to be reported for ~~the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of~~ the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report data for any of the Supplemental Fields to the extent such data are collected by LEI Issuing Organizations ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier~~. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information is collected by ~~has been reported to an~~ LEI Issuing Organization~~-provider~~.

[40] Follow-On Information may be submitted by the later date specified in § 17.02.

[41] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[42] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Owner Website (if any):[43]
Owner NFA ID (if any):
Owner Legal Entity Identifier (if any):[44]

~~*6. Volume Threshold Account Controller(s).*~~

~~For each volume threshold account identified that is not an omnibus account, provide the requested information for each volume threshold account controller ("controller"). NOTE: As defined in § 15.00, a volume threshold account controller must be a natural person.~~

~~Name of Volume Threshold Account Controller(s):~~

~~Follow-On Information:[45]~~

~~Street Address:~~
~~City:~~
~~State:~~
~~Country:~~
~~Zip/Postal Code:~~
~~Phone Number:[46]~~
~~Name of Employer:~~
~~Employer NFA ID (if any):~~
~~Employer Legal Entity Identifier (if any):~~
~~Job Title:~~
~~Relationship to Owner:~~
~~Email Address:~~
~~Controller NFA ID (if any):~~

[43] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[44] The Owner Legal Entity Identifier means a Legal Entity Identifier issued by an LEI issuer accredited by the Global Legal Entity Identifier Foundation (www.gleif.org). If the Owner Legal Entity Identifier is reported ~~was issued by the CICI Utility (or by any other CFTC-accepted LEI provider)~~, then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Trading Account Owner(s), Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields"))~~ that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier~~. Furthermore, in the event data collected by LEI Issuing Organizations include information that is required to be reported for ~~the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of~~ the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report data for any of the Supplemental Fields to the extent such data are collected by LEI Issuing Organizations ~~that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier~~. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information is collected by ~~has been reported to an~~ LEI Issuing Organization~~ provider~~.

~~[45] Follow-On Information may be submitted by the later date specified in § 17.02.~~

~~[46] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

APPENDIX A: FORMS

~~Section 102S – Identifying and reporting a swap counterparty or customer *consolidated account* with a reportable position (102S filing).~~

~~1. *New/Modified Indicator.*~~

~~□ Counterparty or customer reported for the first time~~

~~□ Re-submitted or modified Information for a previously reported counterparty or customer~~

~~2. *102S Identifier*. Please enter the identifier for the consolidated account reported herein. A 102S identifier is a unique identifier for each reporting entity or counterparty/customer as assigned by the reporting entity. If the reporting entity currently identifies a counterparty via Section 102A of a Form 102, the identifier used on Section 102A of the Form 102 may also be used for the 102S identifier, as long as the same legal entity is referenced.~~

~~102S identifier:~~

~~3. *Counterparty or Customer Ownership and Control Information. Please provide the requested counterparty or customer contact information for both owners and controllers of the consolidated account.*~~

~~*(i) Consolidated Account Type. Please indicate the consolidated account type:*~~

~~□ HOUSE~~

~~□ CUSTOMER~~

~~*(ii) Omnibus Account Information*~~[47]

~~Is the reported consolidated account an omnibus account, or used to execute trades for an omnibus account?~~

~~□ YES~~

~~□ NO~~

~~If NO, proceed to (iii) and (iv), below. If YES, indicate whether the account is a house or customer omnibus account and provide contact information for the originator of the omnibus account:~~[48]

[47] ~~As above, omnibus accounts are accounts that one futures commission merchant, clearing member or foreign broker carries for another in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm.~~

[48] ~~As above, house omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.~~

~~□ HOUSE~~

~~□ CUSTOMER~~

~~***Name of Omnibus Account Originator:*** [For each field, check box if field reported to LEI provider in lieu of reported on this form □]~~
~~***Street Address:***~~
~~***City:***~~
~~***State:***~~
~~***Country:***~~
~~***Zip/Postal Code:***~~
~~Phone Number:~~[49]
~~Contact Name:~~
~~Contact Job Title:~~
~~Contact Relationship to Originator:~~
~~Contact Phone Number:~~[50]
~~Contact Email Address:~~
~~Originator Website (if any):~~[51]
~~Originator NFA ID (if any):~~
~~Originator Legal Entity Identifier (if any):~~[52]

~~*(iii) Consolidated Account Owner(s). Counterparty or Clearing Customer.*~~

~~For each reportable consolidated account that is not an omnibus account, provide the requested information for each owner (“owner”).~~

~~Indicate whether the owner is a legal entity or a natural person:~~

~~Legal entity: □~~

~~Natural person: □~~

~~[49] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

~~[50] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

~~[51] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.~~

~~[52] If the Originator Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Omnibus Account Originator, Street Address, City, State, Country, and Zip/Postal Code (collectively, the “Optional Fields”)) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the “Supplemental Fields”), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web faun corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.~~

~~***Name of Consolidated Account Owner(s):*** [For each field, check box if field reported to LEI provider in lieu of reported on this form □]~~
~~***Street Address:***~~
~~***City:***~~
~~***State:***~~
~~***Country:***~~
~~***Zip/Postal Code:***~~
~~Phone Number:~~[53]
~~Email Address (if owner(s) a natural person):~~
~~Contact Name (provide only if owner is not a natural person):~~
~~Contact Job Title:~~
~~Contact Relationship to Owner:~~
~~Contact Phone Number:~~[54]
~~Contact Email Address:~~
~~Owner Website (if any):~~[55]
~~Owner NFA ID (if any):~~
~~Owner Legal Entity Identifier (if any):~~[56]

~~*(iv) Consolidated Account Controller(s).*~~

~~For each reportable consolidated account that is not an omnibus account, provide the requested information for each controller ("controller"). Controllers may be natural persons or any type of legal entity.~~

~~Indicate whether the controller is a legal entity or a natural person:~~

~~Legal entity: □~~

~~Natural person: □~~

~~***Name of Consolidated Account Controller(s):*** [For each field, check box if field reported to LEI provider in lieu of reported on this form □]~~

[53] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[54] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[55] ~~The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.~~

[56] ~~If the Owner Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Consolidated Account Owner(s), Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.~~

~~***Street Address:***~~
~~***City:***~~
~~***State:***~~
~~***Country:***~~
~~***Zip/Postal Code:***~~
~~Phone Number:~~[57]
~~Email Address:~~
~~Contact Name (provide only if controller is not a natural person):~~

~~Contact Job Title:~~
~~Contact Relationship to controller:~~
~~Contact Phone Number:~~[58]
~~Contact Email Address:~~
~~Controller NFA ID (if any):~~
~~Controller Legal Entity Identifier (if any):~~[59]

~~4. *Paired Swaps and Swaptions Market Activity.* Provide a brief description of the nature of the counterparty's or customer's paired swaps and swaptions market activity (please include a response for each type of paired swap or swaption market activity):~~

~~□ Description below relates to paired swap activity.~~

~~□ Description below relates to paired swaption activity.~~

~~*Enter the description here:*~~

[57] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[58] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[59] ~~If the Controller Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Consolidated Account Controller(s), Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Controller Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Controller Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.~~

APPENDIX A: FORMS

Signature/Authentication.

1. *Please sign/authenticate the Form 102 prior to submitting.*

Signature/Electronic Authentication:

□ By checking this box and submitting this form (or by clicking "submit," "send," or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by the reporting firm identified below to provide the information and representations submitted on this Form 102, and that the information and representations are true and correct.

Reporting Firm Authorized Representative (Name and Position):

______________________________ (Name)

______________________________ (Position)

Submitted on behalf of:

______________________________ (Reporting Firm Name)

Date of Submission:

____

~~CFTC FORM 71~~
~~IDENTIFICATION OF~~
~~OMNIBUS ACCOUNTS AND SUB-ACCOUNTS~~

~~**NOTICE:** Failure to file a report required by the Commodity Exchange Act (“CEA” or the “Act”)~~[60] ~~and the regulations thereunder,~~[61] ~~or the filing of a report with the Commodity Futures Trading Commission (“CFTC” or “Commission”) that includes a false, misleading or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.~~

~~PRIVACY ACT NOTICE~~

~~The Commission’s authority for soliciting this information is granted in sections 4a, 4c(b), 4g, 4i and 8 of the CEA and related regulations *(see*, e.g., 17 CFR 17.01(c)). The information solicited from entities and individuals engaged in activities covered by the CEA is required to be provided to the CFTC, and failure to comply may result in the imposition of criminal or administrative sanctions *(see*, e.g., 7 U.S.C. sections 9 and 13a-1, and/or 18 U.S.C. 1001). The information requested is most commonly used in the Commission’s market and trade practice surveillance activities to (a) provide information concerning the size and composition of the commodity derivatives markets, (b) permit the Commission to monitor and enforce speculative position limits and (c) enhance the Commission’s trade surveillance data. The requested information may be used by the Commission in the conduct of investigations and litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to reporting markets to meet responsibilities assigned to them by law. The information will be maintained in, and any additional disclosures will be made in accordance with, the CFTC System of Records Notices, available on wwvv.cftc.gov.~~

[60] ~~7 U.S.C. section 1, *et seq.*~~

[61] ~~Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter 1 of title 17 of the Code of Federal Regulations; 17 CFR Chapter 1 *et seq.*~~

APPENDIX A: FORMS

~~BACKGROUND & GENERAL INSTRUCTIONS~~

~~**Who Must File a Form 71** – 17 CFR 17.01(c) requires each originator of (a) an omnibus volume threshold account or (b) an omnibus reportable sub-account (collectively, “Reporting Parties”) to file a Form 71 – Identification of Omnibus Accounts and Sub-Accounts with the Commodity Futures Trading Commission (“CFTC” or “Commission”).~~

~~**When to file** – Each Reporting Party must file a Form 71 on call by the Commission or its designee.~~

~~**Where to file** – The Form 71 shall be filed by submitting the completed form to the nearest CFTC office or as otherwise instructed by the Commission or its designee. Generally, a Form 71 should be submitted via the CFTC’s web-based Form 71 submission process at www.cftc.gov or via a secure FTP data feed to the Commission. If submission attempts fail, the reporting trader shall contact the Commission at techsupport@cftc.gov for further technical support.~~

~~**Signature** – Each Form 71 submitted to the Commission must be signed or otherwise authenticated by an individual that is duly authorized by the relevant Reporting Party to provide the information and representations contained in the form.~~

~~**What to File** – Each Reporting Party must complete part A, the relevant question in part B, and part C.~~

~~Unless otherwise noted, the terms used herein shall have the same meaning as ascribed in parts 15 to 21 of the Commission’s regulations.~~

~~Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.~~

APPENDIX A: FORMS

~~ACKNOWLEDGEMENT OF DEFINITIONS~~

~~Before proceeding with your submission, please check this box to indicate that you have read the definitions for the following terms, as they are used in the Form 71: □~~

~~**Commodity (or commodities)** – generally, all goods and articles (except onions and motion picture box office receipts, or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value, or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in (*see* 7 U.S.C. 1a(9)).~~

~~**Omnibus account** – any trading account that one futures commission merchant, clearing member or foreign broker carries for another and in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm.~~

~~**Omnibus reportable sub-account** – means any trading sub-account of an omnibus volume threshold account, which sub-account executes reportable trading volume on an omnibus basis. Omnibus reportable sub-account also means any trading account that is itself an omnibus account, executes reportable trading volume, and is a sub-account of another omnibus reportable sub-account.~~

~~**Omnibus volume threshold account** – means any trading account that, on an omnibus basis, carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.~~

~~**Person** – an individual, association, partnership, corporation, trust, or government agency and/or department.~~

~~**Reportable sub-account** – means any trading sub-account of an omnibus volume threshold account or omnibus reportable sub-account, which sub-account executes reportable trading volume.~~

~~**Reportable sub-account controller** – means a natural person who by power of attorney or otherwise actually directs the trading of a reportable sub-account. A reportable sub-account may have more than one controller.~~

~~**Reportable trading volume** – means contract trading volume that meets or exceeds the level specified in 17 CFR 15.04.~~

~~**Volume threshold account** – means any trading account that carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.~~

~~CFTC FORM 71~~

~~A. Re-confirmation of Omnibus Volume Threshold Account or Omnibus Reportable Sub-Account:~~

~~Account number [(auto-populated)] was identified on Form [[102B] OR [71] (auto-populated)] by [[clearing member] OR [preceding originator] (auto-populated)] as an [[omnibus volume threshold account] OR [omnibus reportable sub-account] (auto-populated)] on [reporting market (auto-populated)].~~

~~The following information was provided on Form [[102B] OR [71] (auto-populated)] regarding you as the originator ("Originator") of this [[omnibus volume threshold account] OR [omnibus reportable sub-account] (auto-populated)]. Please update any incorrect information in the space provided below.~~

~~Name of Originator: [(Fields below will be auto-populated)] [space to correct incorrect info]~~
~~Street Address:~~
~~City:~~
~~State:~~
~~Country:~~
~~Zip/Postal Code:~~
~~Phone Number:~~[62]
~~Contact Name:~~
~~Contact Job Title:~~
~~Contact Relationship to Originator:~~
~~Contact Phone Number:~~[63]
~~Contact Email Address:~~
~~Originator Website (if any):~~
~~Originator NFA ID (if any):~~
~~Originator Legal Entity Identifier (if any):~~

~~B. Identification of Reportable Sub-Accounts:~~

~~The following questions request information regarding the allocation of trades from account number [[omnibus volume threshold account number] OR [omnibus reportable sub-account number] (auto-populated)] on [date (auto-populated)] on [reporting market (auto-populated)] to other accounts.~~

~~*1.* If you did not allocate any trades from account number [(auto-populated)] on [date (auto-populated)] on [reporting market (auto-populated)], check this box and proceed to part C:~~ □

[62] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[63] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

~~2. If you allocated trades from account number [(auto-populated)] on [date (auto-populated)] on [reporting market (auto-populated)], but the sum of allocations did not result in reportable trading volume for a recipient account on [date (auto-populated)], check this box and proceed to part C: □~~

~~3. If you allocated trades from account number [(auto-populated)] on [date (auto-populated)] on [reporting market (auto-populated)] that resulted in reportable trading volume for a recipient account, provide the following information for each such recipient account (hereafter, a "reportable sub-account"):~~

~~*(a) Identification of Omnibus Reportable Sub-Accounts.*~~

~~(i) Is the reportable sub-account an omnibus reportable sub-account?~~

~~□ YES~~

~~□ NO~~

~~(ii) If NO, proceed to (b) below. If YES, indicate whether the omnibus reportable sub-account is a house or customer omnibus account and provide the contact information of the originator of the omnibus account~~[64]

~~□ HOUSE~~

~~□ CUSTOMER~~

~~Name of Reportable Sub-Account Originator:~~
~~Account Number of Reportable Sub-Account:~~[65]
~~Street Address:~~
~~City:~~
~~State:~~
~~Country:~~
~~Zip/Postal Code:~~
~~Phone Number:~~[66]
~~Contact Name:~~
~~Contact Job Title:~~
~~Contact Relationship to Originator:~~

[64] ~~House omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.~~

[65] ~~The Account Number should be a number or other identifier that is known to the reportable sub-account originator.~~

[66] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

~~Contact Phone Number:~~[67]
~~Contact Email Address:~~
~~Originator Website (if any):~~[68]
~~Originator NFA ID (if any):~~
~~Originator Legal Entity Identifier (if any):~~

~~*(b) Identification of Non-Omnibus Reportable Sub-Accounts:*~~

~~(i) For each reportable sub-account that is not an omnibus account, provide the requested information for each owner ("owner") of the reportable sub-account.~~

~~Indicate whether the owner is a legal entity or a natural person:~~

~~Legal entity:~~ □

~~Natural person:~~ □

~~Name of Reportable Sub-Account Owner (s):~~
~~Street Address:~~
~~City:~~
~~State:~~
~~Country:~~
~~Zip/Postal Code:~~
~~Phone Number:~~[69]
~~Email Address (if owner is a natural person):~~
~~Contact Name (if owner is not a natural person):~~
~~Contact Job Title:~~
~~Contact Relationship to Owner:~~
~~Contact Phone Number:~~[70]
~~Contact Email Address:~~
~~Owner Website (if any):~~[71]
~~Owner NFA ID (if any):~~
~~Owner Legal Entity Identifier (if any):~~

~~(ii) For each reportable sub-account that is not an omnibus account, provide the requested information for each reportable sub-account controller. (NOTE: a reportable sub-account controller must be a natural person.)~~

[67] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[68] ~~The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.~~

[69] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[70] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[71] ~~The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.~~

~~Name of Reportable Sub-Account Controller(s):~~
~~Street Address:~~
~~City:~~
~~State:~~
~~Country:~~
~~Zip/Postal Code:~~
~~Phone Number:~~[72]
~~Name of Employer:~~
~~Job Title:~~
~~Relationship to Owner:~~
~~Email Address:~~
~~Controller NFA ID (if any):~~

~~After completing the applicable questions in part B.3, proceed to part C.~~

~~C. Signature/Authentication, Name, and Date:~~

~~Please sign/authenticate the Form 71 prior to submitting.~~

~~Signature/Electronic Authentication of [Originator (auto-populated)]:~~

□ ~~By checking this box and submitting this form (or by clicking "submit," "send," or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by [Originator (auto-populated)] to provide the information and representations submitted on this Form 71, and that the information and representations are true and correct.~~

~~Authorized Representative (Name and Position):~~

~~______________________________ (Name)~~

~~______________________________ (Position)~~

~~Submitted on behalf of:~~

~~______________________________ [Originator (auto-populated)]~~

~~Date of Submission:~~

~~______________________________~~

[72] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

APPENDIX A: FORMS

CFTC FORM 40
STATEMENT OF REPORTING TRADER

NOTICE: Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act")[73] and the regulations thereunder,[74] or the filing of a report with the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

PRIVACY ACT NOTICE

The Commission's authority for soliciting information from traders with large futures~~, option, swap, or other derivatives~~ market positions is granted in sections 4a, 4i, 4t and 8 of the CEA (*see* 7 U.S.C. sections 6i and 12). The Commission's authority for soliciting information from volume threshold account controllers, persons who own volume threshold accounts, reportable sub-account controllers, and persons who own reportable sub-accounts is granted in sections 4i and 8 of the CEA and related regulations (*see*, e.g., 17 CFR 18.04(b)). Such entities and individuals are required to provide the information requested, and failure to comply may result in the imposition of criminal or administrative sanctions (*see*, e.g., 7 U.S.C. sections 9 and 13a-1, and/or 18 U.S.C. 1001).

The information requested is most commonly used in the Commission's market and trade practice surveillance activities to (a) provide information concerning the size and composition of the commodity futures ~~derivatives~~ markets, (b) permit the Commission to monitor and enforce speculative position limits and (c) enhance the Commission's trade surveillance data. Information contained in these records may be used by the Commission in the conduct of investigations or litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to contract markets to meet responsibilities assigned to them by law. In accordance with the Privacy Act and the Commission's rules thereunder (*see* 17 CFR part 146), the complete listing of uses of the information contained in these records is found in the Commission's System of Records Notices, available on www.cftc.gov. These uses include CFTC-15, Large Trader Report Files (Integrated Surveillance System).

Information contained in these records may be used by the Commission in the conduct of investigations or litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to reporting markets to meet responsibilities assigned to them by law.

[73] 7 U.S.C. section 1, *et seq*.

[74] Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter 1 of title 17 of the Code of Federal Regulations; 17 CFR Chapter 1 *et seq.*

APPENDIX A: FORMS

General Instructions

Who Must File a Form 40—17 CFR 18.04(a) requires every person who owns or controls a reportable position to file a Form 40—Statement of Reporting Trader with the Commission. 17 CFR 18.04(b) requires every ~~volume threshold account controller,~~ person who owns, holds or controls a volume threshold account~~, reportable sub-account controller, and person who owns a~~ or reportable sub-account to file a Form 40—Statement of Reporting Trader with the Commission. ~~17 CFR 20.5 requires every person subject to books or records under 17 CFR 20.6 to file a 40S filing[75] with the Commission.~~

When to file—A reporting trader must file a Form 40 on call by the Commission or its designee.

Where to file—The Form 40 should be submitted (a) via the CFTC's web-based Form 40 submission process at *www.cftc.gov*, (b) via a secure FTP data feed to the Commission, or (c) as otherwise instructed by the Commission or its designee. If electronic submission attempts fail, the reporting trader shall contact the Commission at *techsupport@cftc.gov* for further technical support.

~~When to update—A reporting trader required to complete a Form 40 will be under a continuing obligation, per direction in the special call, to update and maintain the accuracy of the information it provides. Reporting traders can update this information by either visiting the CFTC's web-based Form 40 portal to review, verify, and/or update their information, or by submitting updated information via FTP.~~

Signature—Each Form 40 submitted to the Commission must be signed or otherwise authenticated by either (1) the reporting trader submitting the form or (2) an individual that is duly authorized by the reporting trader to provide the information and representations contained in the form.

What to File—All reporting traders that are filing a Form 40 pursuant to ~~either~~ 17 CFR 18.04(a) (*i.e.* reportable position reporting traders). ~~or 17 CFR 20.5 (*i.e.* swaps books and records reporting traders) must complete all questions. All reporting traders that are filing a Form 40 pursuant to 17 CFR 18.04(b) (*i.e.* volume threshold account controllers, persons who own a volume threshold account, reportable sub-account controllers, and persons who own a reportable sub-account reporting trader) must complete all questions *unless they are natural persons.* Reporting~~ However, reporting traders that are filing a Form 40 pursuant to 17 CFR 18.04(b) who are natural persons shall mark not applicable for questions 7 and 8.

Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Table of Contents

1. General information for Reporting Trader
2. Contact Information for Individual Responsible for Trading Activities
3. Contact Information for Individual Responsible for Risk Management Operations
4. Contact information for Individual Responsible for Information on the Form 40
5. Omnibus Account Identification
6. Foreign Government Affiliation

~~[75] As used in this document, "Form 40" may refer to either a Form 40—Statement of Reporting Trader or a 40S Filing, as appropriate, and as the context may require.~~

7. Non-Domestic Entity Indicator

8. Ownership Structure (Parent/Parents)

9. Ownership Structure (Subsidiary/Subsidiaries)

10. Control of Reporting Trader’s Trading Activities by Others

11. Control of Other’s Trading Activities by Reporting Trader

~~12. Other Parties Influencing Trading of Reporting Trader~~

12~~13~~. Trading Subject to Express or Implied Agreement

~~14. Commodity Index Trading Indicator~~

13~~15~~. Swap Dealer Identification

14~~16~~. Major Swap Participant Identification

15~~17~~. Business Sectors, Subsectors and Occupation

16~~18~~. Commodities Being Traded in ~~Derivative~~ Futures Markets

17~~19~~. Business Purpose for Trading in ~~Derivative~~ Futures Markets

18~~20~~. Signature/Authentication, Name, and Date

Acknowledgement of Definitions

Before proceeding with your submission, please check this box to indicate that you have read the definitions for the following terms—as they are used in the Form 40: □

Commodity (or commodities)—generally, all goods and articles (except onions and motion picture box office receipts, or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value, or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in (*see* 7 U.S.C. 1a(9)).

~~Commodity Index Trading (“CIT”)—means:~~

~~a. An investment strategy that consists of investing in an instrument (*e.g.*, a commodity index fund, exchange-traded fund for commodities, or exchange-traded note for commodities) that enters into one or more derivative contracts to track the performance of a published index that is based on the price of one or more commodities, or commodities in combination with other securities; or~~

~~b. An investment strategy that consists of entering into one or more derivative contracts to track the performance of a published index that is based on the price of one or more commodities, or commodities in combination with other securities.~~

Control—as used in this Form, “control” means to actually direct, by power of attorney or otherwise, the trading of a special account or a consolidated account. A special account ~~or a consolidated account~~ may have more than one controller.

~~Derivatives~~ Futures—futures~~,~~ contracts, including options on futures, ~~and swaps~~ traded on a designated contract market.

Omnibus volume threshold account—means any trading account that, on an omnibus basis, carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act~~ or a swap execution facility registered under section 5h of the Act.~~

APPENDIX A: FORMS

Parent—for purposes of Form 40, a person is a parent of a reporting trader if it has a direct or indirect controlling interest in the reporting trader; and a person has a controlling interest if such person has the ability to control the reporting trader through the ownership of voting equity, by contract, or otherwise.

Person—an individual, association, partnership, corporation, trust, or government agency and/or department.

~~Reportable sub-account—means any trading sub-account of an omnibus volume threshold account or omnibus reportable sub-account, which sub-account executes reportable trading volume.~~

~~Reportable sub-account controller—means a natural person who by power of attorney or otherwise actually directs the trading of a reportable sub-account. A reportable sub-account may have more than one controller.~~

Reportable trading volume—means contract trading volume that meets or exceeds the level specified in 17 CFR 15.04.

Reporting trader—a person who must file a Form 40, whether pursuant to 17 CFR 18.04(a)~~, or 17 CFR 18.04(b)~~.

Subsidiary—for purposes of Form 40, a person is a subsidiary of a reporting trader if the reporting trader has a direct or indirect controlling interest in the person; and a reporting trader has a controlling interest if such reporting trader has the ability to control the person through the ownership of voting equity, by contract, or otherwise.

Volume threshold account—means any trading account that carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act~~ or a swap execution facility registered under section 5h of the Act.~~

~~Volume threshold account controller—means a natural person who by power of attorney or otherwise actually directs the trading of a volume threshold account. A volume threshold account may have more than one controller.~~

CFTC Form 40

General Information for Reporting Trader:

For question 1, please provide the name, contact information and other requested information regarding the reporting trader. If the reporting trader is an individual, provide their full legal name and the name of the reporting trader's employer.

1. Indicate whether the reporting trader is a legal entity or a natural person:

   Legal entity: □
   Natural person: □
   Name of Reporting Trader
   Street Address
   City
   State
   Country
   Zip/Postal Code
   Phone Number[76]
   Email Address
   Web site

[76] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

NFA ID (if any)
Legal Entity Identifier (if any)
Name of Employer
Employer NFA ID (if any)
Employer Legal Entity Identifier (if any)

Contact Information

For questions 2, 3, and 4, provide the name and contact information as requested.

2. Individual to contact regarding the ~~derivatives~~ futures trading of the reporting trader (this individual should be able to answer specific questions about the reporting trader's trading activity when contacted by Commission staff):

Check here if this individual has the same contact information as that of the reporting trader.

Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[77]
Email Address
NFA ID (if any)

3. Individual to contact regarding the risk management operations of the reporting trader (this individual should be able to answer specific questions about the reporting trader's risk management operations, including account margining, when contacted by Commission staff):

Check here if this individual has the same contact information as that of the reporting trader.

Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[78]
Email Address
NFA ID (if any)

4. Individual responsible for the information on the Form 40 (this individual should be able to verify, clarify, and explain the answers submitted by a reporting trader on the Form 40):

Check here if this individual has the same contact information as that of the reporting trader.

Name
Street Address
City
State
Country

[77] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[78] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Zip/Postal Code
Phone Number[79]
Email Address
NFA ID (if any)

Omnibus Account Identification

For question 5, indicate whether the reporting trader has a customer omnibus account with a futures commission merchant, clearing member, or foreign broker (NOTE: For the purpose of this question, an omnibus account is an account that one futures commission merchant, clearing member or foreign broker carries for another in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm. In addition, the Commission has traditionally identified omnibus accounts as either *house* or *customer* omnibus accounts. House omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity):

5. Does the reporting trader have a customer omnibus account with a futures commission merchant, clearing member, or foreign broker? YES/NO

IF YES, Give the name(s) of the futures commission merchant, clearing member, or foreign broker carrying the account(s) of the reporting trader.

Foreign Government Affiliation

For question 6, please complete the following (NOTE: For the purpose of this question, affiliation can include, but is not limited to, a situation (1) where the foreign government directly or indirectly controls the reporting trader's assets, operations, and/or ~~derivatives~~ futures trading, or (2) where the reporting trader operates as a direct or indirect subsidiary of a foreign government, its agencies or departments, or any investment program of the foreign government):

6. Is the reporting trader directly or indirectly affiliated with a government other than that of the United States? YES/NO

IF YES, give the name of the government(s).

IF YES, explain the nature of the affiliation between the reporting trader and the government(s) listed above.

Non-Domestic Entity Indicator

For question 7, if the Reporting Trader is a legal entity, please complete the following.

7. Is the reporting trader organized under the laws of a country other than the United States? YES/NO

IF YES, give the name of the country or countries under whose laws the reporting trader is organized.

Ownership Structure of the Reporting Trader

For questions 8 and 9, provide the requested ownership information only as applicable.

[79] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

If the Reporting Trader is a commodity pool, also provide the requested information in questions 8i, 8ii, and 8iii. If the Reporting Trader is reporting commodity pools in which it has an ownership interest, also provide the requested information in questions 9i, 9ii, and 9iii.

8. List all the parents of the reporting trader (including the immediate parent and any parent(s) of its parent) and, separately, all persons that have a 10 percent or greater ownership interest in the reporting trader (commodity pool investors are deemed to have an ownership interest in the pool). List the ultimate parent of the reporting trader regardless of whether the ultimate parent engages in futures trading. For all parents and persons other than the ultimate parent, only list parents and persons to which the Reporting Trader is aware of, or should be aware of, their futures trading. For each such parent or 10 percent or greater owner include the following information:

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
~~Street Address~~
~~City~~
~~State~~
~~Country~~
~~Zip/Postal Code~~
~~Phone Number[80]~~
Web site[81]
~~Email Address~~
NFA ID (if any)
Legal Entity Identifier (if any)
Parent Company/10% Owner/or Both Indicator

Upon request by the Commission or its designee, the individual who the Reporting Trader has listed in response to question 4 promptly must provide the contact information below for each parent and person that has a 10 percent or greater ownership interest in the reporting trader:

Street Address
City
State
Country
Zip/Postal Code
Phone Number[82]
Email Address

~~[80] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[81] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

[82] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

8i. For each person identified in question 8 that is a limited partner, shareholder, or other similar type of pool participant, indicate if they are a principal or affiliate of the operator of the commodity pool.

