Core Principle #15: Competition: Recognized futures exchanges should avoid unreasonable restraints of trade or impose any burden on competition not necessary or appropriate in furtherance of the objectives of the Act or the regulations thereunder

(a) *Application Guidance.* A recognized futures exchange should avoid unreasonable restraints of trade in any terms and conditions of access or provision of services or any non-compete clauses or limitations on future activity.

(b) *Acceptable Practices.* [Reserved]

PART 100—[REMOVED AND RESERVED]

12. Part 100 is proposed to be removed and reserved.

PART 170—REGISTERED FUTURES ASSOCIATIONS

13. The authority citation for Part 170 continues to read as follows:

Authority: 7 U.S.C. 6p, 12a, and 21.

14. Section 170.8 is proposed to be revised to read as follows:

§ 170.8 Settlement of customer disputes (section 17(b)(10) of the Act).

A futures association must be able to demonstrate its capacity to promulgate rules and to conduct proceedings which provide a fair, equitable and expeditious procedure, through arbitration or otherwise, for the voluntary settlement of a customer's claim or grievance brought against any member of the association or any employee of a member of the association. Such rules shall conform to and be consistent with section 17(b)(10) of the Act and be consistent with the guidelines and acceptable practices for dispute resolution found within Appendix A and Appendix B to Part 38 of this chapter.

PART 180—ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES [REMOVED]

15. Part 180 is proposed to be removed.

Issued in Washington, DC, this 8th day of June, 2000, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 00–14914 Filed 6–21–00; 8:45 am]

BILLING CODE 6351–01–P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 3, 4, 140, 155 and 166

RIN 3038–AB56

Rules Relating to Intermediaries of Commodity Interest Transactions

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed rules.

SUMMARY: On February 22, 2000, a staff task force of the Commodity Futures Trading Commission (''CFTC'' or ''Commission'') submitted a report to the CFTC's Congressional oversight committees entitled A New Regulatory Framework. To further the regulatory reform process, the Commission is proposing to revise its rules relating to intermediation of commodity futures and commodity options (''commodity interest'') transactions.

The proposed new rules would provide greater flexibility in several areas. To ease barriers to entry for persons seeking registration as futures commission merchants (''FCMs'') or introducing brokers (''IBs''), the Commission would: Provide a simplified registration procedure for those persons wishing to operate as FCMs or IBs only on recognized derivatives transaction facilities ''DTFs'' for institutional customers, and who are regulated by other federal financial regulatory agencies; and eliminate the requirement to submit a certified financial report as part of the standard registration application for FCMs and IBs. For all registrants, the Commission would eliminate its rule requiring ethics training, replacing it with a Statement of Acceptable Practices. In addition, the Commission would respond favorably to a rule change of the National Futures Association (''NFA'') that would relieve sales personnel dealing only with institutional customers of the requirement to pass a proficiency test. The Commission is also proposing to amend the definition of the term ''principal'' in Rule 3.1(a), mainly to eliminate inclusion of certain types of officers of a firm, and to make conforming amendments to other rules.

Account opening procedures would be simplified to allow for all required disclosures (with the exception of arbitration agreements) to be acknowledged with a single signature, which may be an electronic signature. The obligation for FCMs and IBs to provide a specific disclosure statement would also be eliminated for a greater number of spohisticated customers. Electronic transmission of account statements would also be permitted, and the Commission's rules as to close-out of offsetting positions would be streamlined to allow for customer choice.

Further, the Commission proposes to expand the range of instruments in which FCMs may invest customer funds. The Commission also requests comment concerning whether customers should be allowed to ''opt out'' of the rules requiring segregation of customer funds, and whether FCMs should be allowed to maintain, in the same customer segregated account, funds used for the purpose of securing or margining instruments other than those currently permitted. Finally, the Commission is considering the issuance of a separate order revising its previous pronouncements regarding the treatment of customer funds on deposit with FCMs for the purpose of trading on foreign markets.

DATES: Comments must be received on or before August 7, 2000.

ADDRESSES: Comments on the proposed rules should be sent to Jean A. Webb, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Comments may be sent by facsimile transmission to (202) 418–5521, or by e-mail to *secretary@cftc.gov.* Reference should be made to ''Proposed Rules Concerning Intermediaries.''