Principal/Affiliate Indicator

8ii. For each person identified in question 8 that is a limited partner, shareholder, or other similar type of pool participant, indicate if they are also a commodity pool operator of the pool.

Commodity Pool Operator Indicator

8iii. For each person identified in question 8 that is a limited partner, shareholder, or other similar type of pool participant and where the operator of the commodity pool is exempt from registration under § 4.13 of the Commission's regulations, indicate if that person has an ownership or equity interest of 25 percent or greater in the commodity pool.

25% Ownership Indicator

9. List all the subsidiaries of the reporting trader (including the immediate subsidiary and any subsidiaries of those subsidiaries) and, separately, all persons in which the reporting trader has a 10 percent or greater ownership interest (including a 10 percent or greater interest in a commodity pool(s)). Only list subsidiaries and persons that (1) engage in ~~derivatives~~ futures trading, and (2) with respect to which the Reporting Trader is aware of, or should be aware of, their futures trading. For each such subsidiary and/or person include the following information:

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
~~Street Address~~
~~City~~
~~State~~
~~Country~~
~~Zip/Postal Code~~
~~Phone Number~~[83]

Web site[84]
~~Email Address~~

NFA ID (if any)
Legal Entity Identifier (if any)

Upon request by the Commission or its designee, the individual who the Reporting Trader has listed in response to question 4 promptly must provide the contact information below for each subsidiary and person that the reporting trader has a 10 percent or greater ownership interest:

Street Address
City

~~[83] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[84] The Web site and NFA ID requested in this question is only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site if this information has not been previously collected.

State
Country
Zip/Postal Code
Phone Number[85]
Email Address

Subsidiary/10% Ownership/or Both Indicator

9i. For each person identified in question 9 that is a commodity pool and for which you are a limited partner, shareholder or other similar type of pool participant, indicate if you are a principal or affiliate of the operator of the commodity pool.

Principal/Affiliate Indicator

9ii. For each person identified in question 9 that is a commodity pool and for which you are a limited partner, shareholder or other similar type of pool participant, indicate if you are the commodity pool operator for the pool.

Commodity Pool Operator Indicator

9iii. For each person identified in question 9 that is a commodity pool and for which you are a limited partner, shareholder or other similar type of pool participant and for which the operator of the commodity pool is exempt from registration under § 4.13 of the Commission's regulations, indicate if you have an ownership or equity interest of 25 percent or greater in the commodity pool.

25% Ownership Indicator

Control of Trading

For questions 10, 11, and 12~~, and 13~~ provide the requested control information only as applicable.

10. List all persons ~~outside~~ that are unaffiliated third parties of the reporting trader that control some or all of the ~~derivatives~~ futures trading of the reporting trader (including persons that may have been previously identified as a parent, above):

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[86]

[85] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[86] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Web site[87]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

11. List all persons for which the reporting trader controls some or all of the ~~derivatives~~ futures trading (including persons that may have been previously identified as a subsidiary, above):

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[88]
Web site[89]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

~~12. List any other person(s) that directly or indirectly influence, or exercise authority over, some or all of the trading of the reporting trader, but who do not exercise "control" as defined in this Form: Indicate whether the party identified below is a legal entity or a natural person:~~

~~Legal entity: □~~
~~Natural person: □~~
~~Name~~
~~Street Address~~
~~City~~
~~State~~
~~Country~~
~~Zip/Postal Code~~
~~Phone Number~~[90]

[87] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

[88] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[89] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

[90] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

~~Web site[91]~~
~~Email Address~~
~~NFA ID (if any)~~
~~Legal Entity Identifier (if any)~~
~~Some/All Indicator~~

12~~13~~. Is some or all of the ~~derivatives~~ futures trading of the reporting trader subject to an express or implied agreement or understanding with any other person(s) not addressed in questions 10 or~~,~~ 11~~, or 12,~~ above? YES/NO

If yes, provide the following information:

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[92]
Web site[93]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

~~Commodity Index Trading Indicator~~

~~For question 14, please answer the following:~~

~~14i. Is the reporting trader engaged in commodity index trading as defined in paragraph (a) of the definition of CIT above? YES/NO~~

~~14ii. Is the reporting trader engaged in commodity index trading as defined in paragraph (b) of the definition of CIT above? YES/NO~~

~~a. If the reporting trader is engaged in CIT (as defined in paragraph (b)) with respect to one or more commodities or commodity groups appearing on Supplemental List II, indicate whether the reporting trader is, in the aggregate, pursuing long exposure or short exposure with respect to such commodities or commodity groups. It is not necessary to respond to this question with respect to CIT that tracks the~~

~~[91] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.~~

[92] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[93] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

~~performance of multiple unrelated commodities or commodity groups (*e.g.*, an investment in an exchange-traded fund that tracks the performance of an index representing commodities spanning multiple commodity groups).~~

~~14iii. If the reporting trader is currently engaged in commodity index trading as defined in paragraphs (a) or (b) of the CIT definition above, indicate the month and year on which the reporting trader first became engaged in commodity index trading.~~

Swap~~s~~ Dealer ~~Participation~~ and Major Swap Participant Indicators

For questions 13~~15~~ and 14~~16~~, please indicate if the reporting trader meets the specified definition:

13~~15~~. Is the reporting trader a Swap Dealer, as defined in § 1.3~~(ppp)~~ of regulations under the Commodity Exchange Act? YES/NO

14~~16~~. Is the reporting trader a Major Swap Participant, as defined in § 1.3~~(qqq)~~ of regulations under the Commodity Exchange Act? YES/NO

Nature of Business and of ~~Derivatives~~ Futures Trading Activities

For questions 15, 16, and 17~~, 18, and 19~~ provide the requested information only as applicable.

15~~17~~. Select all business sectors and subsectors that pertain to the business activities or occupation of the reporting trader. If more than one business subsector is selected, indicate which business subsector primarily describes the nature of the reporting trader's business.

Choose From Supplemental List I

16~~18~~. Select all commodity groups and individual commodities that the reporting trader presently trades or expects to trade in the near future in ~~derivative~~ futures markets.

Choose From Supplemental List II

17~~19~~. For each selected individual commodity identified in question ~~18~~16, indicate the business purpose(s) for which the reporting trader uses ~~derivative~~ futures markets.

If the reporting trader has more than one business purpose for trading in an individual commodity, also indicate the predominant business purpose.

Choose From Supplemental List III

Signature/Authentication, Name, and Date

18~~20~~. Please sign/authenticate the Form 40 prior to submitting.

Signature/Electronic Authentication:

□ By checking this box and submitting this form (or by clicking "submit," "send," or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by the reporting trader identified below to provide the information and representations submitted on this Form 40, and that the information and representations are true and correct.

Reporting Trader Authorized Representative (Name and Position):

_________________ (Name)

_________________ (Position)

Submitted on behalf of:

_________________ (Reporting Trader Name)

Date of Submission:

APPENDIX A: FORMS

Supplemental List I: List of Business Sectors and Subsectors

Business Sector

Subsector

Agriculture and Forestry
Oilseed Farming
Grain Farming
Fruit and Tree Nut Farming
Other Crop Farming (Specify)
Cattle Ranching and Farming
Hog and Pig Farming
Poultry and Egg Production
Sheep and Goat Farming
Other Animal Production
Forestry, Logging, or Timber Production
Cooperative
Other (Specify)

Mining, Oil and Natural Gas Extraction
Oil Exploration/Production
Natural Gas Exploration/Production
Coal Mining
Precious Metal Mining
Non-Precious Metal Mining
Other (Specify)

Utilities
Utility/Cooperative
Electric Power Generation
Local Distribution Company
Natural Gas Distribution
Other (Specify)

Construction
Building Construction
Heavy and Civil Engineering Construction
Other (Specify)

Manufacturing, Refining and Processing
Animal Food Manufacturing
Grain Milling
Oilseed Milling
Sugar and Confectionery Product Manufacturing
Fruit and Vegetable Preserving and Specialty Food Manufacturing
Dairy Product Manufacturing
Animal Slaughtering and Processing
Bakeries
Other Food Manufacturing
Beverage Manufacturing Textile Mills
Textile Product Mills
Apparel Manufacturing
Wood Product Manufacturing

Paper Manufacturing
Pulp, Paper, and Paperboard Mills
Petroleum and Coal Products Manufacturing
Renewable Fuels Manufacturing
Petrochemical/Chemical Manufacturing
Plastics and Rubber Products Manufacturing
Natural Gas Processing
Precious Metal Processor/Smelter
Non-Precious Metal Processor
Metals Fabricator
Other (Specify)

Wholesale Trade
Lumber and Other Construction Materials Merchant Wholesalers
Metal and Mineral Merchant Dealer
Grocery and Related Product Merchant Wholesaler
Farm Product Raw Material Merchant Wholesalers
Chemical and Allied Products Merchant Wholesalers
Petroleum and Petroleum Products Merchant Wholesalers
Natural Gas, Power Marketer
Importer/Exporter (specify commodities)
Other (Specify)

Retail Trade
Building Materials and Supplies Dealers
Food and Beverage Stores
Jeweler/Precious Metals Retailer
Vehicle Fuel Retailer/Convenience Store Operator
Fuel Dealers
Other (Specify)

Transportation and Warehousing
Air Transport
Trucking
Pipeline Transportation of Crude Oil
Pipeline Transportation of Natural Gas
Farm Product Warehousing and Storage
Energy Distributor (warehousing, storage)
Other (Specify)

End User (NOTE: May not be the only/primary subsector selected)
Metals End User (Construction Co., Brass Mill, Steel Mill)
Emissions End User (Factory, Industrial Cos.)
Petroleum End User (Airline Cos. Municipalities, Industrial Cos., Trucking Cos.)

Information
Other (Specify)

Financial Institutions and Investment Management

Dealers and Financial Intermediaries
Broker/Dealer
Bank Holding Company
Investment/Merchant Bank

- Non-US Commercial Bank
- US Commercial Bank
- Swaps/Derivatives Dealer
- Universal Bank

Asset/Investment/Fund Management:

- Asset/Investment Manager
  - Institutional Clients
  - Retail Clients
- Managed Accounts and Pools (CTAs, CPOs, etc.)
  - Institutional Clients
  - Retail Clients
- College Endowment, Trust, Foundation
- Fund of Hedge Funds
- Hedge Fund
- Mutual Fund
- Pension Fund
- Private Wealth Management
- Private Bank
- Exchange Traded Fund Issuer
- Exchange Traded Note Issuer

Government Financial Institution:

- Central Bank
- Sovereign Wealth Fund
- Government Sponsored Enterprise (GSE)
- Other Governmental Entity (Specify)

Other Financial or Trading Entities:

- Arbitrageur
- Individual Trader/Investor
- Floor Broker
- Floor Trader
- Market Maker
- Proprietary Trader
- Corporate Treasury
- Mortgage Originator
- Savings Bank
- Credit Union
- Insurance Company
- Other (Specify)

Real Estate

- Other (Specify)

Arts, Entertainment, and Recreation

- Performing Arts Companies
- Promoters of Performing Arts
- Agents and Managers for Artists and Entertainers
- Independent Artists, Writers, Performers
- Other (Specify)

Accommodation and Food Services

- Food Services
- Other (Specify)

Public Administration
- Administration of Environmental Quality Programs
- Administration of Economic Programs
- Other (Specify)

Other (specify)

Supplemental List II: Commodity Groups and Individual Commodities

Commodity Group

Individual Commodity

GRAINS
- OATS
- WHEAT
- CORN
- RICE

LIVESTOCK/MEAT PRODUCTS
- LIVE CATTLE
- PORK BELLIES
- FEEDER CATTLE
- LEAN HOGS

DAIRY PRODUCTS
- MILK
- BUTTER
- CHEESE

OILSEED AND PRODUCTS
- SOYBEAN OIL
- SOYBEAN MEAL
- SOYBEANS

FIBER
- COTTON

FOODSTUFFS/SOFTS
- COFFEE
- FROZEN CONCENTRATED ORANGE JUICE
- SUGAR
- COCOA

OTHER AGRICULTURAL

REAL ESTATE

CURRENCY

EQUITIES AND EQUITY INDICIES

INTEREST RATES
- TREASURY COMPLEX
- OTHER INTEREST RATE PRODUCTS

OTHER FINANCIAL INSTRUMENTS

PETROLEUM AND PRODUCTS
- JET FUEL
- ETHANOL
- BIODIESEL
- FUEL OIL

  - HEATING OIL
  - GASOLINE
  - NAPHTHA
  - CRUDE OIL
  - DIESEL
- NATURAL GAS AND PRODUCTS
  - NATURAL GAS LIQUIDS
  - NATURAL GAS
- ELECTRICITY AND SOURCES
  - COAL
- ELECTRICITY
  - URANIUM
- PRECIOUS METALS
  - PALLADIUM
  - PLATINUM
  - SILVER
  - GOLD
- BASE METALS
  - STEEL
  - COPPER
- WOOD PRODUCTS
  - LUMBER
  - PULP
- CHEMICALS
- PLASTICS
- EMISSIONS
- WEATHER
- OTHER (SPECIFY)

APPENDIX B: RULETEXT

PART 15—REPORTS—GENERAL PROVISIONS

§ 15.00 Definitions of terms used in parts 15 to 19, and 21 of this chapter.

As used in parts 15 to 19, and 21 of this chapter:

(a) *Cash or Spot*, when used in connection with any commodity, means the actual commodity as distinguished from a futures or options contract in such commodity.

(b) *Clearing member* means any person who is a member of, or enjoys the privilege of clearing trades in his own name through, the clearing organization of a designated contract market, registered derivatives transaction execution facility, or registered entity under section 1a(29) of the Act.

(c) *Clearing organization* means the person or organization which acts as a medium for clearing transactions in commodities for future delivery or commodity option transactions, or for effecting settlements of contracts for future delivery or commodity option transactions, for and between members of any designated contract market, registered derivatives transaction execution facility or registered entity under section 1a(29) of the Act.

(d) *Compatible data processing media* means data processing media approved by the Commission or its designee.

(e) *Customer* means “customer” (as defined in §1.3 of this chapter) and “options customer” (as defined in §1.3 of this chapter).

(f) *Customer trading program* means any system of trading offered, sponsored, promoted, managed or in any other way supported by, or affiliated with, a futures commission merchant, an introducing broker, a commodity trading advisor, a commodity pool operator, or other trader, or any of its officers, partners or employees, and which by agreement, recommendations, advice or otherwise, directly or indirectly controls trading done and positions held by any other person. The term includes, but is not limited to, arrangements where a program participant enters into an expressed or implied agreement not obtained from other customers and makes a minimum deposit in excess of that required of other customers for the purpose of receiving specific advice or recommendations which are not made available to other customers. The term includes any program which is of the character of, or is commonly known to the trade as, a managed account, guided account, discretionary account, commodity pool or partnership account.

(g) *Discretionary account* means a commodity futures or commodity option trading account for which buying or selling orders can be placed or originated, or for which transactions can be effected, under a general authorization and without the specific consent of the customer, whether the general authorization for such orders or transactions is pursuant to a written agreement, power of attorney, or otherwise.

(h) *Exclusively self-cleared contract* means a cleared contract for which no persons, other than a reporting market and its clearing organization, are permitted to accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trade.

(i) *Foreign clearing member* means a “clearing member” (as defined by paragraph (b) of this section) who resides or is domiciled outside of the United States, its territories or possessions.

(j) *Foreign trader* means any trader (as defined in paragraph (s) of this section) who resides or is domiciled outside of the United States, its territories or possessions.

(k) *Futures, futures contract, future delivery or contract for future delivery*, means any contract for the purchase or sale of any commodity for future delivery that is executed on or subject to the rules of a reporting market, including all agreements, contracts and transactions that are treated by a clearing organization as fungible with such contracts.

(l) *Guided account program* means any customer trading program which limits trading to the purchase or sale of a particular contract for future delivery of a commodity or a particular commodity option that is advised or recommended to the participant in the program.

(m) *Managed account program* means a customer trading program which includes two or more discretionary accounts traded pursuant to a common plan, advice or recommendations.

(n) *Open contracts* means "open contracts" (as defined in §1.3 of this chapter) and commodity option positions held by any person on or subject to the rules of a board of trade designated as a contract market under section 5 of the Act which have not expired, been exercised, or offset.

(o) *Option, options, option contract, or options contract*, unless specifically provided otherwise, means any contract for the purchase or sale of a commodity option that is executed on or subject to the rules of a reporting market, including all agreements, contracts and transactions that are treated by a clearing organization as fungible with such contracts.

(p) *Reportable position* means:

(1) For reports specified in parts 17, 18 and §19.00(a)(2) and (a)(3) of this chapter any open contract position that at the close of the market on any business day equals or exceeds the quantity specified in §15.03 of this part in either:

(i) Any one futures of any commodity on any one reporting market, excluding futures contracts against which notices of delivery have been stopped by a trader or issued by the clearing organization of a reporting market; or

(ii) Long or short put or call options that exercise into the same future of any commodity, or other long or short put or call commodity options that have identical expirations and exercise into the same commodity, on any one reporting market.

(2) For the purposes of reports specified in §19.00(a)(1) of this chapter, any combined futures and futures-equivalent option open contract position as defined in part 150 of this chapter in any one month or in all months combined, either net long or net short in any commodity on any one reporting market, excluding futures positions against which notices of delivery have been stopped by a trader or issued by the clearing organization of a reporting market, which at the close of the market on the last business day of the week exceeds the net quantity limit in spot, single or in all-months fixed in §150.2 of this chapter for the particular commodity and reporting market.

(q) *Reporting market* means a designated contract market or a registered entity under section 1a(40) of the Act.

(r) *Special account* means any commodity futures or option account in which there is a reportable position.

(s) *Trader* means a person who, for his own account or for an account which he controls, makes transactions in commodity futures or options, or has such transactions made.

(t) *Control* means to actually direct, by power of attorney or otherwise, the trading of accounts that comprise a special account ~~or a consolidated account~~. A special account ~~or a consolidated account~~ may have more than one controller.

(u) *Reportable trading volume* means contract trading volume that meets or exceeds the level specified in §15.04.

(v) *Omnibus account* means any trading account that one futures commission merchant, clearing member or foreign broker carries for another and in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm.

(w) *Omnibus account originator* means any futures commission merchant, clearing member or foreign broker that executes trades for one or more customers via one or more accounts that are part of an omnibus account carried by another futures commission merchant, clearing member or foreign broker.

(x) *Volume threshold account* means any trading account that carries reportable trading volume on or subject to the rules of a ~~reporting market that is a~~ board of trade designated as a contract market under section 5~~ of the Act or a swap execution facility registered under section 5h~~ of the Act.

(y) *Omnibus volume threshold account* means any trading account that, on an omnibus basis, carries reportable trading volume on or subject to the rules of a ~~reporting market that is a~~ board of trade designated as a contract market under section 5~~ of the Act or a swap execution facility registered under section 5h~~ of the Act.

~~(z) *Omnibus reportable sub-account* means any trading sub-account of an omnibus volume threshold account, which sub-account executes reportable trading volume on an omnibus basis. Omnibus reportable sub-account also~~

~~means any trading account that is itself an omnibus account, executes reportable trading volume, and is a sub-account of another omnibus reportable sub-account.~~

~~(aa) *Reportable sub-account* means any trading sub-account of an omnibus volume threshold account or omnibus reportable sub-account, which sub-account executes reportable trading volume.~~

~~(bb) *Trading account controller* means, for reports specified in §17.01(a) of this chapter, a natural person who by power of attorney or otherwise actually directs the trading of a trading account. A trading account may have more than one controller.~~

(bb) *Trading account owner* means the person identified as the holder of the account in the books and records of a clearing member.

(cc) *Volume threshold account* ~~controller~~ *owner* means ~~a natural~~ the person ~~who by power of attorney or otherwise actually directs the trading of a volume threshold account. A volume threshold account may have more than one controller.~~ identified as the holder of the account in a clearing member's books and records.

~~(dd) *Reportable sub-account controller* means a natural person who by power of attorney or otherwise actually directs the trading of a reportable sub-account. A reportable sub-account may have more than one controller.~~

§ 15.04 Reportable trading volume level.

The volume quantity for the purpose of reports filed under parts 17 and 18 of this chapter is trading volume of 250 or more contracts, during a single trading day, on a ~~single reporting market that is a~~ board of trade designated as a contract market under section 5 of the Act~~ or a swap execution facility registered under section 5h of the Act~~, in all instruments that such ~~reporting market~~ board of trade designates with the same product identifier (including purchases and sales, and inclusive of all expiration months).

APPENDIX B: RULETEXT

PART 17—REPORTS BY REPORTING MARKETS, FUTURES COMMISSION MERCHANTS, CLEARING MEMBERS, AND FOREIGN BROKERS

§17.01 Identification of special accounts, volume threshold accounts, and omnibus accounts.

(a) *Identification of special accounts.* When a special account is reported for the first time, the futures commission merchant, clearing member, or foreign broker shall identify the special account to the Commission on Form 102, in accordance with the form instructions and as specified in §17.02(b).

(b) *Identification of volume threshold accounts.* Each clearing member shall identify and report its volume threshold accounts to the Commission on Form 102, in accordance with the form instructions and as specified in §17.02(c).

~~(c) *Identification of omnibus accounts and sub-accounts.* Each originator of an omnibus volume threshold account identified in Form 102 or an omnibus reportable sub-account identified in Form 71 shall, after a special call upon such originator by the Commission or its designee, file with the Commission an "Identification of Omnibus Accounts and Sub-Accounts" on Form 71, to be completed in accordance with the instructions thereto, at such time and place as directed in the call.~~

(c~~d~~) *Exclusively self-cleared contracts.* Unless determined otherwise by the Commission, reporting markets that list exclusively self-cleared contracts shall meet the requirements of paragraphs (a) and (b) of this section, as they apply to trading in such contracts by all clearing members, on behalf of all clearing members.

(~~e~~d) *Special call provision.* Upon a call by the Commission or its designee, the reports required to be filed by futures commission merchants, clearing members, foreign brokers, and reporting markets under paragraphs (a) through (d) of this section shall be submitted ~~within 24 hours of the Commission or its designee's request~~ promptly in accordance with the instructions accompanying the request.

§ 17.02 Form, manner and time of filing reports.

Unless otherwise instructed by the Commission or its designee, the reports required to be filed by reporting markets, futures commission merchants, clearing members, and foreign brokers under §§17.00 and 17.01 shall be filed as specified in paragraphs (a) through (c) of this section.

(a) *Section 17.00(a) reports*. Reports filed under §17.00(a) shall be submitted through electronic data transmission procedures approved in writing by the Commission or its designee not later than 9 a.m. on the business day following that to which the information pertains. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.[1]

(b) *Section 17.01(a) reports*. For data submitted pursuant to §17.01(a) on Form 102:

(1) *Form of submission.* Form 102 must be submitted to the Commission in the form and manner provided on www.cftc.gov.

(2) *Time of submission*. For each account that becomes reportable as a special account, the futures commission merchant, clearing member, or foreign broker, as appropriate, shall submit a Form 102 to the Commission, in accordance with the instructions thereto, and in the manner specified by the Commission or its designee. Such form shall be submitted in accordance with the instructions and schedule set forth in paragraph~~s~~ (b)(2)(i~~) and (ii)~~ of this section:

(i) The applicable reporting party shall submit ~~a completed~~ special account controller and omnibus originator contact information for the special account on a Form 102 to the Commission no later than 9 a.m. on the business day following the date on which the special account becomes reportable, or on such other date as directed by special call of the Commission or its designee, and as periodically required thereafter by paragraph (b)(3) ~~and (4)~~ of this section. The applicable reporting party shall submit a

[1] Per section II.B of the Petition, the Commission should clarify in the preamble to the proposed rules that reporting entities can reasonably rely on information provided by customers/counterparties and that the Commission will not commence an enforcement action if a reporting entity has no reason to believe that the information provided was incorrect.

completed Form 102 to the Commission no later than 9 a.m. on the third business day following the date on which the special account becomes reportable (including the correction of data previously reported, if applicable), or on such other date as directed by special call of the Commission or its designee, and as periodically required thereafter by paragraph (b)(3) of this section~~ Such form shall include all required information, including the names of the owner(s) and controller(s) of each trading account that is not an omnibus account, and that comprises a special account reported on the form, provided that, with respect to such owners(s) and controller(s), information other than the names of such parties may be reported in accordance with the instructions and schedule set forth in paragraph (b)(2)(ii) of this section~~. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.

~~(ii) With respect to the owner(s) and controller(s) of each trading account that is not an omnibus account, and that comprises a special account reported on Form 102, information other than the names of such parties must be provided on Form 102 no later than 9 a.m. on the third business day following the date on which the special account becomes reportable, or on such other date as directed by special call of the Commission or its designee, and as periodically required thereafter by paragraphs (b)(3) and (4) of this section. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.~~

(3) *Change updates*. If any change causes the information filed by a futures commission merchant, clearing member, or foreign broker on a Form 102 for a special account to no longer be accurate, then such futures commission merchant, clearing member, or foreign broker shall file an updated Form 102 with the Commission ~~in accordance with the instructions and schedule set forth in paragraphs (b)(2)(i) and (ii) of this section \~~no later than 9 a.m. on the business day following the date on which the futures commission merchant, clearing member, or foreign broker was made aware of the change, or on such other date as directed by special call of the Commission, provided that, a futures commission merchant, clearing member, or foreign broker may stop providing change updates for a Form 102 that it has submitted to the Commission for any special account ~~upon notifying the Commission or its designee that the account in question is no longer reportable as a special account and ~~that has not been reportable as a special account for the past six months.[2]

~~(4) *Refresh updates*. For Special Accounts – Starting on a date specified by the Commission or its designee and at the end of each annual increment thereafter (or such other date specified by the Commission or its designee that is equal to or greater than six months), each futures commission merchant, clearing member, or foreign broker shall resubmit every Form 102 that it has submitted to the Commission for each of its special accounts, provided that, a futures commission merchant, clearing member, or foreign broker may stop providing refresh updates for a Form 102 that it has submitted to the Commission for any special account upon notifying the Commission or its designee that the account in question is no longer reportable as a special account and has not been reportable as a special account for the past six months.~~

(c) *Section 17.01(b) reports*. For data submitted pursuant to §17.01(b) on Form 102:

(1) *Form of submission*. Form 102 must be submitted to the Commission in the form and manner provided on www.cftc.gov.

(2) *Time of submission*. For each account that becomes reportable as a volume threshold account, the clearing member shall submit a Form 102 to the Commission, in accordance with the instructions thereto, and in the manner specified by the Commission or its designee. Such form shall be submitted in accordance with the instructions and schedule set forth in paragraph (c)(2)(i) ~~and (ii)~~ of this section:

(i) The clearing member shall submit ~~a completed ~~the initial contact information for the volume threshold account owner or omnibus account originator on Form 102 to the Commission no later than 9 a.m. on the business day following the date on which the volume threshold account becomes reportable, or on such other date as directed by special call of the Commission or its designee, and as periodically

[2] The Commission should clarify in the preamble to any proposal to modify the OCR Rule that the Commission will not commence an enforcement action against a reporting entity for failure to report a change update if the customer/counterparty did not notify the reporting entity of the applicable change.

required thereafter by paragraph~~s~~ (c)(3) ~~and (4)~~ of this section. ~~Such form shall include all required information, including the names of the owner(s) and controller(s) of each volume threshold account reported on the form that is not an omnibus account, provided that, with respect to such owners(s) and controller(s), information other than the names of such parties may be reported in accordance with the instructions and schedule set forth in paragraph (c)(2)(ii) of this section. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.~~

~~(ii) With respect to the owner(s) and controller(s) of each volume threshold account reported on Form 102 that is not an omnibus account, information other than the names of such parties must be provided on Form 102 no later than 9 a.m.~~ The clearing member shall submit a completed Form 102 to the Commission no later than 9 a.m. on the third business day following the date on which the volume threshold account becomes reportable~~,~~ (including the correction of data previously reported, if applicable), or on such other date as directed by special call of the Commission or its designee, and as periodically required thereafter by paragraph~~s~~ (c)(3) ~~and (4)~~ of this section. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.

(3) *Change updates*. If any change causes the information filed by a clearing member on a Form 102 for a volume threshold account to no longer be accurate, then such clearing member shall file an updated Form 102 with the Commission ~~in accordance with the instructions and schedule set forth in paragraphs (c)(2)(i) and (ii) of this section~~ no later than 9 a.m. on the third business day following the date on which the clearing member was made aware of the change, or on such other date as directed by special call of the Commission, provided that, a clearing member may stop providing Form 102 change updates for a volume threshold account ~~upon notifying the Commission or its designee that the volume threshold account~~ that executed no trades in any product in the past six months on the reporting market at which the volume threshold account reached the reportable trading volume level.[3]

~~(4) *Refresh updates*. For Volume Threshold Accounts – Starting on a date specified by the Commission or its designee and at the end of each annual increment thereafter (or such other date specified by the Commission or its designee that is equal to or greater than six months), each clearing member shall resubmit every Form 102 that it has submitted to the Commission for each of its volume threshold accounts, provided that, a clearing member may stop providing refresh updates for a Form 102 that it has submitted to the Commission for any volume threshold account upon notifying the Commission or its designee that the volume threshold account executed no trades in any product in the past six months on the reporting market at which the volume threshold account reached the reportable trading volume level.~~

[3] Per section IV.B of the Petition, the Commission should clarify in the preamble to any proposal to modify the OCR Rule that the Commission will not commence an enforcement action against a reporting entity for failure to report a change update if the customer/counterparty did not notify the reporting entity of the applicable change.

APPENDIX B: RULETEXT

PART 18 – REPORTS BY TRADERS

§18.04 Statement of reporting trader.

(a) Every trader who owns, holds, or controls a reportable futures and option position shall after a special call upon such trader by the Commission or its designee file with the Commission a "Statement of Reporting Trader" on the Form 40, to be completed in accordance with the instructions thereto, at such time and place as directed in the call.

(b) Every ~~volume threshold account controller,~~ person who owns, holds, or controls a volume threshold ~~account, reportable sub-account controller, and person who owns a reportable sub-~~account shall after a special call upon such person by the Commission or its designee file with the Commission a "Statement of Reporting Trader" on the Form 40, to be completed in accordance with the instructions thereto, at such time and place as directed in the call.

(c) Every person who owns, holds, or controls a futures-equivalent position in "paired swaps" that equals or exceeds the levels described in Part 15.03 of this Chapter shall after a special call upon such person by the Commission or its designee file with the Commission a "Statement of Reporting Trader" on the Form 40S, to be completed in accordance with the instructions thereto, at such time and place as directed in the call.

(d) For purposes of paragraph (c), "paired swaps" shall include a swap that is:

(1) Directly or indirectly linked, including being partially or fully settled on, or priced at a differential to, the price of any commodity futures contract listed paragraph (e);

(2) Directly or indirectly linked, including being partially or fully settled on, or priced at a differential to, the price of the same commodity for delivery at the same location or locations as the futures contracts listed in paragraph (e)

(e) Covered futures contracts:

Covered Futures Contracts
Chicago Board of Trade ("CBOT") Corn.
CBOT Ethanol.
CBOT Oats.
CBOT Rough Rice.
CBOT Soybean Meal.
CBOT Soybean Oil.
CBOT Soybeans.
CBOT Wheat.
Chicago Mercantile Exchange ("CME") Butter.
CME Cheese.
CME Dry Whey.
CME Feeder Cattle.
CME Hardwood Pulp.
CME Lean Hogs.
CME Live Cattle.
CME Milk Class III.
CME Non Fat Dry Milk.

APPENDIX B: RULETEXT

CME Random Length Lumber.
CME Softwood Pulp.
COMEX (“CMX”) Copper Grade #1.
CMX Gold.
CMX Silver.
ICE Futures U.S. (“ICUS”) Cocoa.
ICUS Coffee C.
ICUS Cotton No. 2.
ICUS Frozen Concentrated Orange Juice.
ICUS Sugar No. 11.
ICUS Sugar No. 16.
Kansas City Board of Trade (“KCBT”) Wheat.
Minneapolis Grain Exchange (“MGEX”) Wheat.
NYSELiffe (“NYL”) Gold, 100 Troy Oz.
NYL Silver, 5000 Troy Oz.
New York Mercantile Exchange (“NYMEX”) Cocoa.
NYMEX Brent Financial.
NYMEX Central Appalachian Coal.
NYMEX Coffee.
NYMEX Cotton.
NYMEX Crude Oil, Light Sweet.
NYMEX Gasoline Blendstock (RBOB).
NYMEX Hot Rolled Coil Steel.
NYMEX Natural Gas.
NYMEX No. 2 Heating Oil, New York Harbor.
NYMEX Palladium.
NYMEX Platinum.
NYMEX Sugar No. 11.
NYMEX Uranium.

APPENDIX B: RULETEXT

§ 18.05 Maintenance of books and records.

~~(a) Every volume threshold account controller; person who owns a volume threshold account; reportable sub-account controller; person who owns a reportable sub-account; and trader who owns, holds, or controls a reportable futures or option position shall keep books and records showing all details concerning all positions and transactions in the commodity or swap:~~

~~(1) On all reporting markets;~~

~~(2) Executed over the counter or pursuant to part 35 of this chapter; and~~

~~(3) On foreign boards of trade.~~

~~(b) Every such volume threshold account controller; person who owns a volume threshold account; reportable sub-account controller; person who owns a reportable sub-account; and trader who owns, holds, or controls a reportable futures or option position shall also keep books and records showing all details concerning all positions and transactions in the cash commodity or swap, its products and byproducts, and all commercial activities that it hedges in the futures, option, or swap contract in which it is reportable.~~

~~(c) Every volume threshold account controller; person who owns a volume threshold account; reportable sub-account controller; person who owns a reportable sub-account; and trader who owns, holds, or controls a reportable futures or option position shall upon request furnish to the Commission any pertinent information concerning such positions, transactions, or activities in a form acceptable to the Commission.~~

(a) Every person who owns, holds, or controls a reportable futures position (or options on futures positions) shall keep books and records that are maintained in the course of their regularly conducted business activity concerning:

(1) Futures positions on any designated contract market based upon the same commodity as the reportable futures position; and

(2) Futures positions on any foreign board of trade registered pursuant to Part 48 based upon the same commodity as the reportable futures position.

(b) Every person who owns, holds, or controls a reportable futures position (or options on futures positions), a futures-equivalent position in paired swaps that equals or exceeds the levels described in Part 15.03 of this Chapter, or owns a volume threshold account, shall keep books and records that are maintained in the course of their regularly conducted business activity concerning:

(1) transactions in the cash commodity, its products and byproducts, that the person hedges with the reportable futures position, paired swaps, or volume threshold account; and

(2) all other commercial activities that the person hedges with the reportable futures position, paired swaps, or volume threshold account.

(c) Every person required to retain records pursuant to paragraphs (a) and (b) shall upon request furnish to the Commission any records required to be maintained hereunder concerning such positions, transactions, or activities in a form acceptable to the Commission.

~~**§ 18.06 [Reserved]**~~

§ 18.06 Legal Entity Identifier for Reportable Futures Position or Volume Threshold Account

(a) Every non-natural person that owns, holds, or controls a reportable futures position (or options on futures positions) or volume threshold account shall obtain a legal entity identifier that conforms with Part 45.6 of this Chapter.

June 14, 2018

Via Electronic Submission

Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition for Amendment of the Ownership and Control Reports Rule

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**") and Commodity Markets Council ("**CMC**") respectfully submits this petition (the "**Petition**") to amend the U.S. Commodity Futures Trading Commission's ("**CFTC**" or the "**Commission**") Ownership and Control Reports ("**OCR**") rule.[1]

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. Many FIA members are reporting entities that are directly impacted by the OCR Rule.[2] FIA has participated actively in the OCR rulemaking process by: (1) serving as a liaison between the Commission and the industry; (2) assisting with industry implementation efforts; (3) filing comments on the proposed rules; and (4) working with Commission Staff on no-action relief that addresses various aspects of the OCR Rule.

CMC is a trade association that brings together exchanges and their industry counterparts. Its members include commercial end-users that utilize the futures and swaps markets for agriculture, energy, metal, and soft commodities. Its industry member firms also include regular users and members of swap execution facilities (each, a "**SEF**") as well as designated contract markets (each, a "**DCM**"). Along with these market participants, CMC members also include regulated

[1] Rule 13.2, 17 C.F.R. § 13.2, provides, in part, that "[a]ny person may file a petition with the Secretariat of the Commission for issuance, amendment or repeal of a rule of general application. The petition . . . shall set forth the text of any proposed rule or amendment or shall specify the rule the repeal of which is sought. The petition shall further state the nature of the petitioner's interest and may state arguments in support of the issuance, amendment or repeal of the rule."

[2] Ownership and Control Reports, Forms 102/102S, 40/40S, and 71, 78 Fed. Reg. 69,178 (Nov. 18, 2013) ("**OCR Rule**" or the "**Rule**").

derivatives exchanges and price reporting agencies. The businesses of all CMC members depend upon the efficient and competitive functioning of the risk management products traded on DCMs, SEFs, and over-the-counter ("**OTC**") markets.

I. Summary of the Petition

The principal purpose of the Petition is to codify the latest CFTC Staff OCR no-action Relief ("**No-Action Relief**").[3] In addition, and consistent with the Commission's KISS initiative, the Petition identifies areas where the Commission can streamline and right-size the OCR data that reporting entities are required to submit.[4] We believe that our proposed amendments to the OCR Rule will provide the Commission with the OCR data that it needs to perform its important market surveillance function.

The Petition also requests that the Commission sunset the Part 20 swaps large trader reporting rule. The Commission designed Part 20 as a temporary initiative for collecting swap position data before the establishment of swap data repositories ("**SDRs**"). Now that SDRs have been operating for several years, the Commission should withdraw Part 20 to reduce the data reporting burden on reporting entities.

The Petition includes two attachments: (1) recommended revisions to the current OCR Forms ("**Appendix A: Forms**"); and (2) recommended revisions to the text of relevant CFTC rules ("**Appendix B: Rule text**").

II. Modifications to the OCR Forms

A. Form 102A: Codify No-Action Relief and Streamline Reporting

A futures commission merchant ("**FCM**"), clearing member, or foreign broker must file a Form 102A if the positions in a trading account, or group of trading accounts under common control, exceed a specified reportable level. Trading accounts that exceed a reportable level are collectively referred to as a "special account."[5] We recommend that the Commission modify the process for reporting and the content of Form 102A as set forth below.

1. Eliminate the requirement for clearing members to report natural person controllers.

Pursuant to the No-Action Relief, clearing members are no longer required to report natural person controllers on the Form 102A.[6] The Commission should codify the No-Action Relief and

[3] *See* CFTC Letter No. 17-45 (Sept. 25, 2017).

[4] *See* FIA Letter to Christopher Kirkpatrick, RIN 3038-AE55 (Sept. 28, 2017).

[5] *See* Rules 15.00(r) and 17.00(a).

[6] *See* No-Action Relief, Section II.A.1.b.

eliminate question 10(iii) from the current Form 102A.[7] Furthermore, the Commission should make conforming amendments in Rule 15.00 to remove the definition of a natural person controller.[8]

As the Commission is aware, any requirement that a clearing member report natural person controllers imposes substantial burdens with which clearing members may not be able to comply. In particular, the natural person controller field requires clearing members to report information about their customers that is not in the possession of the clearing member. Furthermore, even if a customer provides the necessary data to the clearing member, we expect that the list of natural person controllers for certain customers will be extensive and change frequently. Rather than require clearing members to report this information, if the Commission needs additional information about the trading activity of a customer, it has the ability to obtain that information directly from the customer (*e.g.*, through a special call).

2. Provide sufficient time for reporting entities to submit a completed Form 102A.

The Commission should enable reporting entities to submit initial contact information on the Form 102A by 9 AM on the first business day after the account becomes reportable. Thereafter, reporting entities should have three business days after the account becomes reportable to submit a completed Form 102A, including to correct data previously reported. This change to the timeframe to report is addressed in the No-Action Relief.[9]

To implement this modification, we recommend that the Commission amend Rule 17.02(b)(2) to require that reporting entities must submit the special account controller or omnibus account originator by 9 AM the business day after the account becomes reportable.[10] Thereafter, reporting entities should have until 9 AM three business days after the account becomes reportable to submit a completed Form 102A, which may correct data previously reported.

3. Eliminate the requirement to file an annual refresh.

Consistent with the No-Action Relief, the Commission should eliminate the requirement in Rule 17.02(b)(4) for reporting entities to submit an annual refresh of Form 102A.[11] The annual refresh requirement is redundant to the requirement that reporting entities must submit change updates. In addition to this redundancy, the annual refresh process imposes substantial burdens on reporting entities to contact customers to refresh existing information. The refresh process also imposes substantial burdens on customers that utilize more than one FCM because the

[7] *See* Appendix A, pages 10-11.

[8] Because Rule 15.00 is a list of definitions, the Commission should also consider removing the numbering system for the various terms in order to list the definitions alphabetically. *Cf. Definitions*, 83 Fed. Reg. 7979 (Feb. 23, 2018) (interim final rule).

[9] *See* No-Action Relief, Section II.A.1.a.

[10] *See* Appendix B, pages 4-5.

[11] *See* No-Action Relief, Section II.A.4. *See also* Appendix B, page 5.

customer would need to refresh its information with each FCM at different times throughout the year.

4. Clarify that the timeframe for a reporting entity to file a change update starts when the reporting entity is made aware of the change.

The Commission should amend Rule 17.02(b)(3) to clarify that a reporting entity must file a change update by 9 AM on the business day after the date when the reporting entity is made aware of the change.[12] As FIA has previously commented, a reporting entity can only report a change update to a Form 102A (*e.g.*, a new telephone number) if the reporting entity's customer notifies the reporting entity of the change. Despite this practical limitation, Rule 17.02(b)(3) obligates a reporting entity to file a change update by 9 AM on the business day after the change *occurred*, regardless of whether the reporting entity has been made aware of the change. The current framework puts reporting entities in the untenable position of potentially being accountable for a reporting omission when the reporting entity is not aware of the need to file an update.

5. Eliminate the condition that a reporting entity notify the Commission that a special account has not been reportable for the prior six months in order to cease submitting change updates.

We recommend that the Commission remove the condition in Rule 17.02(b)(3) that a reporting entity notify the Commission that a special account has not been reportable for the prior six months in order to cease submitting change updates for the Form 102A.[13] At present, if a special account has not been reportable for six months, a reporting entity is no longer required to file a change update for the Form 102A. However, in order to cease filing change updates, Rule 17.02(b)(3) obligates the reporting entity to notify the Commission via email. This manual notice filing imposes an unnecessary burden on reporting entities because the Commission does not need the notice filing to determine whether a special account has been reportable during the prior six months. Furthermore, the email notice filing framework does not enable reporting entities to automate the process to stop filing change updates.

6. Clarify that the trading account owner is the holder of the account in the clearing member's books and records.

The Commission should clarify the definition of a trading account owner in new Rule 15.00(bb), so that a clearing member must report on the Form 102A the holder of the account as identified in the clearing member's books and records.[14] The identity of the account holder should provide

[12] *See* Appendix B, page 5.

[13] *See* Appendix B, page 5.

[14] *See* Appendix B, page 3.

the Commission with sufficient contact details to enable it to issue a Form 40 for additional information about the reportable trader.

7. Clarify that the contact person on the Form 102A can be an individual in a legal or compliance role.

During the implementation process of the Form 102A, certain FIA members received feedback from Staff that the individual contact for a special account on Form 102A should be a person that controls the trading decisions, not an individual in a legal or compliance role. We request that the Commission clarify that the individual contact for a special account on Form 102A can be a person in a legal or compliance role. Because the Form 102A contact person is often the individual who receives a Form 40 special call from the Commission, the Commission should allow a person in a legal or compliance role to be listed to ensure that an entity responds in a timely and appropriate manner to a special call.

8. Remove question 6 requesting a "special account" owner.

The Commission should not require reporting entities to report the special account owner on Form 102A because a special account is a group of trading accounts to which there is no "owner." Therefore, we recommend that the Commission remove question 6 from Form 102A.[15]

As the Commission is aware, a "special account" is a collection of one or more trading accounts subject to common control. Reporting entities already identify the special account controller(s) associated with a special account in response to current question 7. Furthermore, in certain circumstances, it may be difficult to determine a single special account owner. For example, if there are different trading account owners within a special account (*e.g.*, two subsidiaries, each with a trading account subject to common control), it is unclear which entity should be identified as the special account owner.

9. Remove the instruction on Form 102A to report based solely on ownership of a reportable position.

Although current Form 102A includes a box to check if a reporting entity submits a Form 102A based solely on ownership of a reportable position, footnote five states that reporting entities are not required to submit Form 102A based solely upon ownership of a reportable position. Rather than impose a requirement in the body of Form 102A and then remove the requirement in a footnote, the Commission should simply remove the requirement to report Form 102A based solely upon ownership of a reportable position.[16]

[15] *See* Appendix A, page 5.

[16] *See* Appendix A, page 4.

10. Modify the technical specifications for Form 102A to enable reporting entities to list more than one special account controller.

Although the definition of "control" in Rule 15.00(t) and the text of Form 102A provide for a reporting entity to identify more than one special account controller, the technical specifications to submit the data enable a reporting entity to submit only one special account controller.[17] The Commission should conform the technical specifications to the rule text and Form 102A, and enable a reporting entity to identify more than one special account controller.

B. Form 102B: Codify No-Action Relief and Streamline Reporting

Clearing members that clear a trading account that exceeds an intra-day volume threshold must submit a Form 102B identifying the trading account. A trading account that exceeds the intra-day volume threshold is referred to as a "volume threshold account." We recommend that the Commission modify the process for reporting and the content of Form 102B as set forth below. For the convenience of Staff, items 1 through 7 below related to Form 102B address the same issues as items 1 through 7 above related to Form 102A.

1. Eliminate the requirement for clearing members to report volume threshold account controllers.

Consistent with the No-Action Relief, the Commission should remove question 6 on Form 102B regarding natural person controllers (referred to as "volume threshold account controllers").[18] Furthermore, the Commission should make conforming amendments to Rule 15.00 and Forms 40 and 40S to remove references to volume threshold account controllers.

2. Provide sufficient time for reporting entities to submit a completed Form 102B.

Consistent with the No-Action Relief, the Commission should provide for reporting entities to submit initial contact information on the Form 102B by 9 AM on the first business day after the account becomes reportable.[19] Thereafter, reporting entities should have three business days after the account becomes reportable to submit a completed Form 102B, including to correct data previously reported.

To implement this modification, we recommend that the Commission amend Rule 17.02(c)(2) to require that reporting entities submit the volume threshold account owner or omnibus account

[17] Current question 7 refers to "Special Account Controller**(s)** Contact Information" (emphasis added).

[18] *See* No-Action Relief, Section II.A.2.c; and Appendix A, page 14. Our rationale to remove natural person controllers from the Form 102B is the same rationale provided above to remove natural person controllers from the Form 102A.

[19] *See* No-Action Relief II.A.2.E.

originator by 9 AM on the business day after the account becomes reportable.[20] Thereafter, reporting entities should have until 9 AM three business days after the account becomes reportable to submit a completed Form 102B, which may correct data previously reported.

3. Eliminate the requirement to file an annual refresh.

Consistent with the No-Action Relief, the Commission should eliminate the requirement in Rule 17.02(c)(4) for reporting entities to submit an annual refresh to Form 102B.[21] The annual refresh requirement is redundant to the requirement for reporting entities to submit change updates. In addition to the redundancy, the annual refresh process imposes substantial burdens on reporting entities to contact customers to refresh existing information. The refresh process also imposes substantial burdens on customers that utilize more than one clearing member because the customer would need to refresh its information with each clearing member.

4. Clarify that the timeframe for a clearing member to file a change update starts when the clearing member is made aware of the change.

The Commission should amend Rule 17.02(c)(3) to clarify that a clearing member must file a change update by 9 AM on the business day after the date when the clearing member is made aware of the change.[22] As noted above concerning Form 102A, a clearing member can only report a change update if a customer informs the clearing member of a change. Accordingly, the regulatory requirement for a clearing member to file a change update should occur only after the clearing member is aware of (or should have been aware of) the change.

5. Eliminate the condition that a clearing member notify the Commission that a volume threshold account has not been reportable for the prior six months in order to cease submitting change updates.

Consistent with its recommendation concerning Rule 17.02(b)(3), we recommend that the Commission similarly remove the condition in Rule 17.02(c)(3) that a clearing member notify the Commission that a volume threshold account has not been reportable for the prior six months in order to cease submitting change updates for the Form 102B.[23] At present, if a volume threshold account has not been reportable for six months, a clearing member is no longer required to file a change update for the Form 102B. However, in order to cease filing change updates, Rule 17.02(c)(3) obligates the clearing member to notify the Commission. This manual notice filing imposes an unnecessary burden on clearing members because the Commission does not need the notice filing to determine whether a volume threshold account has been reportable

[20] *See* Appendix B, pages 5-6.

[21] *See* No-Action Relief, Section II.A.4; and Appendix B, page 6.

[22] *See* Appendix B, page 6.

[23] *See* Appendix B, page 6.

during the prior six months. Furthermore, the email notice filing framework does not enable reporting entities to automate the process to stop filing change updates.

6. *Clarify that the volume threshold account owner is the holder of the account in the clearing member's books and records.*

The Commission should clarify the definition of a volume threshold account owner in new Rule 15.00(cc), so that a clearing member must report on Form 102B the holder of the account as identified in the clearing member's books and records.[24] The identity of the account holder should provide the Commission with sufficient contact details to enable it to issue a Form 40 for additional information about the reportable trader.

7. *Clarify that the contact person on the Form 102B can be an individual in a legal or compliance role.*

Consistent with our comment concerning Form 102A, the Commission should clarify that the individual contact for a volume threshold account on Form 102B can be a person in a legal or compliance role. Because the Form 102B contact person is often the individual who receives a Form 40 special call from the Commission, the Commission should allow a person in a legal or compliance role to be listed to ensure that an entity responds in a timely and appropriate manner to a special call.

8. *Increase the reportable threshold for Form 102B to 250 contracts.*

Consistent with the No-Action Relief, the Commission should amend Rule 15.04 to increase the reportable level that triggers a Form 102B from 50 contracts to 250 contracts.[25] As FIA has commented in the past, the 50-contract threshold imposes a substantial burden on reporting entities to submit Form 102B, but provides only a limited surveillance benefit to the Commission as compared to the 250-contract threshold established pursuant to the No-Action Relief. Based upon discussions with CME, we understand that a 250-contract threshold should result in approximately 98.41% of contracts traded being reportable. By comparison, the 50-contract threshold would result in 99.56% of contracts traded being reportable, which represents only a incremental 1.15% difference.[26]

9. *Remove volume executed on a swap execution facility from the Form 102B.*

Consistent with the No-Action Relief, the Commission should amend Rule 15.04 to remove contracts traded on a SEF from the intra-day contract threshold that triggers a Form 102B.[27] As the Commission is aware, there are practical limitations that prevent clearing

[24] *See* Appendix B, page 3.

[25] *See* No-Action Relief, Section II.A.2.a; and Appendix B, page 3.

[26] These percentages are based upon volume traded during the first quarter of 2018.

[27] *See* No-Action Relief, Section II.A.2.b; and Appendix B, page 3.

members from tracking an intra-day contract threshold on a SEF. For example, SEFs have not published product identifiers for their various products, so clearing members cannot aggregate contracts subject to the 50-contract threshold.

C. Forms 40 and 40S: Develop Separate Form 40 and Form 40S, and Clarify Data Responsive to the Questions

We continue to support the transition from a hardcopy Form 40 and Form 40S to an electronic form. However, several questions in the 2013 version of the combined Form 40/40S create significant confusion for respondents. Therefore, we recommend modifications to streamline the form to ensure the Commission receives consistent and accurate data from all respondents. In addition to recommending the changes described below, we encourage the Commission to consider comments in the rulemaking process for suggestions about other ways to modify the Form 40 to make it more user-friendly.

1. Develop a Form 40 with questions about futures trading, and a separate Form 40S with questions about physical commodity swaps trading.

The Commission should develop a Form 40 that requests information about a reportable trader's futures trading (including options thereon) and a separate Form 40S that requests information about a reportable trader's physical commodity swaps trading. The current Form 40/40S asks questions about a reportable trader's "derivatives" trading, which includes futures and swaps. Due to the difference in market structure and terminology between futures and swaps, a single question about "derivatives" likely will be difficult to apply within the context of both futures and swaps. Our proposed modifications to the current Form 40/40S remove references to Form 40S and limit Form 40 questions to futures-related activity.[28] These modifications would align the current Form 40 with the historical Form 40 that the Commission utilized successfully for many years.

As set forth in Section V of the Petition, the Commission should sunset the Part 20 swaps large trader reporting rule. In order to enable the Commission to issue Form 40S to collect data about a market participant's physical commodity swaps trading, we suggest amending Rule 18.04 to provide the Commission with the authority to issue a special call for the Form 40S.[29] The threshold to issue a special call for a Form 40S is consistent with the process in Part 20. That is, the Commission can issue the special call if a market participant holds futures-equivalent paired swap positions that meet or exceed the reportable level for futures specified in Rule 15.03.

We also request that the Commission clarify that the questions on the Form 40S relate to physical commodity swaps activity. The use of the term "derivatives" in the combined Form 40/40S significantly expanded the scope of questions about swaps activity compared to the prior version of the Form 40S. The prior Form 40S requested information about physical commodity

[28] For example, Appendix A removes the Form 40/40S questions regarding commodity index trading.

[29] *See* Appendix B, page 7.

swaps activity covered under Part 20, whereas the combined Form 40/40S requests information about all swaps activity. Because the preamble to the OCR Rule did not acknowledge the change in scope, and the OCR Rule did not modify the rule text to Part 20, we believe that the expansion of the questions about swaps activity on the combined Form 40/40S was unintentional.

2. Require reporting traders to update the Form 40 or Form 40S in response to a special call and remove the instruction to update data if and when the information changes.

Consistent with the No-Action Relief, the Commission should obligate a reporting trader to update the Form 40 or the Form 40S upon a request from the Commission.[30] This approach to updating the data on each form is consistent with the Commission's historical approach to obtaining updated forms. In order to remove ambiguity about the scope of a reporting trader's obligation to update, the Commission should remove the instruction in the Forms 40 and 40S to update the forms if and when the information changes.[31]

3. Enable reporting traders to submit information for a single contact for all parents and subsidiaries identified on the Form 40 or Form 40S.

Consistent with the No-Action Relief, a reportable trader should be able to submit on Form 40 or Form 40S the same contact information for all parents, subsidiaries, persons with a 10% or greater ownership interest in the reporting trader, and persons in which the reporting trader holds a 10% or greater ownership interest ("**Identified Persons**").[32] If a reporting trader submits information for a single contact for Identified Persons, the reporting trader should be obligated to provide contact information for each Identified Person upon request from the Commission.[33]

4. Limit the parents and persons that must be identified in response to question 8 to the ultimate parent as well as parents and persons that the reporting trader is aware, or should be aware, trades futures (Form 40) or physical commodity swaps (Form 40S).

At present, question 8 requires a reporting trader to list all parents and 10 percent or greater owners regardless of whether the parent or the owner trades derivatives. We agree that a reporting trader should identify its ultimate parent regardless of whether the ultimate parent trades derivatives. However, for other parents or 10 percent or greater owners that are not the ultimate parent, the reporting trader should identify only persons that engage in futures trading when responding to a Form 40 or physical commodity swaps trading when responding to a Form

[30] *See* No-Action Relief, Section II.B.4.

[31] *See* Appendix A, page 28.

[32] See No-Action Relief, Section II.B.1.

[33] *See* Appendix A, pages 33-35.

40S.[34] Furthermore, consistent with our proposed modifications to question 9 discussed below, a reporting trader should only list such non-ultimate parents or 10 percent or greater owners that the reporting trader is aware, or should be aware, engage in futures trading (Form 40) or physical commodity swaps trading (Form 40S).[35]

The proposed modification would streamline question 8 to require information that the Commission needs to conduct surveillance about the trading of futures or swaps. The modification also makes question 8 consistent with question 9, which is already limited to subsidiaries and owned entities that trade derivatives.

5. *Confirm that in responding to question 9, a reporting trader should not include an owned entity about which it is not aware (and should not be aware) of the owned entity's derivatives trading activity.*

Pursuant to CFTC Rule 150.4, a market participant must aggregate positions subject to limits (a) which the participant controls, and (b) in which the participant holds a 10 percent or greater ownership interest. Rule 150.4(b)(2) establishes an exemption from aggregation if an owner holds a 10 percent or greater ownership interest in an entity ("**Owned Entity**"), provided that the owner and the owned entity meet certain conditions for independence ("**Owned Entity Exemption**"). Furthermore, to the extent the owner is not aware, and should not be aware, of the owned entity's trading activity, then only the owner must meet the independence conditions ("**Streamlined Owned Entity Exemption**").[36] If an owner is relying upon the Streamlined Owned Entity Exemption to disaggregate one or more Owned Entities, we request that the owner not be required to list those Owned Entities in response to question 9 on the Form 40 or Form 40S because the owner is not aware (and should not be aware) of the trading activity of the Owned Entity.[37]

6. *Modify question 10 to request information about "unaffiliated third parties" that control trading as opposed to persons "outside" the reporting trader that control trading.*

Question 10 of the current Form 40/40S requests information about persons "outside" of the reporting trader that "control some or all of the derivatives trading of the reporting trader." The Commission did not define or otherwise provide guidance about when a person is considered to be "outside" of the reporting trader. We believe the question is referring to unaffiliated third

[34] *See* Appendix A, page 33.

[35] *Infra* Petition Section II.C.5. *See also* Appendix A, page 33.

[36] CFTC Letter No. 17-37 (Aug. 10, 2017) further addresses the circumstances under which a market participant is eligible for the Streamlined Owned Entity Exemption.

[37] *See* Appendix A, page 34. As noted above, the Commission should make conforming edits to question 8. *See* Appendix A, page 33.

parties that control trading, so we recommend that the question refer to "unaffiliated third parties" rather than persons "outside" of the reporting trader.[38]

7. Remove question 12 regarding persons that "influence" trading.

Consistent with the No-Action Relief, the Commission should delete question 12 regarding persons who "influence" trading.[39] The Form 40 does not define the term "influence" other than to note that influence does not include a person who exercises "control" of trading. The term "influence" is vague and has created confusion about the scope of persons who are considered to influence trading and therefore should be listed in Form 40.

8. Enable reporting traders to choose "other" when identifying a business sector(s).

The Form 40 requires that a reportable trader review Supplemental List I to identify all "business sectors and subsectors that pertain to the business activities or occupation of the reportable trader." We recommend that the Commission include an "other" category in Supplemental List I that enables a reportable trader to specify its business to the extent that there is no applicable business identified in Supplemental List I.[40]

9. Provide a mechanism for reportable traders to upload data into Forms 40 and 40S.

At present, respondents to the current Form 40/40S must log into a Commission portal and input responses to the various questions on the Form. We appreciate the efforts of Commission Staff to address our concerns about this process by, for example, increasing the timeframe before an online session times out and an individual must restart the process of completing the Form 40/40S. To further streamline the process, the Commission should provide a mechanism for respondents to upload data into the online portal. For example, the Commission should enable respondents to upload data from an excel spreadsheet into the Form 40 and Form 40S. This enhancement to the reporting process would significantly reduce the timeframe to input data into the Form 40 and Form 40S, particularly for individuals who need to complete more than one Form 40 or Form 40S for a corporate group.