FOR FURTHER INFORMATION CONTACT: Lawrence B. Patent, Associate Chief Counsel, Paul H. Bjarnason, Jr., Special Advisor for Accounting Policy (with respect to Rule 1.25 concerning investment of customer funds), or Andrew J. Shipe, Attorney-Advisor, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581. Telephone: (202) 418–5450.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Introduction
II. Proposed Rules
A. Core Principle One: Registration
1. Definition of the Term ''Principal''
2. Special Procedures Available to Firms Subject to Securities or Banking Regulation
3. Standard Application Procedures for FCMs and IBs
B. Core Principles Two and Six: Fitness and Supervision
1. Proficiency Testing and Ethics Training for Individual Registrants
2. Reforms Relating to Statutory Disqualification From Registration
C. Core Principle Three: Financial Requirements
1. Trading by Non-Institutional Customers on DTFs

2. Segregation of Funds
3. Investment of Customer Funds
D. Core Principle Four: Risk Disclosure and Account Statements
E. Core Principle Five: Trading Standards
F. Core Principle Seven: Reporting Requirements
G. Core Principle Eight: Recordkeeping
1. General
2. Customer Account Statements; Close-Out of Offsetting Positions
III. Related Matters
A. Regulatory Flexibility Act
B. Paperwork Reduction Act

I. Introduction

As announced elsewhere in this edition of the **Federal Register**, the Commission has proposed a new regulatory structure that is intended to adapt to the changing needs of the modern marketplace. In reviewing its regulatory structure, the Commission has identified eight Core Principles that it believes are fundamental to assuring proper conduct by intermediaries of commodity interest transactions. While the Commission is not proposing to adopt these Core Principles as rules, they have guided the Commission in its regulatory reform efforts. The Commission has reviewed all of its rules related to intermediaries in light of the Core Principles. To the extent that an existing rule is not discussed herein, and no amendment thereto is being proposed, the rule would apply to intermediaries transacting business on behalf of customers on contract markets, recognized futures exchanges (''RFEs'') and DTFs.

In accordance with these Core Principles, the Commission now proposes reforms contemplating greater flexibility for intermediaries and their customers via a regulatory structure that acknowledges the different levels of safeguards appropriate to the types of instruments, customers and markets involved.[1–3] While the Commission, in this release, is announcing certain proposed changes in its regulatory structure that would be applicable to all categories of Commission registrants (*e.g.,* the principal definition and ethics training requirements discussed below), the Commission is aware that certain proposals would mainly affect FCMs and IBs, and would not be applicable to commodity pool operators (''CPOs'') and commodity trading advisors (''CTAs''). Nevertheless, the Commission seeks comment on these proposals from all categories of Commission registrant.

The Commission also wishes to make clear that its regulatory reform efforts are an ongoing process. Thus, for example, as a part of the regulatory reform process, the Division of Trading and Markets recently permitted designated self-regulatory organizations (''DSROs'') to conduct ''risk-based'' auditing and thereby take into account a firm's business practices in establishing the scope and timing of audits.[4] Similarly, the Commission is considering various changes to the capital requirements for FCMs, including a risk-based approach.

The Commission also intends to consider further rulemaking proposals at a subsequent date that may focus more directly upon Part 4 of the Commission's rules, which govern the activities of CPOs and CTAs. As examples of its reform efforts with regard to such persons, the Commission has recently proposed to bring more persons within the definition of a ''qualified eligible client'' of a CTA or a ''qualified eligible participant'' of a commodity pool, see 65 FR 11253 (March 2, 2000), which would lessen the disclosure, recordkeeping and reporting requirements for CTAs and CPOs, and to permit CTAs to compute the rate of return for partially funded accounts (also known as ''notionally funded accounts'') by dividing net performance by the agreed-upon nominal account size, *see* 64 FR 41843 (Aug. 2, 1999).

Industry representatives have indicated that they would prefer uniform standards for intermediaries dealing with institutional customers without regard to the type of facility on which a trade is executed. Many of the proposals contained herein would have that effect. The Commission requests comment on whether there are other specific requirements that should be modified toward that end.

The Core Principles applicable to intermediaries, which relate to registration, fitness of registrants, financial requirements, risk disclosure, trading standards, supervision of personnel, large position reporting requirements, and recordkeeping, are as follows:

1. Registration Required.

Any person or entity intermediating a transaction on an RFE, or on a DTF that permits intermediation of trading, must be registered in the appropriate capacity with the Commission as an FCM, IB, CTA, CPO, AP of any of the foregoing, or floor broker (''FB''). In addition, a person trading solely for his or her own account on an RFE or DTF with a trading floor must register as a floor trader (''FT'').