III. Eliminate Form 71

Although the Staff did not address Form 71 in the No-Action Relief, we understand that the Commission has yet to issue a Form 71 to an omnibus account originator. We believe that the Commission should remove Form 71 because it is unclear why or how the form is necessary for the Commission's surveillance efforts.[41] In addition, because it requires the disclosure of

[38] *See* Appendix A, page 35.

[39] *See* No-Action Relief, Section II.B.2; and Appendix A, pages 36-37.

[40] *See* Appendix A, page 42.

[41] *See* Appendix A, page 20; and Appendix B, page 4.

personally identifiable information, the form is likely to trigger privacy law concerns in foreign jurisdictions.

IV. Proposed Modifications to the Recordkeeping Requirements in Rule 18.05

The Commission's recordkeeping rule in Rule 18.05 incorporates various terms referenced in the CFTC's OCR Rule. To implement our recommended changes to the OCR Rule, the Commission should make certain conforming amendments to Rule 18.05. We also recommend additional amendments to Rule 18.05 to update the recordkeeping rule to account for significant changes to the Commission's regulations since the Commission adopted the swap recordkeeping provisions in Rule 18.05. Our recommended modifications are detailed below.

A. Remove References in Rule 18.05 to Volume Threshold Account Controllers, Reportable Sub-Account Controllers, and Reportable Sub-Accounts

Our recommended modifications to the Form 102B and recommendation to remove Form 71 mean that the references to the recordkeeping requirements for volume threshold account controllers, reportable sub-account controllers, and reportable sub-accounts are no longer necessary. Therefore, we recommend removing these terms from Rule 18.05.[42]

B. Eliminate Outdated Swap Recordkeeping Requirements and Clarify the Scope of Required Records

In 2007, the Commission adopted swap recordkeeping requirements in Rule 18.05.[43] As a result of Dodd-Frank Act amendments to the CEA and the Commission's new rules implementing those amendments, Rule 18.05 currently refers to rules (*e.g.*, Part 35) and terms (*e.g.*, exempt commercial markets and exempt boards of trade) that no longer are in effect. Furthermore, the swap recordkeeping requirements in Rule 18.05 are redundant and unnecessary now that the Commission has adopted new swap recordkeeping requirements in Rules 45.2 and 23.201-23.203.[44] Therefore, the Commission should remove the outdated swap recordkeeping requirements in Rule 18.05.

The Commission should also redraft Rule 18.05 to clarify the scope of records that market participants must retain. Our suggested revisions are intended to state the recordkeeping requirements more concisely, and to provide rule text that more closely reflects the intended scope of records as articulated in the preamble of a prior Rule 18.05 rulemaking.[45] For example, we propose removing references in Rule 18.05 that a market participant retain "all details concerning positions and transactions" in the relevant commodity or swap as specified in the rule. The modified language would require a market participant to retain "books and records that

[42] *See* Appendix B, page 9.

[43] *See Maintenance of Books, Records and Reports by Traders,* 72 Fed. Reg. 60767 (Oct. 26, 2007).

[44] *See* Appendix B, page 9.

[45] *See* 72 Fed. Reg. at 60770 ("Records required to be retained under Regulation 18.05 consist of accurate records of positions and actual transaction documentation created in the ordinary course of business.").

are maintained in the course of their regularly conducted business activity" concerning the relevant positions and transactions.

C. Require Non-Natural Persons with a Reportable Futures Position or that Have a Volume Threshold Account to Obtain an LEI

The Commission should require that non-natural persons with a reportable futures position or volume threshold account obtain a legal entity identifier ("**LEI**") if they do not already have one.[46] The LEI database provides significant efficiencies for reporting entities to submit a Form 102 because information in the database can be incorporated by reference on the Form 102.[47]

V. Codify No-Action Relief that Addresses Conflicts with Foreign Privacy Laws

We appreciate the Staff's effort to issue no-action relief that addresses when the Commission's reporting rules (including OCR) conflict with the privacy laws of a foreign jurisdiction.[48] We urge the Commission to codify existing no-action relief to provide legal certainty around the reporting process when a reporting entity has a reasonable belief that a conflict with foreign law may exist.

VI. Sunset Part 20 Swaps Large Trader Reporting

We request that the Commission implement the sunset provision in the swaps large trader reporting rule in Part 20 ("**Swaps LTR**"). The Commission designed Swaps LTR as a temporary data collection measure until SDRs became operational. In the interim, swap dealers, clearing members, and the Commission have expended considerable resources implementing the technologically challenging requirements of Swaps LTR. Moreover, because of the many interpretative issues raised by Swaps LTR, DMO Staff issued and revised. on multiple occasions, a 90-page Swaps LTR Guidebook.

In recognition of the temporary nature of Swaps LTR, Rule 20.9 provides that the Commission may render all or part of Swaps LTR "ineffective and unenforceable" if it finds that "operating [SDRs] are processing positional data and that such processing will enable the Commission to effectively surveil trading in paired swaps and swaptions and paired swap and swaption markets." SDRs have been processing swap data for more than five years. Furthermore, Rule 49.12(e) requires that an SDR "establish policies and procedures to calculate positions for position limits and any other purpose as required by the Commission." Accordingly, there is no

[46] *See* Appendix B, page 10.

[47] Our edits to the OCR Forms include modifications to various footnotes that describe how to report an LEI in lieu of other data fields. *See* Appendix A, pages 2 (fn. 4), 6 (fn. 16), 7 (fn. 20), 9 (fn. 25), 10 (fn. 30), 12 (fn. 39), and 14 (fn. 44). These modifications are designed to remove references to outdated terms (*e.g.*, CFTC Interim Compliant Identifier or CICI). In addition, the modifications clarify that OCR reporting entities do not submit the data underlying an LEI to an LEI provider, and OCR reporting entities are not responsible to ensure that the data reported to an LEI provider are kept up-to-date. *See* Rule 45.6.

[48] *See* CFTC Letter No. 17-16 (Mar. 10, 2017).

longer a need for the temporary Swaps LTR requirement. Rather than continuing to require reporting entities and the Commission to invest scarce resources in Swaps LTR, we request that the Commission rely instead on SDR data to monitor positions.[49]

We understand that Form 102S and Form 40S are part of Swaps LTR, so a sunset of Swaps LTR would result in an elimination of the authority to obtain some of the information currently provided in these two forms. In order to ensure that the Commission continues to receive information important to its surveillance function, we recommend, as noted above, that the Commission issue Form 40S under new authority in Rule 18.04, and use another existing data collection to obtain information currently provided in Form 102S.

A. Utilize Legal Entity Identifier Data Reported to an SDR in Lieu of Form 102S

Pursuant to the No-Action Relief, when a swap dealer or clearing member submits a Form 102S for an entity with a reportable swaps position, the swap dealer or clearing member identifies the "counterparty" on the Form 102S.[50] However, the Commission already has access to the identify of a swap counterparty through the reporting of LEIs to SDRs. Furthermore, the Commission can obtain the contact information for a swap counterparty via the Global Legal Entity Identifier Foundation ("**GLEIF**"). We recommend that the Commission eliminate the redundant counterparty information collected through the Form 102S, and instead rely upon the GLEIF to identify counterparties to swap transactions.

B. Incorporate the Commission's Authority to Issue Form 40S in Rule 18.04

As noted above, to enable the Commission to issue a special call for Form 40S after the sunset of Swaps LTR, we recommend that the Commission amend Rule 18.04 to include the authority to issue a Form 40S.[51] To ensure that the same scope of market participants file a Form 40S compared to the process under Swaps LTR, we recommend that Rule 18.04 also incorporate the swaps that are economically equivalent to the swaps covered by Swaps LTR. Following this framework, if a market participant holds swap positions that are economically equivalent to a reportable position in the covered futures contracts, the Commission could issue a special call for a Form 40S.

As noted above, the Commission should develop a Form 40S that is independent of the Form 40. The new Form 40S should incorporate questions relevant to the swaps market and not simply borrow terms from the futures markets. We are willing to assist the Commission in the development of a separate Form 40S.

[49] As FIA commented in its Project KISS letter, the Commission should dedicate resources to improving the SDR reporting rules rather than continuing to invest resources in Swaps LTR. *See* FIA Letter to Christopher Kirkpatrick, Section II.C, page 10 (Sept. 28, 2017).

[50] *See* No-Action Relief, Section II.A.3.

[51] *See* Appendix B, page 7.

C. Incorporate the Swaps LTR Recordkeeping Requirements for Transactions in the Cash Commodity and Commercial Activity Hedged by Physical Commodity Swaps into Rule 18.05

Swaps LTR obligates market participants with a reportable swaps position to retain records of the cash commodity (including products and byproducts) underlying reportable swap positions and all commercial activity hedged by reportable physical commodity swaps.[52] We recommend that the Commission move these recordkeeping requirements to Rule 18.05(b). However, as noted in Section IV.B above, we propose to remove the requirement in Rule 18.05 to retain records of physical commodity swaps because the CFTC already imposes swap recordkeeping requirements in Rule 45.2 (applicable to all market participants) and Rules 23.201 to 23.203 (applicable to swap dealers).

Our recommended rule text modifies the threshold that triggers the requirement to retain records of the cash commodity and commercial activity hedged by physical commodity swaps.[53] In particular, we recommend that the recordkeeping requirement apply if a person holds futures-equivalent paired swaps positions that meet or exceed the reportable thresholds for futures listed in Rule 15.03 as opposed to the 50-contract threshold in Rule 20.6(c).

VII. Implementation Period

As the Commission is aware, modifications to reporting rules require extensive lead time for the development and testing of reporting processes. This lead time enables the Staff to develop technical specifications, and provides the industry with time to develop and test reports to the Commission. We recommend, therefore, that any rule that results from this Petition incorporate a transition period of 12 months after the effective date of a final rule to enable the necessary time for testing and development in order to comply with the rule.

VIII. Conclusion

For the foregoing reasons, we respectfully request that the Commission publish for notice and comment our requested amendments to the OCR Rule, and thereafter adopt them as appropriate. Please contact FIA or CMC if the Commission or Staff have any questions about our Petition.

[52] *See* Rule 20.6(c).

[53] *See* Appendix B, page 9.

Respectfully submitted,

Allison Lurton

Allison Lurton
Senior Vice President and General Counsel

/s/ Kevin K. Batteh

Kevin K. Batteh
General Counsel
Commodity Markets Council

Attachments

cc: Honorable J. Christopher Giancarlo, Chairman
Honorable Brian D. Quintenz, Commissioner
Honorable Rostin Behnam, Commissioner
Amir Zaidi, Director

2001 Pennsylvania Avenue NW
Suite 600 I Washington, DC 20006

T 202 466 5460
F 202 296 3184

June 26, 2015

Via FedEx and Electronic Submission

Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petition for Amendment of the Ownership and Control Reports Rule

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**") respectfully submits this petition (the "**Petition**") to amend the U.S. Commodity Futures Trading Commission's ("**CFTC**" or the "**Commission**") Ownership and Control Reports ("**OCR**") Rule.[1] FIA is the leading trade organization for the futures, options, and over-the-counter cleared derivatives markets. Its members are active users of the commodity futures markets and include derivatives clearing firms of all sizes, as well as leading derivatives exchanges and large commodity firms. Many FIA members are reporting entities that are directly impacted by the OCR Rule.[2] FIA has participated actively in the OCR rulemaking process by: (1) serving as a liaison between the Commission and the industry; (2) assisting with industry implementation efforts; and (3) filing comments to the proposed rules.

I. Summary of FIA's Petition

The Commission designed the OCR Rule to automate and enhance the OCR data that it collects regarding futures and swaps market participants so the Commission can conduct more effective and robust market surveillance.[3] FIA members support the Commission's surveillance goals and have worked diligently to comply for the past 18 months. However, the current OCR Rule has created a number of regulatory gaps and conflicts that effectively prevent reporting

[1] CFTC Rule 13.2, 17 C.F.R. § 13.2, provides, in part, that "[a]ny person may file a petition with the Secretariat of the Commission for issuance, amendment or repeal of a rule of general application. The petition . . . shall set forth the text of any proposed rule or amendment or shall specify the rule the repeal of which is sought. The petition shall further state the nature of the petitioner's interest and may state arguments in support of the issuance, amendment or repeal of the rule."

[2] Ownership and Control Reports, Forms 102/102S, 40/40S, and 71, 78 Fed. Reg. 69178 (Nov. 18, 2013) ("**OCR Rule**" or the "**Rule**").

[3] OCR Rule at 69179.

entities from complying with the Rule. FIA's goal in submitting this Petition is to enhance the quality of the OCR data that the CFTC receives and the ability of reporting entities to comply by:

- Making a limited number of changes to Form 102A/B/S and Form 71;
- Modifying the definitions to provide additional clarity about the data that should be reported; and
- Amending the reporting process to address challenges identified during implementation.

We have worked with a large cross-section of reporting entities to propose language in an amended OCR Rule that would still comport with the CFTC's surveillance goals. FIA's proposed amendments are designed to make the OCR Rule more effective by streamlining and enhancing the collection, processing, and quality of OCR data.[4] The proposed amendments would make relatively minor modifications to the Rule that are designed to retain the benefits of automated OCR reporting.[5] Furthermore, the proposed amendments would leverage the significant time, money, and resources that the Commission and reporting entities have devoted to the development of OCR data collection and reporting systems. They also would eliminate redundant reporting obligations that impose substantial compliance obstacles for reporting entities.

As a consequence of the OCR implementation issues outlined in this Petition, reporting entities have incurred considerable costs, and will continue to incur costs associated with the OCR Rule that substantially exceed the costs projected by the Commission when it issued the Rule. The Commission projected that each reporting entity would spend approximately $18,500 to develop systems to report each category of Form 102 (A/B/S) and approximately $3,700 per year to report each category of Form 102 (A/B/S).[6] FIA and its members have spent the past two years developing systems reasonably designed to come into compliance with the OCR Rule. Based on the implementation efforts to date, FIA estimates that the average start-up costs per entity is approximately $500,000, which is more than 800 percent higher than the Commission's combined projected start-up costs for Forms 102A/B/S.[7] Furthermore, FIA's projects average

[4] FIA's proposed amendments to the rule text of the OCR Rule are set forth herein, and cumulatively, in **Exhibit A** to this Petition. FIA's proposed amendments to the OCR Forms are also described herein, and set forth cumulatively in **Exhibits B-E** to this Petition.

[5] FIA believes that the modifications requested in the Petition would be consistent with the Commission's efforts to improve swap reports to swap data repositories ("**SDRs**"). *See* Remarks of Chairman Timothy G. Massad before the FIA International Derivatives Conference (London) (June 9, 2015) ("We are also taking steps at home to improve our reporting framework. Later this summer, I expect that we will propose some changes to our swap reporting rules for cleared swaps designed to clarify reporting obligations and improve the quality and usability of data in the data repositories. We are looking at other possible changes as well.").

[6] OCR Rule at 69215-20.

[7] The start-up costs consist of systems and operational investments, vendor costs, legal expenses, customer/counterparty outreach and training to obtain OCR data, and project management costs.

annual ongoing costs per entity to be more than $140,000 per year, which is more than 1,200 percent higher than the Commission's combined projected on-going cost for Forms 102A/B/S.

FIA believes that the problems with the OCR Rule outlined in this Petition cannot be resolved by reporting entities dedicating additional resources to attempted compliance. The considerable resources reporting entities have devoted to customer outreach thus far have not improved customer response rates to reporting entities. The issues hindering compliance are caused by the structure of the OCR Rule itself; mainly, the fact that the OCR Rule requires reporting entities to submit OCR data that is not in their possession or control, or that they are legally prohibited from providing.

The problematic aspects of the OCR Rule, and FIA's recommended solutions, include the following:

- **Persons Possessing or Controlling OCR Data:** The Rule imposes an obligation on reporting entities (*e.g.*, futures commission merchants ("**FCMs**"), clearing members, foreign brokers, and swap dealers) to report to the Commission information about customers and counterparties that reporting entities do not possess or control.[8] Reporting entities have no practical means to obtain much of the required OCR data because their customers and counterparties have no regulatory obligation to provide the data to the reporting entities and are reluctant or refuse to do so. To address this regulatory gap, the Commission should rely on the data requested in the Form 40/40S rather than request the same data on the 102A/B/S. As explained further below, FIA's proposed framework would eliminate duplicative reporting but would not increase the burden on reportable traders because a reportable trader possesses and controls its own OCR data and already reports this information in response to Form 40/40S special calls.

    - ➢ The Commission also should require customers and counterparties to provide reporting entities with the requisite OCR data for Forms 102A/B/S and Form 71, as those forms are modified herein by the Petition. Such a regulatory obligation should significantly increase response rates and mitigate against the possibility that reporting entities may need to terminate services if customers/counterparties do not provide reporting entities with OCR data.

- **Foreign Privacy Laws:** The Rule mandates, in some instances, the unlawful disclosure of data covered by foreign privacy-protection laws. The OCR Rule does not take into account the conflicting legal obligations imposed on reporting entities by the OCR Rule and foreign privacy laws. The Commission should provide data masking protection for certain data fields, as necessary, on all OCR Forms where there is a reasonable belief that foreign privacy law prevents the disclosure.

[8] For example, the OCR Rule obligates reporting entities to report natural person controllers for trading accounts that comprise a special account and volume threshold accounts.

- **Technologically Impractical Reporting Deadlines:** The Rule does not provide reporting entities with a reasonable amount of time to submit the required data on Forms 102A/B. It is technologically impracticable for reporting entities to address file rejections and ensure the submission of data within the timeframes specified by the Rule. FIA proposes to amend the Rule to require reporting entities to submit Forms 102A/B by 9:00 A.M. on the business day after the account becomes reportable, but provide reporting entities with an opportunity to finalize the report within three business days after the account becomes reportable.

- **Aggregation of SEF Transactions:** It is impossible for reporting entities to aggregate swap transactions executed on swap execution facilities ("**SEF**") for purposes of completing Form 102B because SEFs have not set and published product identifiers. Moreover, the OCR Rule does not impose an obligation on SEFs to create product identifiers, so product identifiers may not exist in the future. If the Commission expects reporting entities to include SEF-executed transactions in an aggregated volume threshold, the Commission should require SEFs to set product identifiers in an amended rule. It appears that CFTC Staff acknowledged the impossibility of aggregating SEF-executed transactions when Staff issued no-action relief extending the OCR compliance date for aggregating SEF-executed transactions until February 13, 2017.[9]

- **Reporting Threshold:** The 50-contract threshold for Form 102B will result in massive amounts of data being filed with the Commission. Collecting this volume of data will not tangibly benefit the Commission's ability to surveil the market. FIA's proposal would amend the reportable threshold for Form 102B to 250 contracts, which would align the obligations of reporting entities with the Commission's market surveillance objectives.

- **Inapplicable Terms on Form 102S:** Form 102S uses terms, such as "house" and "customer" account, that are generally used in the context of futures contracts and cleared swaps, but do not apply in the context of the over-the-counter swaps market. The use of inapplicable terms has inhibited the ability of swap dealer counterparties to input information responsive to the questions on Form 102S. The inapplicable terminology may also lead to the submission of inconsistent data to the extent different reporting entities interpret Form 102S in different ways. FIA's proposed amendments to Form 102S would eliminate inapplicable terminology.

- **Appropriate Instructions for Form 40S:** Forms 40 and 40S, despite their different titles, use the same document to ask about a reportable trader's futures, options on futures, and swaps activity. However, the instructions on Form 40S include references to terms such as "special account" and "volume threshold account" that are only relevant for Form 40 and may confuse reportable traders reading the instructions

[9] *See* CFTC No-Action Letter No. 15-03 (Feb. 10, 2015).

in advance of completing Form 40S. In addition, CFTC Rule 20.5 still states that a Form 40S shall be completed via the submission of a Form 40 "as if any references to futures or option contracts were references to paired swaps or swaptions." This instruction is outdated and creates confusion because Form 40, as amended by the OCR Rule, already asks for information about swaps. FIA proposes to establish a stand-alone Form 40S and also amend CFTC Rule 20.5 to eliminate the outdated instructions regarding how to complete Form 40S.

Absent Commission action, the problematic aspects of the OCR Rule will make it extremely difficult, if not impossible, for reporting entities to comply fully with the Rule.[10] Additional delays will not correct the inherent deficiencies in the Rule. In the face of unworkable obligations to collect OCR data and conflicting legal obligations to protect the privacy of their customers and counterparties, reporting entities often will be forced to decide between providing insufficient OCR reports or potentially terminating clearing and/or counterparty relationships. If the latter occurs, there may be significant disruptions to the volume of trading and amount of liquidity in the derivatives markets. To avoid these adverse consequences, we urge the Commission to consider the targeted amendments proposed by FIA. Those amendments would not materially affect the CFTC's surveillance goals.

II. The Commission Should Amend the Rule to Establish a Workable Structure for Reporting OCR Data

A. Problem: The Rule obligates reporting entities to report information that is not in their possession

The OCR Rule requires reporting entities to report certain information to the Commission about customers and counterparties that reporting entities do not possess or control. This is not workable for several reasons. For example, reporting entities have been unable to collect a significant amount of the OCR data being sought on Forms 102A/B/S and Form 71, despite substantial customer/counterparty outreach. Reporting entities cannot fulfill their obligation to report customer/counterparty OCR data if they cannot obtain that data because customers and counterparties have no obligation to provide the OCR data to reporting entities. Commenters brought this issue to the Commission's attention during the notice and comment period.[11] For example, the CME stated: "for FCMs to create automated methods to populate this data, it is important that the fields be limited to those records that an FCM obtains in its regular onboarding processes."[12] The Commission cannot correct this problem with additional delays to the compliance date. Rather, it should make the modifications recommended herein, which FIA designed to make the OCR Rule more effective.

[10] FIA appreciates Staff providing additional time for reporting entities to come into compliance with the Rule, and continuing to work with market participants on implementation. CFTC No-Action Letter No. 15-03.

[11] *See, e.g.*, FIA Comment Letter at 5-6 & n.10 (Oct. 15, 2012).

[12] CME Group Comment Letter at 2 (Oct. 16, 2012).

The reluctance of market participants to provide reporting entities with a substantial amount of data is not a systems problem. Reporting entities have been unable to convince their clients to provide the information that would allow reporting entities to comply with the OCR Rule. For example, it appears that the Commission's request for the account controller is no longer limited to the legal entity that controls the account, but rather could be read to request a customer's roster of individual traders who may trade for an account.[13] This includes information such as title, address, phone number, email, and relationship to the entity. It is impossible for reporting entities to report and continuously update this level of OCR data because the information relates to the internal workings of customers and is outside the possession and control of reporting entities.[14]

1. The compliance date for the Rule likely will result in significant market disruptions.

Under the OCR Rule, if a market participant does not provide its own OCR data to a reporting entity, a reporting entity must decide between: (1) providing insufficient OCR reports; or (2) potentially (a) terminating clearing services or (b) refusing to act as a counterparty to the market participant. This Hobson's choice likely will result in significant disruptions to trading volume and liquidity as the market reacts to a reduction in clearing and counterparty relationships. Rather than continue to delay a rule that creates practical problems that could lead to significant market disruptions, the Commission should require reporting directly from the persons in possession or control of the information sought by the Rule.

2. Obligating reporting entities to keep a substantial amount of customer and counterparty OCR data current is not practical.

The current reporting structure presents unworkable obstacles to maintaining updated OCR data. The OCR Rule obligates reporting entities to update Forms 102A/B/S through both change updates and the annual refresh process. Specifically, reporting entities must file change updates to OCR data by 9:00 A.M. on the business day following the change. Given that there is no obligation for customers and counterparties to provide OCR data in the first instance, FIA anticipates that reporting entities will continue to experience low customer/counterparty cooperation to help reporting entities keep OCR data current through change updates. It is impossible for reporting entities to keep existing OCR data current without updated information from their customers and counterparties.

The process for reporting entities to file an annual refresh of the OCR data for each Form 102A/B/S is similarly problematic because there is no regulatory obligation for the customer/counterparty to assist with this process. As with change updates, FIA anticipates that reporting entities will continue to experience low customer/counterparty cooperation to help reporting entities file an annual refresh of OCR data with the Commission. Again, without the

[13] CFTC Rule 15.00(t), (bb), (cc), (dd).

[14] This type of customer information also triggers privacy law concerns, discussed below.

OCR data, it is impossible for reporting entities to perform an annual refresh, so the Commission should not require reporting entities to refresh data that they do not possess or control.

3. The recent CFTC Staff Advisory regarding the Rule did not address FIA's concerns about practical problems created by the Rule.

In FIA's most recent request for no-action relief from the OCR Rule, it requested that the Commission or Staff issue an advisory to encourage customers and counterparties to provide OCR data to reporting entities. In particular, FIA requested that the Commission advisory state that the Commission "expects" *customers and counterparties* to provide reporting entities with the OCR data necessary for the reporting entity to file Forms 102A/B/S. On March 23, 2015, Staff issued an advisory ("**Advisory**") that emphasized the regulatory obligation for *reporting entities* to report OCR data about their customers and counterparties and encouraged *reporting entities* to contact their customers and counterparties to acquire the necessary OCR data in a timely manner.

The Advisory focused on the existing obligations for reporting entities and appears to assume that continued requests for OCR data eventually will address the low response rates. Unfortunately, the difficulty in collecting OCR data is due largely to the lack of response to outreach efforts, not the lack of outreach. As a result, FIA does not expect the Advisory to improve customer response rates. After the first phase of the Commission's testing, CFTC Staff reported that they had received just 30% of the data they expected to receive on Form 102A. This was due, in part, to the inability of the CFTC to accept large files. FIA Technology Services reports on behalf of more than 30 reporting parties and, as of the end of May 2015, it received only 50% of the data. These testing results indicate a continued lack of client cooperation following the Advisory.[15]

B. Solution: Obligate Reporting Entities to Submit OCR Data in their Possession

The Commission should amend Forms 102A/B/S, and the associated rule text to collect a more limited set of OCR data for reportable accounts. The Commission similarly should require clearing members to submit a more limited set of OCR data when responding to a request for a Form 71 regarding customer omnibus accounts. After a reporting entity files a Form 102A/B/S or responds to a Form 71, the Commission should, to the extent it deems necessary, obtain additional detailed OCR data about the market participant with a reportable account by issuing a Form 40/40S directly to the market participant.[16]

[15] We also are aware that, in at least some cases, reporting entities may submit data to comply with the condition in the current OCR no-action relief to submit test data, but this test data may not be sufficient to comply with the OCR Rule.

[16] The Commission already imposes an obligation on market participants to respond to special calls, such as Form 40/40S, pursuant to CFTC Rules 18.05 and 20.5(b).

1. The proposed amendments would eliminate impractical and redundant reporting requirements.

Under the OCR Rule, the Commission receives detailed OCR data about a market participant through Forms 102A/B/S and Form 71. It also receives similar OCR data when market participants respond to a CFTC special call for a Form 40/40S. Given that the CFTC will receive detailed information directly from a market participant in a Form 40/40S, imposing a regulatory obligation on reporting entities to collect and submit the same detailed OCR data imposes an unnecessary cost and creates significant compliance obstacles because there is no obligation on the customer/counterparty to provide it.

FIA's proposed amendments would significantly mitigate against the commercially impractical and potentially market-harming need for reporting entities to contemplate refusing to provide clearing services or to act as a counterparty if the customer/counterparty does not provide detailed OCR data to the reporting entity. In the same regard, the CFTC reducing the number of data fields on Forms 102A/B/S and Form 71 to those in Exhibits B and C would have the same effect. FIA's proposed framework would impose the regulatory obligation on the person in possession or control of the OCR data. The reporting entity's customers/counterparties are in the best position to provide (and file) change updates for the OCR data that FIA proposes to remove from Form 102A/B/S and Form 71.

2. The Commission would continue to receive the same level of OCR data under FIA's framework.

FIA's requested amendments do not modify the scope of OCR data the Commission would receive under the current OCR Rule. The Commission would continue to receive detailed OCR data about reportable traders through the Form 40/40S process. Furthermore, FIA supports the Commission's move to electronic OCR Forms and FIA's proposed amendments retain the electronic format in the OCR Rule.

3. FIA's proposed amendments to OCR Form 102A and the accompanying rule text.

As noted above, Exhibit A to FIA's Petition incorporates FIA's proposed modifications to the OCR rule text and Exhibit B proposes FIA's modifications to OCR Forms 102A/B/S. FIA recommends that the Commission modify Form 102A and the accompanying rule text in the following manner:

- **Remove question 6 regarding the request for "Special Account Owner(s)."** As the Commission is aware, a "special account" is not a single account, but rather a collection of several trading accounts. At present, reporting entities group trading accounts into a special account based on the common controller for the various trading accounts, not common ownership. Furthermore, the OCR Rule already obligates reporting entities to report the trading account owner on Form 102A for each trading account that comprises the special account, so it is unclear why reporting entities should attempt to identify a special account owner.

- **Clarify the definition of the "Trading Account Owner."** FIA recommends that the Commission clarify in new CFTC Rule 15.00(ee) the definition of a trading account owner. Specifically, the reporting entity should provide the Commission with the holder of the account on the reporting entity's books and records. This information should provide the Commission with sufficient contact information so that the Commission can issue a Form 40 for additional information about the reportable trader.

- **Remove question 10(iii) regarding the request for "Trading Account Controller(s)."** Form 102A obligates reporting entities to collect information about the natural person(s) that control specific trading accounts. There is little to no benefit to the Commission collecting natural person controllers information on Form 102A because the Commission already requests this information directly from the reportable trader through the issuance of a Form 40. As noted above, it is impossible for reporting entities to report and continuously update this level of OCR data because the information relates to the internal workings of customers and is outside the possession and control of reporting entities. This amendment also would address, to a certain extent, some of the privacy law concerns addressed below because the reporting of controller information may conflict with data privacy laws in foreign jurisdictions.[17]

4. FIA's proposed amendments to OCR Form 102B and the accompanying rule text.

As set forth in detail in Exhibits A and B to the Petition, FIA recommends that the Commission modify Form 102B and the accompanying rule text in the following manner:

- **Clarify the definition of the "Volume Threshold Account Owner."** FIA recommends that the Commission clarify in new CFTC Rule 15.00(ff) the definition of a volume threshold account owner. A clearing member should provide the Commission with the holder of the account on its books and records. This information should provide the Commission with sufficient contact information such that the Commission can issue a Form 40 for additional information about the reportable trader.

- **Remove question 6 regarding the request for "Volume Threshold Account Controller(s)."** Form 102B, like Form 102A, obligates clearing members to collect information about the natural person(s) that control specific trading accounts. There is little to no benefit to the Commission collecting natural person controllers on Form

[17] *See* Section III below.

102B because the Commission already requests this information directly from the reportable trader through the issuance of a Form 40. In addition, as noted above, it is impossible for reporting entities to report and continuously update this level of OCR data because the information relates to the internal workings of customers and is outside the possession and control of reporting entities.

5. FIA's proposed amendments to OCR Form 71 and the accompanying rule text.

As set forth in detail in Exhibit A and C to the Petition, FIA recommends that the Commission modify Form 71 and the accompanying rule text in the following manner:

- **Clarify the definition of the "Reportable Sub-Account Owner."** FIA recommends that the Commission clarify in new CFTC Rule 15.00(gg) the definition of a reportable sub-account owner. Omnibus account originators should provide the Commission with the holder of the accounts on their books and records. This information should provide the Commission with sufficient contact information about a reportable sub-account so that the Commission can issue a Form 40 for additional information about the reportable trader.

- **Remove the request for "Reportable Sub-Account Controller(s)."** Form 71, like Form 102A/B, obligates omnibus account originators to collect information about the natural person(s) that control specific sub-accounts. There is little to no benefit to the Commission collecting natural person controllers on Form 71 because the Commission already requests this information directly from the reportable trader through the issuance of a Form 40. In addition, as noted above, it is impossible for reporting entities to report and continuously update this level of OCR data because the information relates to the internal workings of customers and is outside the possession and control of reporting entities.

C. Solution: Obligate Customers and Counterparties to Provide Reporting Entities with OCR Data

In addition to FIA's proposed changes to the Form 102A/B/S and Form 71, the Commission should amend CFTC Rules 18.05 and 20.5(c) to require customers and counterparties to provide reporting entities with the requisite OCR data. Absent an obligation for customers/counterparties to provide information to reporting entities, FIA remains concerned about low response rates. This regulatory obligation should significantly increase response rates and mitigate the possibility that reporting entities may need to terminate services if customers/counterparties do not provide reporting entities with OCR data. FIA also requests that the Commission clarify in the preamble to the proposed rules that reporting entities can reasonably rely on information provided by customers/counterparties and that the Commission will not commence an enforcement action if a reporting entity has no reason to believe that the information provided was incorrect.

III. The Commission Should Amend the Rule to Resolve Foreign Privacy Law Conflicts

A. Problem: The OCR Rule Conflicts with Foreign Privacy Laws

As the Commission is aware, foreign privacy laws make it illegal for reporting entities to provide certain CFTC-required OCR data regarding customers and counterparties.[18] For example, reporting a customer's name and contact information may be prohibited by the laws of foreign jurisdictions. CFTC Staff provided industry-wide no-action relief for only one of the OCR Forms (Form 102S), to permit masking certain swap data reported to the CFTC.[19] The no-action relief does not address the fact that other OCR-related forms, such as Form 102A/B and Form 71, raise similar privacy law conflicts. Furthermore, no-action relief does not address the fact that the OCR Rule places reporting entities in the impossible position of having to decide whether to comply with either the laws of another jurisdiction or the Rule.

B. Solution: Codify and Expand Existing No-Action Relief to Permit Data Masking

As FIA previously requested, the Commission should permit reporting entities to mask OCR data for all OCR-related forms.[20] The Commission should codify these masking provisions in an amended rule so that market participants would have legal certainty for data masking as opposed to uncertainty regarding whether CFTC Staff will continue to provide no-action relief. Staff previously acknowledged that foreign privacy laws may conflict with the Commission's swap reporting requirements and granted no-action relief to permit market participants to mask certain swap data reported to the Commission or to an SDR.[21] Although the no-action relief permits data masking for one of the OCR Forms, Form 102S, there is no relief for Forms 102A/B or Form 71.

The Commission should propose rules to make clear that data masking is permitted for OCR Forms 102A/B/S and 71 where reporting entities have a reasonable basis to believe that foreign privacy law prohibits the disclosure. Each of these forms requests information that could be governed by foreign privacy laws. For example, the natural person and legal entity contact information requested on Forms 102A and B, including name, address, and phone number, often falls within the scope of protected data. There is no policy rationale to permit data masking for some but not all OCR forms. The Commission should also permit data masking where a foreign privacy law conditions disclosure upon receipt of a waiver from the customer/counterparty, but the necessary waiver has not been obtained or may be impractical.[22]

[18] Foreign privacy laws include, among others, data privacy, bank secrecy, state secrecy, and blocking statutes.

[19] CFTC No-Action Letter No. 15-01 (Jan. 8, 2015).

[20] *See* FIA No-Action Request to Vincent A. McGonagle, Request to Extend and Expand Existing No-Action Relief for Data Masking Due to Privacy Concerns (Dec. 8, 2014).

[21] No-Action Letter No. 15-01.

[22] For example, where consent is revocable or is required for each individual disclosure, it is of little practical assistance for a reporting entity.

The Commission should also remove some of the impractical conditions to the existing no-action relief. For instance, the Commission should not require an entity to request that a foreign regulatory authority confirm the application of foreign privacy laws and provide a written confirmation of the law's application. Non-U.S. regulatory authorities may not have a process through which to handle these requests or may not respond to requests in a timely manner. As with recent CFTC proposed rules that address conflicts with foreign laws, the Commission should permit reporting entities to rely upon the written advice of internal or external counsel in advance of masking any data.[23]

FIA understands that the Commission is currently considering how to address data masking more broadly within the context of its swap reporting rules. The Commission should incorporate the OCR reporting rules into its consideration of data privacy issues. FIA would like to work with the Commission to develop an appropriate reporting framework so that reporting entities no longer need to decide whether to comply with either the laws of another jurisdiction or the OCR Rule.

IV. The Commission Should Extend the Timeframe for Reporting Entities to Report Forms 102A/B

A. Problem: The Rule Imposes a Technologically Impractical Timeframe to Submit Forms 102A/B and Change Updates to Form 102A/B/S

The OCR Rule requires reporting entities to submit Forms 102A and B by 9:00 A.M. on the business day following the day that an account becomes reportable.[24] Prior to the OCR Rule, reporting entities were obligated to submit a Form 102 within three business days after an account became reportable. The timeframe to submit a Form 102A/B under the OCR Rule exacerbates the problem of requiring reporting entities to submit significant OCR data about their customers. Reporting entities process their large trader reporting files to identify reportable accounts at the end of the business day. The deadline of 9:00 A.M. the following business day likely means that reporting entities will need 24-hour operations support to address any issues in the data collection or errors in the submission of a Form 102A/B.[25] That would exacerbate the already high compliance costs imposed by the Rule.

B. Solution: Establish a Reasonable Timeframe to Submit Forms 102A/B and Change Updates to Form 102A/B/S

As set forth in Exhibit A to this Petition, the Commission should amend CFTC Rule 17.02(b), and (c) to require reporting entities to file a Form 102A/B by 9:00 A.M. the business

[23] In the CFTC's proposed position limits rule, the Commission acknowledged that its rules may conflict with foreign and state laws, which led it to propose an exemption from the proposed position limits aggregation rule. Aggregation of Positions, 78 Fed. Reg 68946, 68950, 68977 (Nov. 15, 2013) (proposed rule).

[24] *See* CFTC Rule 17.02(b)(2)(i) & (c)(2)(i).

[25] FIA previously raised this problem with the CFTC in its comments to the proposed rule. FIA Comment Letter at 7.

day following the date the account first becomes reportable, but provide reporting entities with the opportunity to re-submit, correct, or otherwise modify the report within three business days after the special account or volume threshold account becomes reportable. Similarly, the Commission should amend CFTC Rules 17.02(b), and (c), along with CFTC Rule 20.5, to require reporting entities to file a change update with the CFTC by 9:00 A.M. the business day following when a change occurs, but provide reporting entities the opportunity to finalize the change update within three business days after the change occurs. This modification would provide reporting entities with time to address technical issues such as the correction of files that were rejected by the CFTC's reporting system.

Finally, the Commission should clarify in the preamble to the proposed rule that it will not commence an enforcement action against a reporting entity for failure to report a change update if the customer/counterparty did not notify the reporting entity of the applicable change. To the extent that the Commission decides not to receive the majority of OCR data from the customers and counterparties directly on a Form 40/40S, as requested above, FIA and its members nevertheless request that the Commission amend the OCR Rule to provide additional time to report.

V. The Commission Should Require SEFs to Establish Product Identifiers

A. Problem: A Lack of SEF Product Identifiers Prohibits Reporting Entities from Aggregating SEF-Executed Contracts Toward the Reportable Volume Threshold for Form 102B

Under the OCR Rule, a clearing member must file a Form 102B where a trading account carries a trading volume of 50 or more contracts with the same product identifier, in a single day, on a single designated contract market or SEF.[26] To determine whether the 50-contract threshold has been reached, a reporting entity must aggregate instruments with the same product identifier.

The OCR Rule *assumes*, without factual basis, that SEFs will create and publish product identifiers for products traded on their respective markets, but neither it nor any other Commission rule *requires* SEFs to do so. Without swap product identifiers, a clearing member cannot aggregate contracts toward the 50-contract threshold for purposes of Form 102B. Even after SEFs create product identifiers for swaps, a clearing member will need to expend significant time and resources to develop systems that recognize and collate each SEF product identifier.

No amount of delay will enable clearing members to aggregate SEF-executed transactions without a product identifier. Staff's recognition of this issue in the most recent OCR no-action relief does not address the fact that SEFs are under no regulatory obligation to set SEF product identifiers. This leaves open the likelihood that the February 13, 2017 compliance date to aggregate SEF-executed transactions may arrive without SEFs adopting product identifiers to resolve the issue.

[26] CFTC Rule 15.04.

B. Solution: Obligate SEFs to Create Product Identifiers

It is unclear whether the recent extension until February 13, 2017 to report SEF-executed trades is intended to give Staff sufficient time to develop a methodology, and impose an obligation on SEFs, to establish product identifiers. FIA encourages the Commission and Staff to coordinate with SEFs to create a general framework to set product identifiers, and to codify that framework in a proposed modification to CFTC Rule 15.04 set forth in Exhibit A to this Petition.

VI. The Commission Should Increase the Reportable Volume Threshold

A. Problem: The Current Reportable Volume Threshold Triggers Form 102B Filings for Market Participants With Immaterial Positions

If the CFTC maintains the current 50-contract reportable volume threshold defined in CFTC Rule 15.04, FIA is concerned that reporting entities will report an excessive amount of data to the Commission. This data appears to relate to small accounts that are attributable to an immaterial amount of intraday volume. Based on discussions with CME, FIA understands that the 50-contract threshold should result in approximately 99% of CME volume being reportable. Even if the Commission increased the threshold to 500 contracts, the Commission should expect approximately 96% of the volume on CME to be reportable. Although the 50-contract threshold amounts to a very minor increase in volume that is attributable to a reportable account compared to a 500-contract threshold, the 50-contract threshold greatly increases the burden on clearing members to collect, maintain, and report Form 102B to the Commission.

B. Solution: Increase the Form 102B Reporting Threshold

As set forth in Exhibit A to this Petition, FIA requests that the Commission modify the reportable volume threshold in CFTC Rule 15.04 from 50 to 250 contracts. This amended threshold still would enable the Commission to conduct robust market oversight because a very high degree of volume would be attributable to reportable accounts. Given the marginal increase to reportable volume under the 50-contract threshold, the threshold appears to sweep in accounts that do not trade meaningful volume. Rather than attempt to collect OCR data about all market participants, the Commission should focus its surveillance efforts on accounts attributable to the overwhelming majority of trading volume.

VII. The Commission Should Amend Form 102S and Publish a Stand-Alone Form 40S to Limit Confusing References to Futures-Related Terminology

A. Problem: Form 102S Relates to Cleared and Uncleared Swaps Activity, But Utilizes Futures-Related Terminology that is Only Relevant for Cleared Swaps

Because Form 102S reporting entities include swap dealers and clearing members, Form 102S relates to both cleared and uncleared swaps activity. In designing Form 102S, the Commission borrowed language from existing futures-related OCR Forms (*e.g.*, Form 102A).

Although the futures-related terminology applies within the context of cleared swaps, the same terminology does not apply within the context of uncleared swaps. As a result, Form 102S utilizes terminology that is ambiguous and confusing for uncleared swap activity. For example, Form 102S refers to "omnibus" accounts. This term may be relevant to clearing members completing Form 102S for cleared swaps, but it has no meaning within the context of swap dealers reporting a Form 102S for uncleared swaps. A reporting form that does not use language relevant to swap positions and counterparty relationships creates confusion when market participants attempt to input responsive information. Because Form 102S requests information regarding cleared and uncleared swap activity, the Commission should incorporate the language used in both markets. Otherwise, there is a significant risk that the current questions will elicit inaccurate or incomplete OCR data from customers and counterparties.

B. Solution: Amend Form 102S to Differentiate Between Cleared and Uncleared Swaps and Streamline the Form

For Form 102S, the Commission should adopt FIA's requested amendments and only obligate swap dealers and clearing members to report certain OCR data about their customers and counterparties. The Commission should also modify Form 102S to incorporate language applicable to clearing members and their customers, as well as swap dealers and their counterparties. FIA recommends that the Commission make the following modifications to Form 102S, which FIA incorporates into the proposed Form 102S in Exhibit B and the accompanying rule text in Exhibit A to this Petition:

- **Question 3(i) regarding the consolidated account type, should differentiate between a reporting clearing member and a reporting swap dealer.** A reporting clearing member should be required to identify the consolidated account as "house," "clearing customer," "principal," or "counterparty." However, a reporting swap dealer only should identify the consolidated account as "principal," or "counterparty." Through these amendments, reporting entities submitting a Form 102S in their role as a swap dealer would no longer be obligated to interpret terms such as "house" account, which are relevant to cleared swaps, but are not relevant to uncleared swaps.

- **Only a reporting clearing member should respond to question 3(ii) regarding omnibus account information.** Omnibus account information is not relevant to uncleared swaps. Accordingly, the Commission should only require reporting clearing members to respond to question 3(ii).

- **Clarify the definition of the "Consolidated Account Owner."** FIA recommends that the Commission clarify in new CFTC Rule 20.1 the definition of a consolidated account owner. Reporting entities should provide the Commission with the person attributed to a consolidated account as indicated in the reporting entity's records. This information should provide the Commission with sufficient contact information about a consolidated account such that the Commission can issue a Form 40S for additional information about the reportable trader.

- **Question 3(iv) should only be required if the consolidated account controller information is different than the consolidated account owner information.** At present, the request for the consolidated account owner and controller information creates confusion within the context of the over-the-counter swaps markets because the account owner and controller is oftentimes the counterparty. To limit the potential for confusion, Form 102S should only require account controller information if it is different than the account owner information.

- **The Commission should eliminate questions added after the Commission finalized Form 102S.** Question 4 requests a brief description of the nature of the counterparty's or customer's paired swaps and swaptions activity. Many reporting entities did not read this question also to require reporting entities to identify whether each particular activity is associated with paired swaps, paired swaptions, or both. In an update to the CFTC's technical guidance, Staff clarified that reporting entities must identify whether the nature of the each particular activity on the Form 102S is associated with paired swaps and/or paired swaptions. This additional request imposes a significant burden on a reporting entity to categorize the nature of the activity and continuously to update whether that activity is associated with paired swaps and/or paired swaptions. The burden on reporting entities does not appear to provide the Commission with a corresponding surveillance benefit. Therefore, the Commission should remove the additional data and require reporting entities only to identify the nature of the customer's or counterparty's activity.

C. Problem: The Instructions to Form 40/40S Create Confusion

Despite their different titles, Forms 40 and 40S use the same document to ask about a reportable trader's futures, options on futures, and swaps activity. However, the instructions include references to "special account" and "volume threshold account" that only apply to a Form 40 and may confuse reportable traders reading the instructions to complete a Form 40S. Furthermore, CFTC Rule 20.5 still states that a Form 40S shall be completed via the submission of a Form 40 "as if any references to futures or option contracts were references to paired swaps or swaptions." This instruction is outdated because Form 40, as amended by the OCR Rule, already asks for information about swaps activity, so any instruction to replace futures references with swap references is not accurate.

D. Solution: Establish a Stand-Alone Form 40S Rather than Incorporate Form 40 and Form 40S into the Same Form

The Commission should establish a stand-alone Form 40S, removing references and definitions that relate only to Form 40. In addition, because the Commission requests information regarding swaps activity on Form 40, the Commission should remove the outdated instruction in CFTC Rule 20.5(b) to complete Form 40S as if it were a Form 40, and replace references to futures or options with references to paired swaps or swaptions. Therefore, FIA requests that the Commission modify CFTC Rule 20.5(b) as set forth in Exhibit A to this Petition.

VIII. Conclusion

For the foregoing reasons, FIA respectfully requests that the Commission publish for notice and comment FIA's requested amendments to the OCR Rule and, thereafter, adopt them as appropriate. Please contact FIA if the Commission or Staff have any questions about our Petition.

Respectfully submitted,

Allison Lurton

Allison Lurton
Senior Vice President and General Counsel

Enclosures

cc: Honorable Timothy G. Massad, Chairman
Honorable Mark P. Wetjen, Commissioner
Honorable Sharon Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner
Vincent A. McGonagle, Director
Jonathan L. Marcus, General Counsel

APPENDIX A

PART 15—REPORTS—GENERAL PROVISIONS

§ 15.00 Definitions of terms used in parts 15 to 19, and 21 of this chapter.

As used in parts 15 to 19, and 21 of this chapter:

(a) *Cash or Spot*, when used in connection with any commodity, means the actual commodity as distinguished from a futures or options contract in such commodity.

(b) *Clearing member* means any person who is a member of, or enjoys the privilege of clearing trades in his own name through, the clearing organization of a designated contract market, registered derivatives transaction execution facility, or registered entity under section 1a(29) of the Act.

(c) *Clearing organization* means the person or organization which acts as a medium for clearing transactions in commodities for future delivery or commodity option transactions, or for effecting settlements of contracts for future delivery or commodity option transactions, for and between members of any designated contract market, registered derivatives transaction execution facility or registered entity under section 1a(29) of the Act.

(d) *Compatible data processing media* means data processing media approved by the Commission or its designee.

(e) *Customer* means "customer" (as defined in §1.3(k) of this chapter) and "options customer" (as defined in §1.3(jj) of this chapter).

(f) *Customer trading program* means any system of trading offered, sponsored, promoted, managed or in any other way supported by, or affiliated with, a futures commission merchant, an introducing broker, a commodity trading advisor, a commodity pool operator, or other trader, or any of its officers, partners or employees, and which by agreement, recommendations, advice or otherwise, directly or indirectly controls trading done and positions held by any other person. The term includes, but is not limited to, arrangements where a program participant enters into an expressed or implied agreement not obtained from other customers and makes a minimum deposit in excess of that required of other customers for the purpose of receiving specific advice or recommendations which are not made available to other customers. The term includes any program which is of the character of, or is commonly known to the trade as, a managed account, guided account, discretionary account, commodity pool or partnership account.

(g) *Discretionary account* means a commodity futures or commodity option trading account for which buying or selling orders can be placed or originated, or for which transactions can be effected, under a general authorization and without the specific consent of the customer, whether the general authorization for such orders or transactions is pursuant to a written agreement, power of attorney, or otherwise.

(h) *Exclusively self-cleared contract* means a cleared contract for which no persons, other than a reporting market and its clearing organization, are permitted to accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trade.

(i) *Foreign clearing member* means a "clearing member" (as defined by paragraph (b) of this section) who resides or is domiciled outside of the United States, its territories or possessions.

(j) *Foreign trader* means any trader (as defined in paragraph (s) of this section) who resides or is domiciled outside of the United States, its territories or possessions.

(k) *Futures, futures contract, future delivery or contract for future delivery*, means any contract for the purchase or sale of any commodity for future delivery that is executed on or subject to the rules of a reporting market, including all agreements, contracts and transactions that are treated by a clearing organization as fungible with such contracts.

(l) *Guided account program* means any customer trading program which limits trading to the purchase or sale of a particular contract for future delivery of a commodity or a particular commodity option that is advised or recommended to the participant in the program.

(m) *Managed account program* means a customer trading program which includes two or more discretionary accounts traded pursuant to a common plan, advice or recommendations.

(n) *Open contracts* means "open contracts" (as defined in §1.3(t) of this chapter) and commodity option positions held by any person on or subject to the rules of a board of trade which have not expired, been exercised, or offset.

(o) *Option, options, option contract, or options contract*, unless specifically provided otherwise, means any contract for the purchase or sale of a commodity option that is executed on or subject to the rules of a reporting market, including all agreements, contracts and transactions that are treated by a clearing organization as fungible with such contracts.

(p) *Reportable position* means:

(1) For reports specified in parts 17, 18 and §19.00(a)(2) and (a)(3) of this chapter any open contract position that at the close of the market on any business day equals or exceeds the quantity specified in §15.03 of this part in either:

(i) Any one futures of any commodity on any one reporting market, excluding futures contracts against which notices of delivery have been stopped by a trader or issued by the clearing organization of a reporting market; or

(ii) Long or short put or call options that exercise into the same future of any commodity, or other long or short put or call commodity options that have identical expirations and exercise into the same commodity, on any one reporting market.

(2) For the purposes of reports specified in §19.00(a)(1) of this chapter, any combined futures and futures-equivalent option open contract position as defined in part 150 of this chapter in any one month or in all months combined, either net long or net short in any commodity on any one reporting market, excluding futures positions against which notices of delivery have been stopped by a trader or issued by the clearing organization of a reporting market, which at the close of the market on the last business day of the week exceeds the net quantity limit in spot, single or in all-months fixed in §150.2 of this chapter for the particular commodity and reporting market.

(q) *Reporting market* means a designated contract market or a registered entity under section 1a(40) of the Act.

(r) *Special account* means any commodity futures or option account in which there is a reportable position.

(s) *Trader* means a person who, for his own account or for an account which he controls, makes transactions in commodity futures or options, or has such transactions made.

(t) *Control* means to actually direct, by power of attorney or otherwise, the trading of a special account or a consolidated account. A special account or a consolidated account may have more than one controller.

(u) *Reportable trading volume* means contract trading volume that meets or exceeds the level specified in §15.04.

(v) *Omnibus account* means any trading account that one futures commission merchant, clearing member or foreign broker carries for another and in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm.

(w) *Omnibus account originator* means any futures commission merchant, clearing member or foreign broker that executes trades for one or more customers via one or more accounts that are part of an omnibus account carried by another futures commission merchant, clearing member or foreign broker.

(x) *Volume threshold account* means any trading account that carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.

(y) *Omnibus volume threshold account* means any trading account that, on an omnibus basis, carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.

(z) *Omnibus reportable sub-account* means any trading sub-account of an omnibus volume threshold account, which sub-account executes reportable trading volume on an omnibus basis. Omnibus reportable sub-account also means any trading account that is itself an omnibus account, executes reportable trading volume, and is a sub-account of another omnibus reportable sub-account.

(aa) *Reportable sub-account* means any trading sub-account of an omnibus volume threshold account or omnibus reportable sub-account, which sub-account executes reportable trading volume.

(bb) *Trading account controller* means~~, for reports specified in §17.01(a) of this chapter,~~ a natural person who by power of attorney or otherwise actually directs the trading of a reportable trader~~trading account~~. A trading account may have more than one controller.

(cc) *Volume threshold account* controller means a natural person who by power of attorney or otherwise actually directs the trading of a volume threshold account. A volume threshold account may have more than one controller.

(dd) *Reportable sub-account controller* means a natural person who by power of attorney or otherwise actually directs the trading of a reportable sub-account. A reportable sub-account may have more than one controller.

(ee) *Trading account owner* means the person indicated in a futures commission merchant's, clearing member's, or foreign broker's books and records as the holder of the account.

(ff) *Volume threshold account owner* means the person indicated in a clearing member's books and records as the holder of the account.

(gg) *Reportable sub-account owner* means the person indicated in an omnibus account originator's books and records as the holder of the account.

§ 15.04 Reportable trading volume level.

The volume quantity for the purpose of reports filed under parts 17 and 18 of this chapter is trading volume of 250 or more contracts, during a single trading day, on a single reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act, in all instruments that such reporting market shall designate~~s~~ with the same product identifier (including purchases and sales, and inclusive of all expiration months).

APPENDIX A

PART 17—REPORTS BY REPORTING MARKETS, FUTURES COMMISSION MERCHANTS, CLEARING MEMBERS, AND FOREIGN BROKERS

§17.01 Identification of special accounts, volume threshold accounts, and omnibus accounts.

(a) *Identification of special accounts.* When a special account is reported for the first time, the futures commission merchant, clearing member, or foreign broker shall identify the special account to the Commission on Form 102, in accordance with the form instructions and as specified in §17.02(b).

(b) *Identification of volume threshold accounts.* Each clearing member shall identify and report its volume threshold accounts to the Commission on Form 102, in accordance with the form instructions and as specified in §17.02(c).

(c) *Identification of omnibus accounts and sub-accounts.* Each originator of an omnibus volume threshold account identified in Form 102 or an omnibus reportable sub-account identified in Form 71 shall, after a special call upon such originator by the Commission or its designee, file with the Commission an "Identification of Omnibus Accounts and Sub-Accounts" on Form 71, to be completed in accordance with the instructions thereto, at such time and place as directed in the call.

(d) *Exclusively self-cleared contracts.* Unless determined otherwise by the Commission, reporting markets that list exclusively self-cleared contracts shall meet the requirements of paragraphs (a) and (b) of this section, as they apply to trading in such contracts by all clearing members, on behalf of all clearing members.

(e) *Special call provision.* Upon a call by the Commission or its designee, the reports required to be filed by futures commission merchants, clearing members, foreign brokers, and reporting markets under paragraphs (a) through (d) of this section shall be submitted within 24 hours of the Commission or its designee's request in accordance with the instructions accompanying the request.

§ 17.02 Form, manner and time of filing reports.

Unless otherwise instructed by the Commission or its designee, the reports required to be filed by reporting markets, futures commission merchants, clearing members, and foreign brokers under §§17.00 and 17.01 shall be filed as specified in paragraphs (a) through (c) of this section.

(a) *Section 17.00(a) reports*. Reports filed under §17.00(a) shall be submitted through electronic data transmission procedures approved in writing by the Commission or its designee not later than 9 a.m. on the business day following that to which the information pertains. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.[1]

(b) *Section 17.01(a) reports*. For data submitted pursuant to §17.01(a) on Form 102:

(1) *Form of submission.* Form 102 must be submitted to the Commission in the form and manner provided on www.cftc.gov.

(2) *Time of submission*. For each account that becomes reportable as a special account, the futures commission merchant, clearing member, or foreign broker, as appropriate, shall submit a Form 102 to the Commission, in accordance with the instructions thereto, and in the manner specified by the Commission or its designee. Such form shall be submitted in accordance with the instructions and schedule set forth in paragraph~~s~~ (b)(2)(i)~~ and (ii)~~ of this section:

(i) The applicable reporting party shall submit a completed Form 102 to the Commission no later than 9 a.m. on the business day following the date on which the special account becomes reportable, or on such other date as directed by special call of the Commission or its designee, and as periodically required thereafter by paragraphs (b)(3) and (4) of this section, *provided however,* the reporting party may re-submit, amend, or otherwise modify the report no later than 9 a.m. on the third business day after the

[1] Per section II.B of the Petition, the Commission should clarify in the preamble to the proposed rules that reporting entities can reasonably rely on information provided by customers/counterparties and that the Commission will not commence an enforcement action if a reporting entity has no reason to believe that the information provided was incorrect.

special account becomes reportable. Such form shall include all required information, including the names of trading account owner(s).~~ and controller(s) of each trading account that is not an omnibus account, and that comprises a special account reported on the form, provided that, with respect to such owners(s) and controller(s), information other than the names of such parties may be reported in accordance with the instructions and schedule set forth in paragraph (b)(2)(ii) of this section.~~ Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.

~~(ii) With respect to the owner(s) and controller(s) of each trading account that is not an omnibus account, and that comprises a special account reported on Form 102, information other than the names of such parties must be provided on Form 102 no later than 9 a.m. on the third business day following the date on which the special account becomes reportable, or on such other date as directed by special call of the Commission or its designee, and as periodically required thereafter by paragraphs (b)(3) and (4) of this section. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.~~

(3) *Change updates*. If any change causes the information filed by a futures commission merchant, clearing member, or foreign broker on a Form 102 for a special account to no longer be accurate, then such futures commission merchant, clearing member, or foreign broker shall file an updated Form 102 with the Commission in accordance with the instructions and schedule set forth in paragraph~~s~~ (b)(2)(i)~~ and (ii)~~ of this section, or on such other date as directed by special call of the Commission, provided that, a futures commission merchant, clearing member, or foreign broker may stop providing change updates for a Form 102 that it has submitted to the Commission for any special account upon notifying the Commission or its designee that the account in question is no longer reportable as a special account and has not been reportable as a special account for the past six months.[2]

(4) *Refresh updates*. For Special Accounts—Starting on a date specified by the Commission or its designee and at the end of each annual increment thereafter (or such other date specified by the Commission or its designee that is equal to or greater than six months), each futures commission merchant, clearing member, or foreign broker shall resubmit every Form 102 that it has submitted to the Commission for each of its special accounts, provided that, a futures commission merchant, clearing member, or foreign broker may stop providing refresh updates for a Form 102 that it has submitted to the Commission for any special account upon notifying the Commission or its designee that the account in question is no longer reportable as a special account and has not been reportable as a special account for the past six months.

(c) *Section 17.01(b) reports*. For data submitted pursuant to §17.01(b) on Form 102:

(1) *Form of submission*. Form 102 must be submitted to the Commission in the form and manner provided on www.cftc.gov.

(2) *Time of submission*. For each account that becomes reportable as a volume threshold account, the clearing member shall submit a Form 102 to the Commission, in accordance with the instructions thereto, and in the manner specified by the Commission or its designee. Such form shall be submitted in accordance with the instructions and schedule set forth in paragraph~~s~~ (c)(2)(i)~~ and (ii)~~ of this section:

(i) The clearing member shall submit a completed Form 102 to the Commission no later than 9 a.m. on the business day following the date on which the volume threshold account becomes reportable, or on such other date as directed by special call of the Commission or its designee, and as periodically required thereafter by paragraphs (c)(3) and (4) of this section, *provided however,* the clearing member may re-submit, amend, or otherwise modify the report no later than 9 a.m. on the third business day after the volume threshold account becomes reportable. Such form shall include all required information, including the names of~~ the~~ volume threshold account owner(s).~~ and controller(s) of each volume threshold account reported on the form that is not an omnibus account, provided that, with respect to such owners(s) and~~

[2] Per section IV.B of the Petition, the Commission should clarify in the preamble to any proposal to modify the OCR Rule that the Commission will not commence an enforcement action against a reporting entity for failure to report a change update if the customer/counterparty did not notify the reporting entity of the applicable change.

~~controller(s), information other than the names of such parties may be reported in accordance with the instructions and schedule set forth in paragraph (c)(2)(ii) of this section.~~ Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.

~~(ii) With respect to the owner(s) and controller(s) of each volume threshold account reported on Form 102 that is not an omnibus account, information other than the names of such parties must be provided on Form 102 no later than 9 a.m. on the third business day following the date on which the volume threshold account becomes reportable, or on such other date as directed by special call of the Commission or its designee, and as periodically required thereafter by paragraphs (c)(3) and (4) of this section. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.~~

(3) *Change updates*. If any change causes the information filed by a clearing member on a Form 102 for a volume threshold account to no longer be accurate, then such clearing member shall file an updated Form 102 with the Commission in accordance with the instructions and schedule set forth in paragraph~~s~~ (c)(2)(i)~~ and (ii)~~ of this section, or on such other date as directed by special call of the Commission, provided that, a clearing member may stop providing Form 102 change updates for a volume threshold account upon notifying the Commission or its designee that the volume threshold account executed no trades in any product in the past six months on the reporting market at which the volume threshold account reached the reportable trading volume level.[3]

(4) *Refresh updates*. For Volume Threshold Accounts—Starting on a date specified by the Commission or its designee and at the end of each annual increment thereafter (or such other date specified by the Commission or its designee that is equal to or greater than six months), each clearing member shall resubmit every Form 102 that it has submitted to the Commission for each of its volume threshold accounts, provided that, a clearing member may stop providing refresh updates for a Form 102 that it has submitted to the Commission for any volume threshold account upon notifying the Commission or its designee that the volume threshold account executed no trades in any product in the past six months on the reporting market at which the volume threshold account reached the reportable trading volume level.

[3] Per section IV.B of the Petition, the Commission should clarify in the preamble to any proposal to modify the OCR Rule that the Commission will not commence an enforcement action against a reporting entity for failure to report a change update if the customer/counterparty did not notify the reporting entity of the applicable change.

PART 18 – REPORTS BY TRADERS

§ 18.05 Maintenance of books and records.

(a) Every volume threshold account controller; person who owns a volume threshold account; reportable sub-account controller; person who owns a reportable sub-account; and trader who owns, holds, or controls a reportable futures or option position shall keep books and records showing all details concerning all positions and transactions in the commodity or swap:

(1) On all reporting markets;

(2) Executed over the counter or pursuant to part 35 of this chapter;

(3) On exempt commercial markets operating under a Commission grandfather relief order issued pursuant to Section 723(c)(2)(B) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, 124 Stat. 1376 (2010));

(4) On exempt boards of trade operating under a Commission grandfather relief order issued pursuant to Section 734(c)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, 124 Stat. 1376 (2010)); and

(5) On foreign boards of trade.

(b) Every such volume threshold account controller; person who owns a volume threshold account; reportable sub-account controller; person who owns a reportable sub-account; and trader who owns, holds, or controls a reportable futures or option position shall also keep books and records showing all details concerning all positions and transactions in the cash commodity or swap, its products and byproducts, and all commercial activities that it hedges in the futures, option, or swap contract in which it is reportable.

(c) Every volume threshold account controller; person who owns a volume threshold account; reportable sub-account controller; person who owns a reportable sub-account; and trader who owns, holds, or controls a reportable futures or option position shall provide to a futures commission merchant, clearing member, or foreign broker the information necessary to file the reports specified under § 17.01 of this chapter, and upon request furnish to the Commission any pertinent information concerning such positions, transactions, or activities in a form acceptable to the Commission.

APPENDIX A

PART 20—LARGE TRADER REPORTING FOR PHYSICAL COMMODITY SWAPS

§ 20.1 Definitions.

As used in, and solely for the purposes of, this part:

Business day means "business day" as that term is defined in §1.3 of this chapter.

Cleared product means a paired swap or swaption that a clearing organization offers or accepts for clearing.

Clearing member means any person who is a member of, or enjoys the privilege of, clearing trades in its own name through a clearing organization.

Clearing organization means the person or organization that acts as a medium between clearing members for the purpose of clearing swaps or swaptions or effecting settlements of swaps or swaptions.

Closed swap or closed swaption means a swap or swaption that has been settled, exercised, closed out or terminated.

Commodity reference price means the price series (including derivatives contract and cash market prices or price indices) used by the parties to a swap or swaption to determine payments made, exchanged, or accrued under the terms of the contracts.

Consolidated Account Owner means the person attributed to a consolidated account as indicated in the reporting entity's records.

Counterparty means, from the perspective of one side to a contract, the person that is the direct legal counterparty corresponding to the other side of the contract.

Clearing member customer means any person for whom a reporting entity clears a swap or swaption position.

Futures equivalent means an economically equivalent amount of one or more futures contracts that represents a position or transaction in one or more paired swaps or swaptions consistent with the conversion guidelines in appendix A of this part.

Open swap or swaption means a swap or swaption that has not been closed.

Paired swap or paired swaption means an open swap or swaption that is:

(1) Directly or indirectly linked, including being partially or fully settled on, or priced at a differential to, the price of any commodity futures contract listed in §20.2; or

(2) Directly or indirectly linked, including being partially or fully settled on, or priced at a differential to, the price of the same commodity for delivery at the same location or locations.

Person means any "person" as that term is defined in §1.3 of this chapter.

Reportable account or consolidated account that is reportable means a consolidated account that includes a reportable position.

Reportable position means:

(1)(i) A position, in any one futures equivalent month, comprised of 50 or more futures equivalent paired swaps or swaptions based on the same commodity underlying a futures contract listed in §20.2, grouped separately by swaps and swaptions, then grouped by gross long contracts on a futures equivalent basis or gross short contracts on a futures equivalent basis;

(ii) For a consolidated account (described in §20.4(a)) that includes a reportable position as defined in paragraph (1)(i) of this definition, all other positions in that account that are based on the commodity that renders the account reportable; and

(iii) The first reporting day on which a consolidated account (described in §20.4(a)) no longer includes a reportable position as described in paragraph (1)(i) of this definition (because on such day, the reporting entity's consolidated account shall continue to be considered and treated as if it in fact included reportable positions as described in paragraph (1)(i) of this definition); or

(2) At the discretion of a reporting entity, and as an alternative to paragraph (1) of this definition, so long as the same method is consistently applied to all consolidated accounts (as described in §20.4(a)) of the reporting entity, all positions on a gross basis in a consolidated account that are based on the same commodity.

Reporting day means the period of time between a clearing organization or reporting entity's usual and customary last internal valuation of paired swaps or swaptions and the next such period, so long as the period of time is consistently observed on a daily basis and the Commission is notified, upon its request, of the manner by which such period is calculated and any subsequent changes thereto.

Reporting entity means:

(1) A clearing member; or

(2) A swap dealer in one or more paired swaps or swaptions as that term is defined in section 1a of the Act and any Commission definitional regulations adopted thereunder.

Swap means:

(1) Until the effective date of any definitional rulemaking regarding "swap" by the Commission under section 1a of the Act, an agreement (including terms and conditions incorporated by reference therein) which is a commodity swap (including any option to enter into such swap) within the meaning of "swap agreement" under §35.1(b)(1) of this chapter, or a master agreement for a commodity swap together with all supplements thereto; or

(2) "Swap" as defined in section 1a of the Act and any Commission definitional regulations adopted thereunder, upon the effective date of such regulations.

Swaption means an option to enter into a swap or a swap that is an option.

§ 20.5 Series S filings.

(a) *102S filing.*

(1) When a counterparty consolidated account first becomes reportable, the reporting entity shall submit a 102S filing, in accordance with the form instructions and as specified in this section.

(2) A reporting entity may submit a 102S filing only once for each counterparty, even if such persons at various times have multiple reportable positions in the same or different paired swaps or swaptions.

(3) Reporting entities shall submit a 102S filing within three days following the first day a consolidated account first becomes reportable or at such time as instructed by the Commission upon special call.[4]

(4) *Change updates.* If any change causes the information filed by a clearing member or swap dealer on a Form 102 for a consolidated account to no longer be accurate, then such clearing member or swap dealer shall file an updated Form 102 with the Commission no later than 9 a.m. on the business day after such change occurs, *provided however,* the clearing member or swap dealer may re-submit, amend, or otherwise modify the report no later than 9 a.m. on the third business day after the consolidated account becomes reportable, or on such other date as directed by special call of the Commission.~~,~~ ~~p~~Provided that, a clearing member or swap dealer may stop providing change updates for a Form 102 that it has submitted to the Commission for any consolidated account upon notifying the Commission or its designee that the account in question is no longer reportable as a consolidated account and has not been reportable as a consolidated account for the past six months. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for

[4] Per section II.B of the Petition, the Commission should clarify in the preamble to the proposed rules that reporting entities can reasonably rely on information provided by customers/counterparties and that the Commission will not commence an enforcement action if a reporting entity has no reason to believe that the information provided was incorrect.

information concerning markets located in that time zone, and central time for information concerning all other markets. [5]

(5) *Refresh updates.* For Consolidated Accounts—Starting on a date specified by the Commission or its designee and at the end of each annual increment thereafter (or such other date specified by the Commission or its designee that is equal to or greater than six months), each clearing member or swap dealer shall resubmit every Form 102 that it has submitted to the Commission for each of its consolidated accounts, provided that, a clearing member or swap dealer may stop providing refresh updates for a Form 102 that it has submitted to the Commission for any consolidated account upon notifying the Commission or its designee that the account in question is no longer reportable as a consolidated account and has not been reportable as a consolidated account for the past six months.

(b) *40S filing.* Every person subject to books or records under § 20.6 shall after a special call upon such person by the Commission file with the Commission a 40S filing at such time and place as directed in the call. ~~A 40S filing shall consist of the submission of a Form 40, which shall be completed by such person as if any references to futures or option contracts were references to paired swaps or swaptions as defined in §20.1.~~

(c) Every person with a reportable position shall provide to a reporting entity the information necessary to file the reports specified under paragraph (a) of this Section.

[5] Per section IV.B of the Petition, the Commission should clarify in the preamble to any proposal to modify the OCR Rule that the Commission will not commence an enforcement action against a reporting entity for failure to report a change update if the customer/counterparty did not notify the reporting entity of the applicable change.

Exhibit B

CFTC FORM 102
Identification of Special Accounts, Volume Threshold Accounts, and Consolidated Accounts

NOTICE: Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act")[1] and the regulations thereunder,[2] or the filing of a report with the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

PRIVACY ACT NOTICE

The Commission's authority for soliciting this information is granted in sections 4a, 4c(b), 4g, 4i and 8 of the CEA and related regulations (*see*, e.g., 17 CFR § 17.01(b)). The information solicited from entities and individuals engaged in activities covered by the CEA is required to be provided to the CFTC, and failure to comply may result in the imposition of criminal or administrative sanctions (*see*, e.g., 7 U.S.C. sections 9 and 13a-1, and/or 18 U.S.C. 1001). The information requested is most commonly used in the Commission's market and trade practice surveillance activities to (a) provide information concerning the size and composition of the commodity derivatives markets, (b) permit the Commission to monitor and enforce speculative position limits and (c) enhance the Commission's trade surveillance data. The requested information may be used by the Commission in the conduct of investigations and litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to contract markets to meet responsibilities assigned to them by law. The information will be maintained in, and any additional disclosures will be made in accordance with, the CFTC System of Records Notices, available on www.cftc.gov.

[1] 7 U.S.C. section 1, *et seq*.

[2] Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter 1 of title 17 of the Code of Federal Regulations; 17 CFR Chapter 1 *et seq*.

Exhibit B

BACKGROUND & INSTRUCTIONS

17 CFR 17.01(a) requires each futures commission merchant, clearing member, or foreign broker to identify and report its special accounts to the Commission on Form 102. 17 CFR 17.01(b) requires each clearing member to identify and report its volume threshold accounts to the Commission on Form 102. In addition, 17 CFR 20.5 requires each reporting entity holding or carrying a consolidated account with a reportable position to identify and report the counterparty of such account to the Commission by submitting a 102S filing. As appropriate, please follow the instructions below to generate and submit the required report or filing. Unless the context requires otherwise, the terms used herein shall have the same meaning as ascribed in parts 15 to 21 of the Commission's regulations.

Complete Form 102 as follows:

General Information – Cover Sheet:	All filers.
Section 102A:	Only complete when submitting Form 102 for a special account.
Section 102B:	Only complete when submitting Form 102 for a volume threshold account.
Section 102S:	Only complete when submitting a 102S filing.
Signature/Authentication:	All filers.

Submitting Form 102: Once completed, please submit this form to the Commission pursuant to the instructions on www.cftc.gov or as otherwise directed by Commission staff. If submission attempts fail, the reporting trader shall contact the Commission at techsupport@cftc.gov for further technical support.

Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Exhibit B

General Information – Cover Sheet.

Please indicate the type of account to be reported (choose only one):

Special Account (please complete section 102A)	□
Volume Threshold Account 102 (please complete section 102B)	□
Consolidated Account 102S filing (please complete section 102S)	□

Reporting Firm Contact Information:[3]

Whether submitting Form 102 for a special account, volume threshold account, or as a 102S filing for a consolidated account, please provide the contact information of the reporting firm and, as applicable, indicate whether the reporting firm is a futures commission merchant, clearing member, foreign broker, and/or swap dealer. In addition, provide the reporting firm's reporting firm ID.[4]

Name of Reporting Firm: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Reporting Firm Contact Name (a natural person, "Contact"):
Contact Job Title:
Contact Phone Number:[5]
Contact Email Address:
Firm Website:
Firm NFA ID (if any):
Firm Legal Entity Identifier (if any):[6]
Reporting Firm Type(s) (mark all that apply):

[3] The term "reporting firm" as used herein may refer to a futures commission merchant, clearing member, foreign broker, swap dealer, or other reporting entity, as appropriate.

[4] The "reporting firm ID" is an alpha-numeric identifier assigned by the Commission.

[5] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[6] If the Firm Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Reporting Firm, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Firm Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Firm Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

Exhibit B

□ Futures commission merchant

□ Clearing member

□ Foreign broker

□ Swap dealer

□ Other: ____________________________

Reporting Firm ID:

Exhibit B

Section 102A – Identifying and reporting *a special account.*

1. *New/Modified Indicator:*

□ Special account being reported for the first time

□ Re-submitted or modified Information for a previously reported special account

2. *Special Account Origination.*

For each special account, indicate whether the account is being reported based on ownership of a reportable position, control of a reportable position, both ownership and control of a reportable position, or because it is an omnibus account with a reportable position (choose only one):

Ownership of a reportable position[7] (complete questions 3, 4, ~~6~~, 8~~9~~, and 9~~10~~)	□
Control of a reportable position (complete questions 3, 6~~7~~, and 8~~9~~, and 9~~10~~)	□
Ownership and control of a reportable position (complete questions 3, ~~6~~, 6~~7~~, 8~~9~~, and 9~~10~~)	□
Omnibus account with a reportable position[8] (complete questions 3, 5, 7~~8~~, 8~~9~~, and 9~~10~~)	□

3. *Reporting number and name.*[9]

Provide the reporting number and name of the special account.

Special Account Number:
Special Account Name:

4. *House or Customer Indicator.*

If the reported special account is being reported based on ownership of a reportable position, indicate whether the special account is a house or customer account of the reporting firm:

□ HOUSE

□ CUSTOMER

[7] Reporting parties are not required to submit Form 102A based solely on ownership of a reportable position at this time.

[8] Omnibus accounts are accounts that one futures commission merchant, clearing member or foreign broker carries for another in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm.

[9] Reporting firms shall assign a reporting number and name to each special account when it is reportable for the first time in futures or options on futures. If an account has been assigned a number and name for reporting in futures (options), use the same number and name for reporting options (futures). Such reporting number and name must not be changed or assigned to any other special account without the prior approval of the Commission.

Exhibit B

5. *Omnibus Account Information.*

If the reported special account is an omnibus account, indicate whether the account is a house or customer omnibus account:[10]

□ HOUSE

□ CUSTOMER

~~*6. Special Account Owner(s) Contact Information.*~~

~~Provide the following information regarding the owner of this special account. Owners may be natural persons or any type of legal entity.~~

~~Indicate whether the owner is a legal entity or a natural person:~~

~~Legal entity: □~~
~~Natural person: □~~

~~***Name of Special Account Owner:*** [For each field, check box if field reported to LEI provider in lieu of reported on this form □]~~
~~***Street Address:***~~
~~***City:***~~
~~***State:***~~
~~***Country:***~~
~~***Zip/Postal Code:***~~
~~Phone Number:~~[11]
~~Email Address:~~
~~Contact Name (if owner not a natural person):~~
~~Contact Job Title:~~
~~Contact Relationship to Owner:~~
~~Contact Phone Number:~~[12]
~~Contact Email Address:~~
~~Owner Website (if any):~~[13]
~~Owner NFA ID (if any):~~
~~Owner Legal Entity Identifier (if any):~~[14]

[10] House omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.

[11] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[12] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[13] ~~The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.~~

[14] ~~If the Owner Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Special Account Owner, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility~~

Exhibit B

~~7.~~ 6. *Special Account Controller(s) Contact Information.*

Provide the following information regarding the controller of this special account. Controllers may be natural persons or any type of legal entity.

Indicate whether the controller is a legal entity or a natural person:

Legal entity: □
Natural person: □

Name of Special Account Controller: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[15]
Email Address:
Contact Name (if controller not a natural person):
Contact Job Title:
Contact Relationship to Controller:
Contact Phone Number:[16]
Contact Email Address:
Controller Website (if any):[17]
Controller NFA ID (if any):
Controller Legal Entity Identifier (if any):[18]

~~(or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.~~

[15] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[16] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[17] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[18] If the Controller Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Special Account Controller, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Controller Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Controller Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

Exhibit B

~~8.~~ 7. *Omnibus Account Originator Contact Information.*

Provide contact information for the originator of the omnibus account in this special account.

Name of Omnibus Account Originator: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[19]
Contact Name:
Contact Job Title:
Contact Relationship to Originator:
Contact Phone Number:[20]
Contact Email Address:
Originator Website (if any):[21]
Originator NFA ID (if any):
Originator Legal Entity Identifier (if any):[22]

~~9.~~ 8. *Identification of Trading Account(s) that Comprise the Special Account.*

For each special account reported by an entity acting as a *clearing member*, provide the trading account number(s), and any related short code(s), that comprise this special account. Also identify the reporting market at which each trading account number appears.

Trading Account Number:
Short Code(s):
Reporting Market:

[19] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[20] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[21] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[22] If the Originator Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Omnibus Account Originator, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

Exhibit B

~~10.~~9. *Trading Account Ownership~~ and Control~~ Information.*

(i) Omnibus Account Information.

For each trading account identified in question 8~~9~~, is such account an omnibus account, or used to execute trades for an omnibus account?

□ YES

□ NO

If NO, proceed to (ii) and (iii), below. If YES, indicate whether the account is a house or customer omnibus account and provide contact information for the originator of the omnibus account:[23]

□ HOUSE

□ CUSTOMER

Name of Omnibus Account Originator: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[24]
Contact Name:
Contact Job Title:
Contact Relationship to Originator:
Contact Phone Number:[25]
Contact Email Address:
Originator Website (if any):[26]
Originator NFA ID (if any):
Originator Legal Entity Identifier (if any):[27]

[23] As above, house omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.

[24] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[25] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[26] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[27] If the Originator Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Omnibus Account Originator, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated

Exhibit B

(ii) Trading Account Owner(s).

For each trading account identified in question 8~~9~~ that is not an omnibus account, provide the requested information for each trading account owner (“owner”), as defined in Rule 15.00(bb).

Indicate whether the owner is a legal entity or a natural person:

Legal entity: □

Natural person: □

Name of Trading Account Owner(s): [For each field, check box if field reported to LEI provider in lieu of reported on this form □]

Follow-On Information:[28]

Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[29]
Email Address (if owner(s) a natural person):
Contact Name (provide only if owner is not a natural person):

Contact Job Title:
Contact Relationship to Owner:
Contact Phone Number:[30]
Contact Email Address:

Owner Website (if any):[31]
Owner NFA ID (if any):
Owner Legal Entity Identifier (if any):[32]

with this Originator Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the “Supplemental Fields”), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

[28] Follow-On Information may be submitted by the later date specified in § 17.02.

[29] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[30] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[31] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[32] If the Owner Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Trading Account Owner(s), Street Address, City, State, Country, and Zip/Postal Code (collectively, the “Optional Fields”)) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI

Exhibit B

~~*(iii) Trading Account Controller(s).*~~

~~For each trading account identified in question 9 that is not an omnibus account, provide the requested information for each controller (“controller”). NOTE: As defined in § 15.00, the controller identified for a trading account that comprises or pertains to a special account must be a natural person.~~

~~Name of Trading Account Controller(s):~~

~~Follow-On Information:[33]~~

~~Street Address:~~
~~City:~~
~~State:~~
~~Country:~~
~~Zip/Postal Code:~~
~~Phone Number:[34]~~
~~Name of Employer:~~
~~Employer NFA ID (if any):~~
~~Employer Legal Entity Identifier (if any):~~
~~Job Title:~~
~~Relationship to Owner:~~
~~Email Address:~~
~~Controller NFA ID (if any):~~

10~~1~~. *For Reporting Firms That Are Foreign Brokers.*

If the reporting firm indicated that it is a foreign broker in the “Reporting Firm Contact Information” above, identify the reporting firm’s U.S. futures commission merchant.

Name of U.S. futures commission merchant:
Street Address:
City:
State:
Country:
Zip/Postal Code:
Contact Name at U.S. futures commission merchant (a natural person, “Contact”):
Contact Job Title:
Contact Phone Number:[35]
Contact Email Address:

provider) is modified in the future to accept any of the underlined fields above (the “Supplemental Fields”), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

~~[33] Follow-On Information may be submitted by the later date specified in § 17.02.~~

~~[34] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

[35] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Exhibit B

Section 102B – Identifying and reporting *a volume threshold account.*

1. *New/Modified Indicator:*

   □ Volume threshold account being reported for the first time

   □ Re-submitted or modified Information for a previously reported volume threshold account

2. *Trading Account Data for the Volume Threshold Account.*

   Provide the trading account number, and any related short code(s), deemed to be a volume threshold account. Also identify the reporting market at which the volume threshold account had reportable trading volume.

   Trading Account Number:
   Short Code(s):
   Reporting Market:

3. *Associated Special Account Number.*

   If the volume threshold account has been previously identified as a trading account that comprises a special account(s) reported by a clearing member in question 8~~9~~ in section 102A of this form, provide the associated special account number(s).

4. *Omnibus Account Information.*[36]

   Is the reported volume threshold account an omnibus account, or used to execute trades for an omnibus account?

   □ YES

   □ NO

   If NO, proceed to (5) and (6), below. If YES, indicate whether the account is a house or customer omnibus account and provide contact information for the originator of the omnibus account:[37]

   □ HOUSE

   □ CUSTOMER

[36] As above, omnibus accounts are accounts that one futures commission merchant, clearing member or foreign broker carries for another in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm.

[37] As above, house omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.

Exhibit B

Name of Omnibus Account Originator: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[38]
Contact Name:
Contact Job Title:
Contact Relationship to Originator:
Contact Phone Number:[39]
Contact Email Address:
Originator Website (if any):[40]
Originator NFA ID (if any):
Originator Legal Entity Identifier (if any):[41]

5. *Volume Threshold Account Owner(s).*

For each volume threshold account that is not an omnibus account, provide the requested information for each owner ("owner").

Indicate whether the owner is a legal entity or a natural person:

Legal entity: □

Natural person: □

[38] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[39] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[40] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[41] If the Originator Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Omnibus Account Originator, Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

Exhibit B

Name of Volume Threshold Account Owner(s): [For each field, check box if field reported to LEI provider in lieu of reported on this form □]

Follow-On Information:[42]

Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[43]
Email Address (if owner(s) a natural person):
Contact Name (provide only if owner is not a natural person):
Contact Job Title:
Contact Relationship to Owner:
Contact Phone Number:[44]
Contact Email Address:
Owner Website (if any):[45]
Owner NFA ID (if any):
Owner Legal Entity Identifier (if any):[46]

~~*6. Volume Threshold Account Controller(s).*~~

~~For each volume threshold account identified that is not an omnibus account, provide the requested information for each volume threshold account controller ("controller"). NOTE: As defined in § 15.00, a volume threshold account controller must be a natural person.~~

~~Name of Volume Threshold Account Controller(s):~~

~~Follow-On Information:[47]~~

[42] Follow-On Information may be submitted by the later date specified in § 17.02.

[43] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[44] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[45] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[46] If the Owner Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Volume Threshold Account Owner(s), Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

~~[47] Follow-On Information may be submitted by the later date specified in § 17.02~~.

Exhibit B

~~Street Address:~~
~~City:~~
~~State:~~
~~Country:~~
~~Zip/Postal Code:~~
~~Phone Number:~~[48]
~~Name of Employer:~~
~~Employer NFA ID (if any):~~
~~Employer Legal Entity Identifier (if any):~~
~~Job Title:~~
~~Relationship to Owner:~~
~~Email Address:~~
~~Controller NFA ID (if any):~~

[48] ~~Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

Exhibit B

Section 102S – Identifying and reporting a swap counterparty,~~ or~~ customer, principal, or house *consolidated account* with a reportable position (102S filing).

1. *New/Modified Indicator.*

   □ Counterparty or customer reported for the first time

   □ Re-submitted or modified Information for a previously reported counterparty or customer

2. *102S Identifier.* Please enter the identifier for the consolidated account reported herein. A 102S identifier is a unique identifier for each reporting entity or counterparty/customer as assigned by the reporting entity. If the reporting entity currently identifies a counterparty via Section 102A of a Form 102, the identifier used on Section 102A of the Form 102 may also be used for the 102S identifier, as long as the same legal entity is referenced.

   102S identifier:

3. *Counterparty or Customer ~~Ownership and Control~~ Information. Please provide the requested house, clearing customer, principal or counterparty ~~or customer~~ contact information~~ for both owners and controllers of the consolidated account~~.*

   (i) Consolidated Account Type. Please indicate the consolidated account type:[49]

   (a) If reporting as a clearing member:

   □ HOUSE

   □ CLEARING CUSTOMER

   □ PRINCIPAL[50]

   □ COUNTERPARTY[51]

   (b) If reporting as a swap dealer:

   □ PRINCIPAL[52]

   □ COUNTERPARTY[53]

[49] *See* CFTC Rule 20.4, which requires that both house/principal and counterparty/clearing customer positions be reported.

[50] This field represents a clearing member's uncleared principal positions.

[51] This field represents the counterparty to a clearing member.

[52] This field represents a swap dealer's uncleared, principal positions.

[53] This field represents the counterparty to a swap dealer.

Exhibit B

(ii) *Omnibus Account Information (complete only if reporting as a Clearing Member for a house or clearing customer consolidated account).*[54]

Is the reported consolidated account an omnibus account, or used to execute trades for an omnibus account?

□ YES

□ NO

If NO, proceed to (iii) and (iv), below. If YES, indicate whether the account is a house or customer omnibus account and provide contact information for the originator of the omnibus account:[55]

□ HOUSE

□ CUSTOMER

Name of Omnibus Account Originator: [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[56]
Contact Name:
Contact Job Title:
Contact Relationship to Originator:
Contact Phone Number:[57]
Contact Email Address:
Originator Website (if any):[58]
Originator NFA ID (if any):
Originator Legal Entity Identifier (if any):[59]

[54] As above, omnibus accounts are accounts that one futures commission merchant, clearing member or foreign broker carries for another in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm. Swap dealers do not need to answer this question.

[55] As above, house omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.

[56] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[57] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[58] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[59] If the Originator Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Omnibus Account Originator, Street Address, City, State, Country, and Zip/Postal Code (collectively, the

Exhibit B

(iii) Consolidated Account Owner(s).

For each reportable consolidated account that is not an omnibus account, provide the requested information for each owner (“owner”).

Indicate whether the owner is a legal entity or a natural person:

Legal entity: □

Natural person: □

Name of Consolidated Account Owner(s): [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[60]
Email Address (if owner(s) a natural person):
Contact Name (provide only if owner is not a natural person):
Contact Job Title:
Contact Relationship to Owner:[61]
Contact Phone Number:[62]
Contact Email Address:
Owner Website (if any):[63]
Owner NFA ID (if any):
Owner Legal Entity Identifier (if any):[64]

“Optional Fields”)) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the “Supplemental Fields”), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Originator Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web faun corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

[60] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[61] Possible narrative responses in this field include: employee, employee of affiliate, contractor, *etc.*

[62] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[63] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. NFA IDs may not exist for all principals, house accounts, clearing customers, or counterparties. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[64] If the Owner Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Consolidated Account Owner(s), Street Address, City, State, Country, and Zip/Postal Code (collectively, the “Optional Fields”)) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the “Supplemental Fields”), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility

Exhibit B

(iv) *Consolidated Account Controller(s) (complete only if different than Consolidated Account Owner).*

For each reportable consolidated account that is not an omnibus account, provide the requested information for each controller ("controller"). Controllers may be natural persons or any type of legal entity.

Indicate whether the controller is a legal entity or a natural person:

Legal entity: □

Natural person: □

Name of Consolidated Account Controller(s): [For each field, check box if field reported to LEI provider in lieu of reported on this form □]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[65]
Email Address:
Contact Name (provide only if controller is not a natural person):
Contact Job Title:
Contact Relationship to controller:
Contact Phone Number:[66]
Contact Email Address:
Controller NFA ID (if any):
Controller Legal Entity Identifier (if any):[67]

(or other CFTC-accepted LEI provider) and are associated with this Owner Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

[65] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[66] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[67] If the Controller Legal Entity Identifier was issued by the CICI Utility (or by any other CFTC-accepted LEI provider), then the reporting party is not required to report any of the fields marked above in bold and italics (Name of Consolidated Account Controller(s), Street Address, City, State, Country, and Zip/Postal Code (collectively, the "Optional Fields")) that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Controller Legal Entity Identifier. Furthermore, in the event the CICI Utility (or any other CFTC-accepted LEI provider) is modified in the future to accept any of the underlined fields above (the "Supplemental Fields"), then the reporting party will not be required to report any of the Supplemental Fields that were reported to the CICI Utility (or other CFTC-accepted LEI provider) and are associated with this Controller Legal Entity Identifier. Reporting parties that take advantage of such relief from duplicative reporting when making their web-based or FTP submission should check the box in the web form corresponding to the appropriate field (or make appropriate changes to their FTP data submission) to indicate that the omitted information has been reported to an LEI provider.

Exhibit B

4. *Paired Swaps and Swaptions Market Activity*. Provide a brief description of the nature of the counterparty’s or customer’s paired swaps and swaptions market activity (please include a response for each type of paired swap or swaption market activity):

~~□ Description below relates to paired swap activity.~~

~~□ Description below relates to paired swaption activity.~~

Enter the description here:

Exhibit B

Signature/Authentication.

1. *Please sign/authenticate the Form 102 prior to submitting.*

Signature/Electronic Authentication:

□ By checking this box and submitting this form (or by clicking "submit," "send," or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by the reporting firm identified below to provide the information and representations submitted on this Form 102, and that the information and representations are true and correct.

Reporting Firm Authorized Representative (Name and Position):

______________________________ (Name)

______________________________ (Position)

Submitted on behalf of:

______________________________ (Reporting Firm Name)

Date of Submission:

____

Exhibit C

CFTC FORM 71
IDENTIFICATION OF
OMNIBUS ACCOUNTS AND SUB-ACCOUNTS

NOTICE: Failure to file a report required by the Commodity Exchange Act (“CEA” or the “Act”)[1] and the regulations thereunder,[2] or the filing of a report with the Commodity Futures Trading Commission (“CFTC” or “Commission”) that includes a false, misleading or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

PRIVACY ACT NOTICE

The Commission’s authority for soliciting this information is granted in sections 4a, 4c(b), 4g, 4i and 8 of the CEA and related regulations (*see*, e.g., 17 CFR 17.01(c)). The information solicited from entities and individuals engaged in activities covered by the CEA is required to be provided to the CFTC, and failure to comply may result in the imposition of criminal or administrative sanctions (*see*, e.g., 7 U.S.C. sections 9 and 13a-1, and/or 18 U.S.C. 1001). The information requested is most commonly used in the Commission’s market and trade practice surveillance activities to (a) provide information concerning the size and composition of the commodity derivatives markets, (b) permit the Commission to monitor and enforce speculative position limits and (c) enhance the Commission’s trade surveillance data. The requested information may be used by the Commission in the conduct of investigations and litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to reporting markets to meet responsibilities assigned to them by law. The information will be maintained in, and any additional disclosures will be made in accordance with, the CFTC System of Records Notices, available on wwvv.cftc.gov.

[1] 7 U.S.C. section 1, *et seq*.

[2] Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter 1 of title 17 of the Code of Federal Regulations; 17 CFR Chapter 1 *et seq.*

Exhibit C

BACKGROUND & GENERAL INSTRUCTIONS

Who Must File a Form 71 – 17 CFR 17.01(c) requires each originator of (a) an omnibus volume threshold account or (b) an omnibus reportable sub-account (collectively, "Reporting Parties") to file a Form 71 – Identification of Omnibus Accounts and Sub-Accounts with the Commodity Futures Trading Commission ("CFTC" or "Commission").

When to file – Each Reporting Party must file a Form 71 on call by the Commission or its designee.

Where to file – The Form 71 shall be filed by submitting the completed form to the nearest CFTC office or as otherwise instructed by the Commission or its designee. Generally, a Form 71 should be submitted via the CFTC's web-based Form 71 submission process at www.cftc.gov or via a secure FTP data feed to the Commission. If submission attempts fail, the reporting trader shall contact the Commission at techsupport@cftc.gov for further technical support.

Signature – Each Form 71 submitted to the Commission must be signed or otherwise authenticated by an individual that is duly authorized by the relevant Reporting Party to provide the information and representations contained in the form.

What to File – Each Reporting Party must complete part A, the relevant question in part B, and part C.

Unless otherwise noted, the terms used herein shall have the same meaning as ascribed in parts 15 to 21 of the Commission's regulations.

Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Exhibit C

ACKNOWLEDGEMENT OF DEFINITIONS

Before proceeding with your submission, please check this box to indicate that you have read the definitions for the following terms, as they are used in the Form 71: □

Commodity (or commodities) – generally, all goods and articles (except onions and motion picture box office receipts, or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value, or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in *(see* 7 U.S.C. 1a(9)).

Omnibus account – any trading account that one futures commission merchant, clearing member or foreign broker carries for another and in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm.

Omnibus reportable sub-account – means any trading sub-account of an omnibus volume threshold account, which sub-account executes reportable trading volume on an omnibus basis. Omnibus reportable sub-account also means any trading account that is itself an omnibus account, executes reportable trading volume, and is a sub-account of another omnibus reportable sub-account.

Omnibus volume threshold account – means any trading account that, on an omnibus basis, carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.

Person – an individual, association, partnership, corporation, trust, or government agency and/or department.

Reportable sub-account – means any trading sub-account of an omnibus volume threshold account or omnibus reportable sub-account, which sub-account executes reportable trading volume.

Reportable sub-account controller – means a natural person who by power of attorney or otherwise actually directs the trading of a reportable sub-account. A reportable sub-account may have more than one controller.

Reportable sub-account owner means the person indicated in an omnibus account originator's books and records as the holder of the account.

Reportable trading volume – means contract trading volume that meets or exceeds the level specified in 17 CFR 15.04.

Volume threshold account – means any trading account that carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.

Exhibit C

CFTC FORM 71

A. Re-confirmation of Omnibus Volume Threshold Account or Omnibus Reportable Sub-Account:

Account number [(auto-populated)] was identified on Form [[102B] OR [71] (auto-populated)] by [[clearing member] OR [preceding originator] (auto-populated)] as an [[omnibus volume threshold account] OR [omnibus reportable sub-account] (auto-populated)] on [reporting market (auto-populated)].

The following information was provided on Form [[102B] OR [71] (auto-populated)] regarding you as the originator ("Originator") of this [[omnibus volume threshold account] OR [omnibus reportable sub-account] (auto-populated)]. Please update any incorrect information in the space provided below.

Name of Originator: [(Fields below will be auto-populated)] [space to correct incorrect info]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[1]
Contact Name:
Contact Job Title:
Contact Relationship to Originator:
Contact Phone Number:[2]
Contact Email Address:
Originator Website (if any):
Originator NFA ID (if any):
Originator Legal Entity Identifier (if any):

B. Identification of Reportable Sub-Accounts:

The following questions request information regarding the allocation of trades from account number [[omnibus volume threshold account number] OR [omnibus reportable sub-account number] (auto-populated)] on [date (auto-populated)] on [reporting market (auto-populated)] to other accounts.

1. If you did not allocate any trades from account number [(auto-populated)] on [date (auto-populated)] on [reporting market (auto-populated)], check this box and proceed to part C: □

2. If you allocated trades from account number [(auto-populated)] on [date (auto-populated)] on [reporting market (auto-populated)], but the sum of allocations did not result in reportable

[1] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[2] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Exhibit C

trading volume for a recipient account on [date (auto-populated)], check this box and proceed to part C: □

3. If you allocated trades from account number [(auto-populated)] on [date (auto-populated)] on [reporting market (auto-populated)] that resulted in reportable trading volume for a recipient account, provide the following information for each such recipient account (hereafter, a "reportable sub-account"):

(a) Identification of Omnibus Reportable Sub-Accounts.

(i) Is the reportable sub-account an omnibus reportable sub-account?

□ YES

□ NO

(ii) If NO, proceed to (b) below. If YES, indicate whether the omnibus reportable sub-account is a house or customer omnibus account and provide the contact information of the originator of the omnibus account[3]

□ HOUSE

□ CUSTOMER

Name of Reportable Sub-Account Originator:
Account Number of Reportable Sub-Account:[4]
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[5]
Contact Name:
Contact Job Title:
Contact Relationship to Originator:
Contact Phone Number:[6]
Contact Email Address:

[3] House omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity.

[4] The Account Number should be a number or other identifier that is known to the reportable sub-account originator.

[5] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[6] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Exhibit C

Originator Website (if any):[7]
Originator NFA ID (if any):
Originator Legal Entity Identifier (if any):

(b) Identification of Non-Omnibus Reportable Sub-Accounts:

(i) For each reportable sub-account that is not an omnibus account, provide the requested information for each owner ("owner") of the reportable sub-account.

Indicate whether the owner is a legal entity or a natural person:

Legal entity: □

Natural person: □

Name of Reportable Sub-Account Owner (s):
Street Address:
City:
State:
Country:
Zip/Postal Code:
Phone Number:[8]
Email Address (if owner is a natural person):
Contact Name (if owner is not a natural person):
Contact Job Title:
Contact Relationship to Owner:
Contact Phone Number:[9]
Contact Email Address:
Owner Website (if any):[10]
Owner NFA ID (if any):
Owner Legal Entity Identifier (if any):

~~(ii) For each reportable sub-account that is not an omnibus account, provide the requested information for each reportable sub-account controller. (NOTE: a reportable sub-account controller must be a natural person.)~~

~~Name of Reportable Sub-Account Controller(s):~~
~~Street Address:~~
~~City:~~
~~State:~~

[7] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

[8] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[9] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[10] The website and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the website and NFA ID if this information has not been previously collected.

Exhibit C

~~Country:~~
~~Zip/Postal Code:~~
~~Phone Number:~~~~[11]~~
~~Name of Employer:~~
~~Job Title:~~
~~Relationship to Owner:~~
~~Email Address:~~
~~Controller NFA ID (if any):~~

After completing the applicable questions in part B.3, proceed to part C.

C. Signature/Authentication, Name, and Date:

Please sign/authenticate the Form 71 prior to submitting.

Signature/Electronic Authentication of [Originator (auto-populated)]:

□ By checking this box and submitting this form (or by clicking “submit,” “send,” or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by [Originator (auto-populated)] to provide the information and representations submitted on this Form 71, and that the information and representations are true and correct.

Authorized Representative (Name and Position):

_________________________ (Name)

_________________________ (Position)

Submitted on behalf of:

_________________________ [Originator (auto-populated)]

Date of Submission:

____

~~[11] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.~~

Exhibit D

CFTC FORM 40
STATEMENT OF REPORTING TRADER

NOTICE: Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act")[1] and the regulations thereunder,[2] or the filing of a report with the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

PRIVACY ACT NOTICE

The Commission's authority for soliciting information from traders with large futures, option, swap, or other derivatives market positions is granted in sections 4a, 4i, 4t and 8 of the CEA (*see* 7 U.S.C. sections 6i and 12). The Commission's authority for soliciting information from special account controllers, persons who own special accounts, volume threshold account controllers, persons who own volume threshold accounts, reportable sub-account controllers, and persons who own reportable sub-accounts is granted in sections 4i and 8 of the CEA and related regulations (*see*, e.g., 17 CFR 18.04(b)). Such entities and individuals are required to provide the information requested, and failure to comply may result in the imposition of criminal or administrative sanctions (*see*, e.g., 7 U.S.C. sections 9 and 13a-1, and/or 18 U.S.C. 1001).

The information requested is most commonly used in the Commission's market and trade practice surveillance activities to (a) provide information concerning the size and composition of the commodity derivatives markets, (b) permit the Commission to monitor and enforce speculative position limits and (c) enhance the Commission's trade surveillance data. Information contained in these records may be used by the Commission in the conduct of investigations or litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to contract markets to meet responsibilities assigned to them by law. In accordance with the Privacy Act and the Commission's rules thereunder (*see* 17 CFR part 146), the complete listing of uses of the information contained in these records is found in the Commission's System of Records Notices, available on www.cftc.gov. These uses include CFTC-15, Large Trader Report Files (Integrated Surveillance System).

Information contained in these records may be used by the Commission in the conduct of investigations or litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to reporting markets to meet responsibilities assigned to them by law.

[1] 7 U.S.C. section 1, *et seq*.

[2] Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter 1 of title 17 of the Code of Federal Regulations; 17 CFR Chapter 1 *et seq*.

Exhibit D

General Instructions

Who Must File a Form 40—17 CFR 18.04(a) requires every person who owns or controls a reportable position to file a Form 40—Statement of Reporting Trader with the Commission. 17 CFR 18.04(b) requires every volume threshold account controller, person who owns a volume threshold account, reportable sub-account controller, and person who owns a reportable sub-account to file a Form 40—Statement of Reporting Trader with the Commission. ~~17 CFR 20.5 requires every person subject to books or records under 17 CFR 20.6 to file a 40S filing[3] with the Commission.~~

When to file—A reporting trader must file a Form 40 on call by the Commission or its designee.

Where to file—The Form 40 should be submitted (a) via the CFTC's web-based Form 40 submission process at *www.cftc.gov*, (b) via a secure FTP data feed to the Commission, or (c) as otherwise instructed by the Commission or its designee. If electronic submission attempts fail, the reporting trader shall contact the Commission at *techsupport@cftc.gov* for further technical support.

When to update—A reporting trader required to complete a Form 40 will be under a continuing obligation, per direction in the special call, to update and maintain the accuracy of the information it provides. Reporting traders can update this information by either visiting the CFTC's web-based Form 40 portal to review, verify, and/or update their information, or by submitting updated information via FTP.

Signature—Each Form 40 submitted to the Commission must be signed or otherwise authenticated by either (1) the reporting trader submitting the form or (2) an individual that is duly authorized by the reporting trader to provide the information and representations contained in the form.

What to File—All reporting traders that are filing a Form 40 pursuant to either 17 CFR 18.04(a) (*i.e.* reportable position reporting traders) ~~or 17 CFR 20.5 (*i.e.* swaps books and records reporting traders)~~ must complete all questions. All reporting traders that are filing a Form 40 pursuant to 17 CFR 18.04(b) (*i.e.* volume threshold account controllers, persons who own a volume threshold account, reportable sub-account controllers, and persons who own a reportable sub-account reporting trader) must complete all questions *unless they are natural persons.* Reporting traders that are filing a Form 40 pursuant to 17 CFR 18.04(b) who are natural persons shall mark not applicable for questions 7 and 8.

Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Table of Contents

1. General information for Reporting Trader
2. Contact Information for Individual Responsible for Trading Activities
3. Contact Information for Individual Responsible for Risk Management Operations
4. Contact information for Individual Responsible for Information on the Form 40
5. Omnibus Account Identification
6. Foreign Government Affiliation
7. Non-Domestic Entity Indicator

~~[3] As used in this document, "Form 40" may refer to either a Form 40—Statement of Reporting Trader or a 40S Filing, as appropriate, and as the context may require.~~

Exhibit D

8. Ownership Structure (Parent/Parents)
9. Ownership Structure (Subsidiary/Subsidiaries)
10. Control of Reporting Trader's Trading Activities by Others
11. Control of Other's Trading Activities by Reporting Trader
12. Other Parties Influencing Trading of Reporting Trader
13. Trading Subject to Express or Implied Agreement
14. Commodity Index Trading Indicator
15. Swap Dealer Identification
16. Major Swap Participant Identification
17. Business Sectors, Subsectors and Occupation
18. Commodities Being Traded in Derivative Markets
19. Business Purpose for Trading in Derivative Markets
20. Signature/Authentication, Name, and Date

Acknowledgement of Definitions

Before proceeding with your submission, please check this box to indicate that you have read the definitions for the following terms—as they are used in the Form 40: □

Commodity (or commodities)—generally, all goods and articles (except onions and motion picture box office receipts, or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value, or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in (*see* 7 U.S.C. 1a(9)).

Commodity Index Trading ("CIT")—means:

a. An investment strategy that consists of investing in an instrument (*e.g.*, a commodity index fund, exchange-traded fund for commodities, or exchange-traded note for commodities) that enters into one or more derivative contracts to track the performance of a published index that is based on the price of one or more commodities, or commodities in combination with other securities; or

b. An investment strategy that consists of entering into one or more derivative contracts to track the performance of a published index that is based on the price of one or more commodities, or commodities in combination with other securities.

Control—as used in this Form, "control" means to actually direct, by power of attorney or otherwise, the trading of a special account or a consolidated account. A special account or a consolidated account may have more than one controller.

Derivatives—futures, options on futures, and swaps.

Omnibus volume threshold account—means any trading account that, on an omnibus basis, carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.

Exhibit D

Parent—for purposes of Form 40, a person is a parent of a reporting trader if it has a direct or indirect controlling interest in the reporting trader; and a person has a controlling interest if such person has the ability to control the reporting trader through the ownership of voting equity, by contract, or otherwise.

Person—an individual, association, partnership, corporation, trust, or government agency and/or department.

Reportable sub-account—means any trading sub-account of an omnibus volume threshold account or omnibus reportable sub-account, which sub-account executes reportable trading volume.

Reportable sub-account controller—means a natural person who by power of attorney or otherwise actually directs the trading of a reportable sub-account. A reportable sub-account may have more than one controller.

Reportable trading volume—means contract trading volume that meets or exceeds the level specified in 17 CFR 15.04.

Reporting trader—a person who must file a Form 40, whether pursuant to 17 CFR 18.04(a)~~,~~ or 17 CFR 18.04(b)~~, or 17 CFR 20.05~~.

Subsidiary—for purposes of Form 40, a person is a subsidiary of a reporting trader if the reporting trader has a direct or indirect controlling interest in the person; and a reporting trader has a controlling interest if such reporting trader has the ability to control the person through the ownership of voting equity, by contract, or otherwise.

Volume threshold account—means any trading account that carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.

Volume threshold account controller—means a natural person who by power of attorney or otherwise actually directs the trading of a volume threshold account. A volume threshold account may have more than one controller.

CFTC Form 40

General Information for Reporting Trader:

For question 1, please provide the name, contact information and other requested information regarding the reporting trader. If the reporting trader is an individual, provide their full legal name and the name of the reporting trader's employer.

1. Indicate whether the reporting trader is a legal entity or a natural person:

   Legal entity: □
   Natural person: □
   Name of Reporting Trader
   Street Address
   City
   State
   Country
   Zip/Postal Code
   Phone Number[4]
   Email Address
   Web site
   NFA ID (if any)

[4] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Exhibit D

Legal Entity Identifier (if any)
Name of Employer
Employer NFA ID (if any)
Employer Legal Entity Identifier (if any)

Contact Information

For questions 2, 3, and 4, provide the name and contact information as requested.

2. Individual to contact regarding the derivatives trading of the reporting trader (this individual should be able to answer specific questions about the reporting trader's trading activity when contacted by Commission staff):

Check here if this individual has the same contact information as that of the reporting trader.

Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[5]
Email Address
NFA ID (if any)

3. Individual to contact regarding the risk management operations of the reporting trader (this individual should be able to answer specific questions about the reporting trader's risk management operations, including account margining, when contacted by Commission staff):

Check here if this individual has the same contact information as that of the reporting trader.

Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[6]
Email Address
NFA ID (if any)

4. Individual responsible for the information on the Form 40 (this individual should be able to verify, clarify, and explain the answers submitted by a reporting trader on the Form 40):

Check here if this individual has the same contact information as that of the reporting trader.

Name
Street Address
City
State
Country
Zip/Postal Code

[5] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[6] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Exhibit D

Phone Number[7]
Email Address
NFA ID (if any)

Omnibus Account Identification

For question 5, indicate whether the reporting trader has a customer omnibus account with a futures commission merchant, clearing member, or foreign broker (NOTE: For the purpose of this question, an omnibus account is an account that one futures commission merchant, clearing member or foreign broker carries for another in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm. In addition, the Commission has traditionally identified omnibus accounts as either *house* or *customer* omnibus accounts. House omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity):

5. Does the reporting trader have a customer omnibus account with a futures commission merchant, clearing member, or foreign broker? YES/NO

IF YES, Give the name(s) of the futures commission merchant, clearing member, or foreign broker carrying the account(s) of the reporting trader.

Foreign Government Affiliation

For question 6, please complete the following (NOTE: For the purpose of this question, affiliation can include, but is not limited to, a situation (1) where the foreign government directly or indirectly controls the reporting trader's assets, operations, and/or derivatives trading, or (2) where the reporting trader operates as a direct or indirect subsidiary of a foreign government, its agencies or departments, or any investment program of the foreign government):

6. Is the reporting trader directly or indirectly affiliated with a government other than that of the United States? YES/NO

IF YES, give the name of the government(s).

IF YES, explain the nature of the affiliation between the reporting trader and the government(s) listed above.

Non-Domestic Entity Indicator

For question 7, if the Reporting Trader is a legal entity, please complete the following.

7. Is the reporting trader organized under the laws of a country other than the United States? YES/NO

IF YES, give the name of the country or countries under whose laws the reporting trader is organized.

Ownership Structure of the Reporting Trader

For questions 8 and 9, provide the requested ownership information only as applicable.

If the Reporting Trader is a commodity pool, also provide the requested information in questions 8i, 8ii, and 8iii. If the Reporting Trader is reporting commodity pools in which it has an ownership interest, also provide the requested information in questions 9i, 9ii, and 9iii.

[7] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Exhibit D

8. List all the parents of the reporting trader (including the immediate parent and any parent(s) of its parent) and, separately, all persons that have a 10 percent or greater ownership interest in the reporting trader (commodity pool investors are deemed to have an ownership interest in the pool). For each such parent or 10 percent or greater owner include the following information:

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[8]
Web site[9]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Parent Company/10% Owner/or Both Indicator

8i. For each person identified in question 8 that is a limited partner, shareholder, or other similar type of pool participant, indicate if they are a principal or affiliate of the operator of the commodity pool.

Principal/Affiliate Indicator

8ii. For each person identified in question 8 that is a limited partner, shareholder, or other similar type of pool participant, indicate if they are also a commodity pool operator of the pool.

Commodity Pool Operator Indicator

8iii. For each person identified in question 8 that is a limited partner, shareholder, or other similar type of pool participant and where the operator of the commodity pool is exempt from registration under § 4.13 of the Commission's regulations, indicate if that person has an ownership or equity interest of 25 percent or greater in the commodity pool.

25% Ownership Indicator

9. List all the subsidiaries of the reporting trader (including the immediate subsidiary and any subsidiaries of those subsidiaries) and, separately, all persons in which the reporting trader has a 10 percent or greater ownership interest (including a 10 percent or greater interest in a commodity pool(s)). Only list subsidiaries and persons that engage in derivatives trading. For each such subsidiary and/or person include the following information:

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □

[8] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[9] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

Exhibit D

Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[10]
Web site[11]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)

Subsidiary/10% Ownership/or Both Indicator

9i. For each person identified in question 9 that is a commodity pool and for which you are a limited partner, shareholder or other similar type of pool participant, indicate if you are a principal or affiliate of the operator of the commodity pool.

Principal/Affiliate Indicator

9ii. For each person identified in question 9 that is a commodity pool and for which you are a limited partner, shareholder or other similar type of pool participant, indicate if you are the commodity pool operator for the pool.

Commodity Pool Operator Indicator

9iii. For each person identified in question 9 that is a commodity pool and for which you are a limited partner, shareholder or other similar type of pool participant and for which the operator of the commodity pool is exempt from registration under § 4.13 of the Commission's regulations, indicate if you have an ownership or equity interest of 25 percent or greater in the commodity pool.

25% Ownership Indicator

Control of Trading

For questions 10, 11, 12, and 13 provide the requested control information only as applicable.

10. List all persons outside of the reporting trader that control some or all of the derivatives trading of the reporting trader (including persons that may have been previously identified as a parent, above):

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country

[10] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[11] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

Exhibit D

Zip/Postal Code
Phone Number[12]
Web site[13]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

11. List all persons for which the reporting trader controls some or all of the derivatives trading (including persons that may have been previously identified as a subsidiary, above):

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[14]
Web site[15]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

12. List any other person(s) that "control(s)" ~~directly or indirectly influence, or exercise authority over, some or all of~~ the trading of all accounts associated with the reporting trader (including, as applicable, trading account controller(s), volume threshold account controller(s), and reportable sub-account controller(s))~~, but who do not exercise "control" as defined in this Form~~: Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City

[12] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[13] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

[14] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[15] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

Exhibit D

State
Country
Zip/Postal Code
Phone Number[16]
Web site[17]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

13. Is some or all of the derivatives trading of the reporting trader subject to an express or implied agreement or understanding with any other person(s) not addressed in questions 10, 11, or 12, above? YES/NO

If yes, provide the following information:

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[18]
Web site[19]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

Commodity Index Trading Indicator

For question 14, please answer the following:

14i. Is the reporting trader engaged in commodity index trading as defined in paragraph (a) of the definition of CIT above? YES/NO

[16] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[17] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

[18] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[19] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

Exhibit D

14ii. Is the reporting trader engaged in commodity index trading as defined in paragraph (b) of the definition of CIT above? YES/NO

a. If the reporting trader is engaged in CIT (as defined in paragraph (b)) with respect to one or more commodities or commodity groups appearing on Supplemental List II, indicate whether the reporting trader is, in the aggregate, pursuing long exposure or short exposure with respect to such commodities or commodity groups. It is not necessary to respond to this question with respect to CIT that tracks the performance of multiple unrelated commodities or commodity groups (*e.g.*, an investment in an exchange-traded fund that tracks the performance of an index representing commodities spanning multiple commodity groups).

14iii. If the reporting trader is currently engaged in commodity index trading as defined in paragraphs (a) or (b) of the CIT definition above, indicate the month and year on which the reporting trader first became engaged in commodity index trading.

Swaps Participation Indicators

For questions 15 and 16, please indicate if the reporting trader meets the specified definition:

15. Is the reporting trader a Swap Dealer, as defined in § 1.3(ppp) of regulations under the Commodity Exchange Act? YES/NO

16. Is the reporting trader a Major Swap Participant, as defined in § 1.3(qqq) of regulations under the Commodity Exchange Act? YES/NO

Nature of Business and of Derivatives Trading Activities

For questions 17, 18, and 19 provide the requested information only as applicable.

17. Select all business sectors and subsectors that pertain to the business activities or occupation of the reporting trader. If more than one business subsector is selected, indicate which business subsector primarily describes the nature of the reporting trader's business.

Choose From Supplemental List I

18. Select all commodity groups and individual commodities that the reporting trader presently trades or expects to trade in the near future in derivative markets.

Choose From Supplemental List II

19. For each selected individual commodity identified in question 18, indicate the business purpose(s) for which the reporting trader uses derivative markets.

If the reporting trader has more than one business purpose for trading in an individual commodity, also indicate the predominant business purpose.

Choose From Supplemental List III

Signature/Authentication, Name, and Date

20. Please sign/authenticate the Form 40 prior to submitting.

Signature/Electronic Authentication:

□ By checking this box and submitting this form (or by clicking "submit," "send," or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by the reporting trader identified below to provide the information and representations submitted on this Form 40, and that the information and representations are true and correct.

Reporting Trader Authorized Representative (Name and Position):

________________ (Name)

Exhibit D

________________ (Position)

Submitted on behalf of:

________________ (Reporting Trader Name)

Date of Submission:

____

Supplemental List I: List of Business Sectors and Subsectors

Business Sector

Subsector

Agriculture and Forestry
- Oilseed Farming
- Grain Farming
- Fruit and Tree Nut Farming
- Other Crop Farming (Specify)
- Cattle Ranching and Farming
- Hog and Pig Farming
- Poultry and Egg Production
- Sheep and Goat Farming
- Other Animal Production
- Forestry, Logging, or Timber Production
- Cooperative
- Other (Specify)

Mining, Oil and Natural Gas Extraction
- Oil Exploration/Production
- Natural Gas Exploration/Production
- Coal Mining
- Precious Metal Mining
- Non-Precious Metal Mining
- Other (Specify)

Utilities
- Utility/Cooperative
- Electric Power Generation
- Local Distribution Company
- Natural Gas Distribution
- Other (Specify)

Construction
- Building Construction
- Heavy and Civil Engineering Construction
- Other (Specify)

Manufacturing, Refining and Processing
- Animal Food Manufacturing
- Grain Milling
- Oilseed Milling
- Sugar and Confectionery Product Manufacturing
- Fruit and Vegetable Preserving and Specialty Food Manufacturing
- Dairy Product Manufacturing
- Animal Slaughtering and Processing

Exhibit D

- Bakeries
- Other Food Manufacturing
- Beverage Manufacturing Textile Mills
- Textile Product Mills
- Apparel Manufacturing
- Wood Product Manufacturing
- Paper Manufacturing
- Pulp, Paper, and Paperboard Mills
- Petroleum and Coal Products Manufacturing
- Renewable Fuels Manufacturing
- Petrochemical/Chemical Manufacturing
- Plastics and Rubber Products Manufacturing
- Natural Gas Processing
- Precious Metal Processor/Smelter
- Non-Precious Metal Processor
- Metals Fabricator
- Other (Specify)

Wholesale Trade

- Lumber and Other Construction Materials Merchant Wholesalers
- Metal and Mineral Merchant Dealer
- Grocery and Related Product Merchant Wholesaler
- Farm Product Raw Material Merchant Wholesalers
- Chemical and Allied Products Merchant Wholesalers
- Petroleum and Petroleum Products Merchant Wholesalers
- Natural Gas, Power Marketer
- Importer/Exporter (specify commodities)
- Other (Specify)

Retail Trade

- Building Materials and Supplies Dealers
- Food and Beverage Stores
- Jeweler/Precious Metals Retailer
- Vehicle Fuel Retailer/Convenience Store Operator
- Fuel Dealers
- Other (Specify)

Transportation and Warehousing

- Air Transport
- Trucking
- Pipeline Transportation of Crude Oil
- Pipeline Transportation of Natural Gas
- Farm Product Warehousing and Storage
- Energy Distributor (warehousing, storage)
- Other (Specify)

End User (NOTE: May not be the only/primary subsector selected)

- Metals End User (Construction Co., Brass Mill, Steel Mill)
- Emissions End User (Factory, Industrial Cos.)
- Petroleum End User (Airline Cos. Municipalities, Industrial Cos., Trucking Cos.)

Information

- Other (Specify)

Exhibit D

- Financial Institutions and Investment Management
- Dealers and Financial Intermediaries
  - Broker/Dealer
  - Bank Holding Company
  - Investment/Merchant Bank
  - Non-US Commercial Bank
  - US Commercial Bank
  - Swaps/Derivatives Dealer
  - Universal Bank
- *Asset/Investment/Fund Management:*
  - Asset/Investment Manager
    - Institutional Clients
    - Retail Clients
  - Managed Accounts and Pools (CTAs, CPOs, etc.)
    - Institutional Clients
    - Retail Clients
  - College Endowment, Trust, Foundation
  - Fund of Hedge Funds
  - Hedge Fund
  - Mutual Fund
  - Pension Fund
  - Private Wealth Management
  - Private Bank
  - Exchange Traded Fund Issuer
  - Exchange Traded Note Issuer
- *Government Financial Institution*:
  - Central Bank
  - Sovereign Wealth Fund
  - Government Sponsored Enterprise (GSE)
  - Other Governmental Entity (Specify)
- *Other Financial or Trading Entities:*
  - Arbitrageur
  - Individual Trader/Investor
  - Floor Broker
  - Floor Trader
  - Market Maker
  - Proprietary Trader
  - Corporate Treasury
  - Mortgage Originator
  - Savings Bank
  - Credit Union
  - Insurance Company
  - Other (Specify)
- *Real Estate*
  - Other (Specify)
- *Arts, Entertainment, and Recreation*
  - Performing Arts Companies
  - Promoters of Performing Arts

Exhibit D

Agents and Managers for Artists and Entertainers
Independent Artists, Writers, Performers
Other (Specify)

Accommodation and Food Services
Food Services
Other (Specify)

Public Administration
Administration of Environmental Quality Programs
Administration of Economic Programs
Other (Specify)

Supplemental List II: Commodity Groups and Individual Commodities

Commodity Group

Individual Commodity

GRAINS
OATS
WHEAT
CORN
RICE

LIVESTOCK/MEAT PRODUCTS
LIVE CATTLE
PORK BELLIES
FEEDER CATTLE
LEAN HOGS

DAIRY PRODUCTS
MILK
BUTTER
CHEESE

OILSEED AND PRODUCTS
SOYBEAN OIL
SOYBEAN MEAL
SOYBEANS

FIBER
COTTON

FOODSTUFFS/SOFTS
COFFEE
FROZEN CONCENTRATED ORANGE JUICE
SUGAR
COCOA

OTHER AGRICULTURAL

REAL ESTATE

CURRENCY

EQUITIES AND EQUITY INDICIES

INTEREST RATES
TREASURY COMPLEX
OTHER INTEREST RATE PRODUCTS

OTHER FINANCIAL INSTRUMENTS

Exhibit D

PETROLEUM AND PRODUCTS
- JET FUEL
- ETHANOL
- BIODIESEL
- FUEL OIL
- HEATING OIL
- GASOLINE
- NAPHTHA
- CRUDE OIL
- DIESEL

NATURAL GAS AND PRODUCTS
- NATURAL GAS LIQUIDS
- NATURAL GAS

ELECTRICITY AND SOURCES
- COAL

ELECTRICITY
- URANIUM

PRECIOUS METALS
- PALLADIUM
- PLATINUM
- SILVER
- GOLD

BASE METALS
- STEEL
- COPPER

WOOD PRODUCTS
- LUMBER
- PULP

CHEMICALS

PLASTICS

EMISSIONS

WEATHER

OTHER (SPECIFY)

Exhibit E

CFTC FORM 40S
STATEMENT OF REPORTING TRADER

NOTICE: Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act")[1] and the regulations thereunder,[2] or the filing of a report with the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

PRIVACY ACT NOTICE

The Commission's authority for soliciting information from traders with large futures, option, swap, or other derivatives market positions is granted in sections 4a, 4i, 4t and 8 of the CEA (*see* 7 U.S.C. sections 6i and 12). The Commission's authority for soliciting information from consolidated account controllers and persons who own consolidated accounts ~~volume threshold account controllers, persons who own volume threshold accounts, reportable sub-account controllers, and persons who own reportable sub-accounts~~ is granted in sections 4i and 8 of the CEA and related regulations (*see*, e.g., 17 CFR 20.5~~18.04(b)~~). Such entities and individuals are required to provide the information requested, and failure to comply may result in the imposition of criminal or administrative sanctions (*see*, e.g., 7 U.S.C. sections 9 and 13a-1, and/or 18 U.S.C. 1001).

The information requested is most commonly used in the Commission's market and trade practice surveillance activities to (a) provide information concerning the size and composition of the commodity derivatives markets, (b) permit the Commission to monitor and enforce speculative position limits and (c) enhance the Commission's trade surveillance data. Information contained in these records may be used by the Commission in the conduct of investigations or litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to contract markets to meet responsibilities assigned to them by law. In accordance with the Privacy Act and the Commission's rules thereunder (*see* 17 CFR part 146), the complete listing of uses of the information contained in these records is found in the Commission's System of Records Notices, available on www.cftc.gov. These uses include CFTC-15, Large Trader Report Files (Integrated Surveillance System).

Information contained in these records may be used by the Commission in the conduct of investigations or litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to reporting markets to meet responsibilities assigned to them by law.

[1] 7 U.S.C. section 1, *et seq*.

[2] Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter 1 of title 17 of the Code of Federal Regulations; 17 CFR Chapter 1 *et seq.*

Exhibit E

BILLING CODE 6351–01–P

General Instructions

Who Must File a Form 40S—~~17 CFR 18.04(a) requires every person who owns or controls a reportable position to file a Form 40—Statement of Reporting Trader with the Commission. 17 CFR 18.04(b) requires every volume threshold account controller, person who owns a volume threshold account, reportable sub-account controller, and person who owns a reportable sub-account to file a Form 40—Statement of Reporting Trader with the Commission.~~ 17 CFR 20.5 requires every person subject to books or records under 17 CFR 20.6 to file a 40S filing[3] with the Commission.

When to file—A reporting trader must file a Form 40S on call by the Commission or its designee.

Where to file—The Form 40S should be submitted (a) via the CFTC's web-based Form 40S submission process at *www.cftc.gov*, (b) via a secure FTP data feed to the Commission, or (c) as otherwise instructed by the Commission or its designee. If electronic submission attempts fail, the reporting trader shall contact the Commission at *techsupport@cftc.gov* for further technical support.

When to update—A reporting trader required to complete a Form 40S will be under a continuing obligation, per direction in the special call, to update and maintain the accuracy of the information it provides. Reporting traders can update this information by either visiting the CFTC's web-based Form 40S portal to review, verify, and/or update their information, or by submitting updated information via FTP.

Signature—Each Form 40S submitted to the Commission must be signed or otherwise authenticated by either (1) the reporting trader submitting the form or (2) an individual that is duly authorized by the reporting trader to provide the information and representations contained in the form.

What to File—All reporting traders that are filing a Form 40S pursuant to ~~either 17 CFR 18.04(a) (*i.e.* reportable position reporting traders) or~~ 17 CFR 20.5 (*i.e.* swaps books and records reporting traders) must complete all questions. ~~All reporting traders that are filing a Form 40 pursuant to 17 CFR 18.04(b) (*i.e.* volume threshold account controllers, persons who own a volume threshold account, reportable sub-account controllers, and persons who own a reportable sub-account reporting trader) must complete all questions *unless they are natural persons.* Reporting traders that are filing a Form 40 pursuant to 17 CFR 18.04(b) who are natural persons shall mark not applicable for questions 7 and 8.~~

Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Table of Contents

1. General information for Reporting Trader
2. Contact Information for Individual Responsible for Trading Activities
3. Contact Information for Individual Responsible for Risk Management Operations
4. Contact information for Individual Responsible for Information on the Form 40S
5. Omnibus Account Identification
6. Foreign Government Affiliation
7. Non-Domestic Entity Indicator
8. Ownership Structure (Parent/Parents)
9. Ownership Structure (Subsidiary/Subsidiaries)
10. Control of Reporting Trader's Trading Activities by Others

[3] ~~As used in this document, "Form 40" may refer to either a Form 40—Statement of Reporting Trader or a 40S Filing, as appropriate, and as the context may require.~~

Exhibit E

11. Control of Other’s Trading Activities by Reporting Trader
12. Other Parties Influencing Trading of Reporting Trader
13. Trading Subject to Express or Implied Agreement
14. Commodity Index Trading Indicator
15. Swap Dealer Identification
16. Major Swap Participant Identification
17. Business Sectors, Subsectors and Occupation
18. Commodities Being Traded in Derivative Markets
19. Business Purpose for Trading in Derivative Markets
20. Signature/Authentication, Name, and Date

Acknowledgement of Definitions

Before proceeding with your submission, please check this box to indicate that you have read the definitions for the following terms—as they are used in the Form 40S: □

Commodity (or commodities)—generally, all goods and articles (except onions and motion picture box office receipts, or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value, or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in (*see* 7 U.S.C. 1a(9)).

Commodity Index Trading (“CIT”)—means:

a. An investment strategy that consists of investing in an instrument (*e.g.*, a commodity index fund, exchange-traded fund for commodities, or exchange-traded note for commodities) that enters into one or more derivative contracts to track the performance of a published index that is based on the price of one or more commodities, or commodities in combination with other securities; or

b. An investment strategy that consists of entering into one or more derivative contracts to track the performance of a published index that is based on the price of one or more commodities, or commodities in combination with other securities.

Control—as used in this Form, “control” means to actually direct, by power of attorney or otherwise, the trading of a~~ special accountor a~~ consolidated account. A ~~special account or a~~ consolidated account may have more than one controller.

Derivatives—futures, options on futures, and swaps.

~~Omnibus volume threshold account—means any trading account that, on an omnibus basis, carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.~~

Parent—for purposes of Form 40S, a person is a parent of a reporting trader if it has a direct or indirect controlling interest in the reporting trader; and a person has a controlling interest if such person has the ability to control the reporting trader through the ownership of voting equity, by contract, or otherwise.

Person—an individual, association, partnership, corporation, trust, or government agency and/or department.

~~Reportable sub-account—means any trading sub-account of an omnibus volume threshold account or omnibus reportable sub-account, which sub-account executes reportable trading volume.~~

~~Reportable sub-account controller—means a natural person who by power of attorney or otherwise actually directs the trading of a reportable sub-account. A reportable sub-account may have more than one controller.~~

Exhibit E

Reportable ~~trading volume~~Position—means contract trading volume that meets or exceeds the level specified in 17 CFR ~~15.04~~ 20.1.

Reporting trader—a person who must file a Form 40S, ~~whether~~ pursuant to ~~17 CFR 18.04(a), 17 CFR 18.04(b), or~~ 17 CFR 20.05.

Subsidiary—for purposes of Form 40S, a person is a subsidiary of a reporting trader if the reporting trader has a direct or indirect controlling interest in the person; and a reporting trader has a controlling interest if such reporting trader has the ability to control the person through the ownership of voting equity, by contract, or otherwise.

~~Volume threshold account—means any trading account that carries reportable trading volume on or subject to the rules of a reporting market that is a board of trade designated as a contract market under section 5 of the Act or a swap execution facility registered under section 5h of the Act.~~

~~Volume threshold account controller—means a natural person who by power of attorney or otherwise actually directs the trading of a volume threshold account. A volume threshold account may have more than one controller.~~

CFTC Form 40S

General Information for Reporting Trader:

For question 1, please provide the name, contact information and other requested information regarding the reporting trader. If the reporting trader is an individual, provide their full legal name and the name of the reporting trader's employer.

1. Indicate whether the reporting trader is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name of Reporting Trader
Street Address
City
State
Country
Zip/Postal Code
Phone Number[4]
Email Address
Web site
NFA ID (if any)
Legal Entity Identifier (if any)
Name of Employer
Employer NFA ID (if any)
Employer Legal Entity Identifier (if any)

Contact Information

For questions 2, 3, and 4, provide the name and contact information as requested.

2. Individual to contact regarding the derivatives trading of the reporting trader (this individual should be able to answer specific questions about the reporting trader's trading activity when contacted by Commission staff):

Check here if this individual has the same contact information as that of the reporting trader.

[4] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Exhibit E

Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[5]
Email Address
NFA ID (if any)

3. Individual to contact regarding the risk management operations of the reporting trader (this individual should be able to answer specific questions about the reporting trader's risk management operations, including account margining, when contacted by Commission staff):

Check here if this individual has the same contact information as that of the reporting trader.

Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[6]
Email Address
NFA ID (if any)

4. Individual responsible for the information on the Form 40S (this individual should be able to verify, clarify, and explain the answers submitted by a reporting trader on the Form 40S):

Check here if this individual has the same contact information as that of the reporting trader.

Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[7]
Email Address
NFA ID (if any)

Omnibus Account Identification

For question 5, indicate whether the reporting trader has a customer omnibus account with a futures commission merchant, clearing member, or foreign broker (NOTE: For the purpose of this question, an omnibus account is an account that one futures commission merchant, clearing member or foreign broker carries for another in which the transactions of multiple individual accounts are combined. The identities of the holders of the individual accounts are not generally known or disclosed to the carrying firm. In

[5] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[6] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[7] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

Exhibit E

addition, the Commission has traditionally identified omnibus accounts as either *house* or *customer* omnibus accounts. House omnibus accounts exclusively contain the proprietary accounts of the omnibus account originator. Customer omnibus accounts contain the accounts of customers of the omnibus account originator. It is the obligation of the omnibus account originator to correctly identify the omnibus account type to the reporting entity):

5. Does the reporting trader have a customer omnibus account with a futures commission merchant, clearing member, or foreign broker? YES/NO

IF YES, Give the name(s) of the futures commission merchant, clearing member, or foreign broker carrying the account(s) of the reporting trader.

Foreign Government Affiliation

For question 6, please complete the following (NOTE: For the purpose of this question, affiliation can include, but is not limited to, a situation (1) where the foreign government directly or indirectly controls the reporting trader's assets, operations, and/or derivatives trading, or (2) where the reporting trader operates as a direct or indirect subsidiary of a foreign government, its agencies or departments, or any investment program of the foreign government):

6. Is the reporting trader directly or indirectly affiliated with a government other than that of the United States? YES/NO

IF YES, give the name of the government(s).

IF YES, explain the nature of the affiliation between the reporting trader and the government(s) listed above.

Non-Domestic Entity Indicator

For question 7, if the Reporting Trader is a legal entity, please complete the following.

7. Is the reporting trader organized under the laws of a country other than the United States? YES/NO

IF YES, give the name of the country or countries under whose laws the reporting trader is organized.

Ownership Structure of the Reporting Trader

For questions 8 and 9, provide the requested ownership information only as applicable.

If the Reporting Trader is a commodity pool, also provide the requested information in questions 8i, 8ii, and 8iii. If the Reporting Trader is reporting commodity pools in which it has an ownership interest, also provide the requested information in questions 9i, 9ii, and 9iii.

8. List all the parents of the reporting trader (including the immediate parent and any parent(s) of its parent) and, separately, all persons that have a 10 percent or greater ownership interest in the reporting trader (commodity pool investors are deemed to have an ownership interest in the pool). For each such parent or 10 percent or greater owner include the following information:

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code

Exhibit E

Phone Number[8]
Web site[9]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Parent Company/10% Owner/or Both Indicator

8i. For each person identified in question 8 that is a limited partner, shareholder, or other similar type of pool participant, indicate if they are a principal or affiliate of the operator of the commodity pool.

Principal/Affiliate Indicator

8ii. For each person identified in question 8 that is a limited partner, shareholder, or other similar type of pool participant, indicate if they are also a commodity pool operator of the pool.

Commodity Pool Operator Indicator

8iii. For each person identified in question 8 that is a limited partner, shareholder, or other similar type of pool participant and where the operator of the commodity pool is exempt from registration under § 4.13 of the Commission's regulations, indicate if that person has an ownership or equity interest of 25 percent or greater in the commodity pool.

25% Ownership Indicator

9. List all the subsidiaries of the reporting trader (including the immediate subsidiary and any subsidiaries of those subsidiaries) and, separately, all persons in which the reporting trader has a 10 percent or greater ownership interest (including a 10 percent or greater interest in a commodity pool(s)). Only list subsidiaries and persons that engage in derivatives trading. For each such subsidiary and/or person include the following information:

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[10]
Web site[11]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)

[8] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[9] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

[10] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[11] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

Exhibit E

Subsidiary/10% Ownership/or Both Indicator

9i. For each person identified in question 9 that is a commodity pool and for which you are a limited partner, shareholder or other similar type of pool participant, indicate if you are a principal or affiliate of the operator of the commodity pool.

Principal/Affiliate Indicator

9ii. For each person identified in question 9 that is a commodity pool and for which you are a limited partner, shareholder or other similar type of pool participant, indicate if you are the commodity pool operator for the pool.

Commodity Pool Operator Indicator

9iii. For each person identified in question 9 that is a commodity pool and for which you are a limited partner, shareholder or other similar type of pool participant and for which the operator of the commodity pool is exempt from registration under § 4.13 of the Commission's regulations, indicate if you have an ownership or equity interest of 25 percent or greater in the commodity pool.

25% Ownership Indicator

Control of Trading

For questions 10, 11, 12, and 13 provide the requested control information only as applicable.

10. List all persons outside of the reporting trader that control some or all of the derivatives trading of the reporting trader (including persons that may have been previously identified as a parent, above):

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[12]
Web site[13]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

11. List all persons for which the reporting trader controls some or all of the derivatives trading (including persons that may have been previously identified as a subsidiary, above):

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □

[12] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[13] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

Exhibit E

Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[14]
Web site[15]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

12. List any other person(s) that directly or indirectly influence, or exercise authority over, some or all of the trading of the reporting trader, but who do not exercise "control" as defined in this Form: Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name
Street Address
City
State
Country
Zip/Postal Code
Phone Number[16]
Web site[17]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

13. Is some or all of the derivatives trading of the reporting trader subject to an express or implied agreement or understanding with any other person(s) not addressed in questions 10, 11, or 12, above? YES/NO

If yes, provide the following information:

Indicate whether the party identified below is a legal entity or a natural person:

Legal entity: □
Natural person: □
Name

[14] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[15] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

[16] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[17] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

Exhibit E

Street Address
City
State
Country
Zip/Postal Code
Phone Number[18]
Web site[19]
Email Address
NFA ID (if any)
Legal Entity Identifier (if any)
Some/All Indicator

Commodity Index Trading Indicator

For question 14, please answer the following:

14i. Is the reporting trader engaged in commodity index trading as defined in paragraph (a) of the definition of CIT above? YES/NO

14ii. Is the reporting trader engaged in commodity index trading as defined in paragraph (b) of the definition of CIT above? YES/NO

a. If the reporting trader is engaged in CIT (as defined in paragraph (b)) with respect to one or more commodities or commodity groups appearing on Supplemental List II, indicate whether the reporting trader is, in the aggregate, pursuing long exposure or short exposure with respect to such commodities or commodity groups. It is not necessary to respond to this question with respect to CIT that tracks the performance of multiple unrelated commodities or commodity groups (*e.g.*, an investment in an exchange-traded fund that tracks the performance of an index representing commodities spanning multiple commodity groups).

14iii. If the reporting trader is currently engaged in commodity index trading as defined in paragraphs (a) or (b) of the CIT definition above, indicate the month and year on which the reporting trader first became engaged in commodity index trading.

Swaps Participation Indicators

For questions 15 and 16, please indicate if the reporting trader meets the specified definition:

15. Is the reporting trader a Swap Dealer, as defined in § 1.3(ppp) of regulations under the Commodity Exchange Act? YES/NO

16. Is the reporting trader a Major Swap Participant, as defined in § 1.3(qqq) of regulations under the Commodity Exchange Act? YES/NO

Nature of Business and of Derivatives Trading Activities

For questions 17, 18, and 19 provide the requested information only as applicable.

17. Select all business sectors and subsectors that pertain to the business activities or occupation of the reporting trader. If more than one business subsector is selected, indicate which business subsector primarily describes the nature of the reporting trader's business.

[18] Please provide a direct number, without any telephone extension. Non-U.S. respondents should also provide the applicable international area code.

[19] The Web site and NFA ID requested in this question are only required to be reported to the extent the respondent has this information available in its records. Respondents are not required to poll customers or other parties for the Web site and NFA ID if this information has not been previously collected.

Exhibit E

Choose From Supplemental List I

18. Select all commodity groups and individual commodities that the reporting trader presently trades or expects to trade in the near future in derivative markets.

Choose From Supplemental List II

19. For each selected individual commodity identified in question 18, indicate the business purpose(s) for which the reporting trader uses derivative markets.

If the reporting trader has more than one business purpose for trading in an individual commodity, also indicate the predominant business purpose.

Choose From Supplemental List III

Signature/Authentication, Name, and Date

20. Please sign/authenticate the Form 40S prior to submitting.

Signature/Electronic Authentication:

□ By checking this box and submitting this form (or by clicking "submit," "send," or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by the reporting trader identified below to provide the information and representations submitted on this Form 40S, and that the information and representations are true and correct.

Reporting Trader Authorized Representative (Name and Position):

_________________ (Name)

_________________ (Position)

Submitted on behalf of:

_________________ (Reporting Trader Name)

Date of Submission:

____

Supplemental List I: List of Business Sectors and Subsectors

Business Sector

Subsector

Agriculture and Forestry
Oilseed Farming
Grain Farming
Fruit and Tree Nut Farming
Other Crop Farming (Specify)
Cattle Ranching and Farming
Hog and Pig Farming
Poultry and Egg Production
Sheep and Goat Farming
Other Animal Production
Forestry, Logging, or Timber Production
Cooperative
Other (Specify)

Mining, Oil and Natural Gas Extraction
Oil Exploration/Production

Exhibit E

- Natural Gas Exploration/Production
- Coal Mining
- Precious Metal Mining
- Non-Precious Metal Mining
- Other (Specify)

Utilities
- Utility/Cooperative
- Electric Power Generation
- Local Distribution Company
- Natural Gas Distribution
- Other (Specify)

Construction
- Building Construction
- Heavy and Civil Engineering Construction
- Other (Specify)

Manufacturing, Refining and Processing
- Animal Food Manufacturing
- Grain Milling
- Oilseed Milling
- Sugar and Confectionery Product Manufacturing
- Fruit and Vegetable Preserving and Specialty Food Manufacturing
- Dairy Product Manufacturing
- Animal Slaughtering and Processing
- Bakeries
- Other Food Manufacturing
- Beverage Manufacturing Textile Mills
- Textile Product Mills
- Apparel Manufacturing
- Wood Product Manufacturing
- Paper Manufacturing
- Pulp, Paper, and Paperboard Mills
- Petroleum and Coal Products Manufacturing
- Renewable Fuels Manufacturing
- Petrochemical/Chemical Manufacturing
- Plastics and Rubber Products Manufacturing
- Natural Gas Processing
- Precious Metal Processor/Smelter
- Non-Precious Metal Processor
- Metals Fabricator
- Other (Specify)

Wholesale Trade
- Lumber and Other Construction Materials Merchant Wholesalers
- Metal and Mineral Merchant Dealer
- Grocery and Related Product Merchant Wholesaler
- Farm Product Raw Material Merchant Wholesalers
- Chemical and Allied Products Merchant Wholesalers
- Petroleum and Petroleum Products Merchant Wholesalers
- Natural Gas, Power Marketer
- Importer/Exporter (specify commodities)
- Other (Specify)

Exhibit E

- Retail Trade
  - Building Materials and Supplies Dealers
  - Food and Beverage Stores
  - Jeweler/Precious Metals Retailer
  - Vehicle Fuel Retailer/Convenience Store Operator
  - Fuel Dealers
  - Other (Specify)
- Transportation and Warehousing
  - Air Transport
  - Trucking
  - Pipeline Transportation of Crude Oil
  - Pipeline Transportation of Natural Gas
  - Farm Product Warehousing and Storage
  - Energy Distributor (warehousing, storage)
  - Other (Specify)
- *End User (NOTE: May not be the only/primary subsector selected)*
  - Metals End User (Construction Co., Brass Mill, Steel Mill)
  - Emissions End User (Factory, Industrial Cos.)
  - Petroleum End User (Airline Cos. Municipalities, Industrial Cos., Trucking Cos.)
- Information
  - Other (Specify)
- Financial Institutions and Investment Management
- Dealers and Financial Intermediaries
  - Broker/Dealer
  - Bank Holding Company
  - Investment/Merchant Bank
  - Non-US Commercial Bank
  - US Commercial Bank
  - Swaps/Derivatives Dealer
  - Universal Bank
- *Asset/Investment/Fund Management:*
  - Asset/Investment Manager
    - Institutional Clients
    - Retail Clients
  - Managed Accounts and Pools (CTAs, CPOs, etc.)
    - Institutional Clients
    - Retail Clients
  - College Endowment, Trust, Foundation
  - Fund of Hedge Funds
  - Hedge Fund
  - Mutual Fund
  - Pension Fund
  - Private Wealth Management
  - Private Bank
  - Exchange Traded Fund Issuer
  - Exchange Traded Note Issuer

Exhibit E

Government Financial Institution:
- Central Bank
- Sovereign Wealth Fund
- Government Sponsored Enterprise (GSE)
- Other Governmental Entity (Specify)

Other Financial or Trading Entities:
- Arbitrageur
- Individual Trader/Investor
- Floor Broker
- Floor Trader
- Market Maker
- Proprietary Trader
- Corporate Treasury
- Mortgage Originator
- Savings Bank
- Credit Union
- Insurance Company
- Other (Specify)

Real Estate
- Other (Specify)

Arts, Entertainment, and Recreation
- Performing Arts Companies
- Promoters of Performing Arts
- Agents and Managers for Artists and Entertainers
- Independent Artists, Writers, Performers
- Other (Specify)

Accommodation and Food Services
- Food Services
- Other (Specify)

Public Administration
- Administration of Environmental Quality Programs
- Administration of Economic Programs
- Other (Specify)

Supplemental List II: Commodity Groups and Individual Commodities

Commodity Group

Individual Commodity

GRAINS
- OATS
- WHEAT
- CORN
- RICE

LIVESTOCK/MEAT PRODUCTS
- LIVE CATTLE
- PORK BELLIES
- FEEDER CATTLE
- LEAN HOGS

DAIRY PRODUCTS
- MILK

Exhibit E

- BUTTER
- CHEESE

OILSEED AND PRODUCTS

- SOYBEAN OIL
- SOYBEAN MEAL
- SOYBEANS

FIBER

- COTTON

FOODSTUFFS/SOFTS

- COFFEE
- FROZEN CONCENTRATED ORANGE JUICE
- SUGAR
- COCOA

OTHER AGRICULTURAL

REAL ESTATE

CURRENCY

EQUITIES AND EQUITY INDICIES

INTEREST RATES

- TREASURY COMPLEX
- OTHER INTEREST RATE PRODUCTS

OTHER FINANCIAL INSTRUMENTS

PETROLEUM AND PRODUCTS

- JET FUEL
- ETHANOL
- BIODIESEL
- FUEL OIL
- HEATING OIL
- GASOLINE
- NAPHTHA
- CRUDE OIL
- DIESEL

NATURAL GAS AND PRODUCTS

- NATURAL GAS LIQUIDS
- NATURAL GAS

ELECTRICITY AND SOURCES

- COAL

ELECTRICITY

- URANIUM

PRECIOUS METALS

- PALLADIUM
- PLATINUM
- SILVER
- GOLD

BASE METALS

- STEEL
- COPPER

Exhibit E

WOOD PRODUCTS
- LUMBER
- PULP

CHEMICALS

PLASTICS

EMISSIONS

WEATHER

OTHER (SPECIFY)