2. Fitness of Registrants

Intermediaries and FTs in all MTEF markets recognized by the CFTC must be and remain fit.

3. Financial

FCMs must keep and safeguard customer money and FCMs and IBs must have sufficient capital to ensure their capacity to meet their obligations to customers.

4. Risk Disclosure

Intermediaries must provide to customers risk disclosure appropriate to the particular instrument and the customer.

5. Trading Standards

Intermediaries and their affiliated persons are prohibited from misusing knowledge of their customers' orders.

6. Supervision

All intermediaries, including APs having supervisory responsibilities, must diligently supervise all commodity interest accounts that they carry, operate, advise, introduce, handle or trade, as well as all of the other activities that arise in their business as intermediaries. All intermediaries must establish and maintain supervisory procedures.

7. Reporting of Positions

All intermediaries must report to the Commission, RFE or DTF information that permits the Commission, RFE or DTF to identify concentrations of positions and market composition. Reports of transactions on RFEs would be required on a routine and nonroutine basis as is the case for transactions on contract markets. Reports of transactions on DTFs would be required only on a non-routine basis.

8. Recordkeeping

All intermediaries (and FTs) must keep full books and records of all activities related to their business as an FCM, IB, CPO, CTA, FB or FT, in a form

[1–3] As noted elsewhere in this edition of the **Federal Register**, the Commission is proposing a new market structure, an exempt multilateral transaction execution facility (''MTEF''), wholly exempt from Commission regulation, except for the antifraud and antimanipulation provisions of the Commodity Exchange Act (''Act''). Intermediaries would generally not be subject to regulation as to their activities on such an exempt MTEF. Accordingly, the proposals discussed in this release are applicable generally only to intermediaries on RFEs, DTFs and contract markets. It should also be noted that some DTFs may permit trading only on a principal-to-principal basis. Since the rule amendments proposed herein relate only to intermediaries, they would not be applicable to such a market structure.

[4] *See* Interpretative No. 4–2, CFTC Staff Letter 99–32, [1998–1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,745 (August 20, 1999).

and manner acceptable to the Commission for a period of five years. Such information must be readily available during the first two years and be produced to the Commission at the expense of the person required to keep the books or records. All such books and records shall be open to inspection by any representative of the Commission or the U.S. Department of Justice.

II. Proposed Rules

A. Core Principle One: Registration

1. Definition of the Term ''Principal''

The second proviso to Section 8a(2) of the Act states that a principal shall mean a general partner of a partnership, any officer, director or beneficial owner of at least ten percent of the voting shares of a corporation, ''and any other person that the Commission by rule, regulation or order determines has the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the activities of [a firm] which are subject to regulation by the Commission.''

The Commission has implemented this statutory provision by adopting a definition of ''principal'' in its registration rules that includes certain specified persons, such as corporate officers and directors, as well as persons who have the power ''directly or indirectly, through agreement or otherwise, to exercise a controlling influence'' over the activities of a firm.[5] The identification of an applicant's or registrant's principals is crucial to enabling the Commission or the National Futures Association (''NFA''), which performs various registration functions for the Commission pursuant to delegations of authority, to perform a fitness assessment under the Act. It also provides information about individuals and firms who provide commodity interest services to market participants. Because of the important role principals play in the Commission's regulatory structure, CFTC rules impose various listing, disclosure, and recordkeeping requirements on a registrant with regard to its principals.[6]

The Commission staff's current interpretation of Rules 3.1(a)(1) and 4.10(e)(1)(i) is to treat all officers and directors of a registrant as principals, pursuant to the language of the second proviso to Section 8a(2) of the Act.[7] The Commission recognizes, however, that there have been changes in management structures over the last 20 years. The Commission further notes that it has received requests from registrants that certain employees, such as some vice presidents, not be considered principals because they do not exercise a controlling influence over the registrant or any of its activities subject to Commission regulation. While the Commission believes that, under its rules, certain officers should continue to be listed as principals, it also recognizes that listing may be unnecessary for some mid-level officers. The Commission therefore believes it appropriate to amend its rules so that not all of a registrant's officers will be considered to be principals, while ensuring that appropriate personnel remain listed as such.

The Commission proposes to amend Rule 3.1(a)(1) by defining as principals persons within a given organizational structure who hold specific offices. Thus, the principal definition would include, if the entity is organized as a sole proprietorship, the proprietor; if a partnership, any general partner (including individuals and entities, such as corporations); if a corporation, any director, the president, chief executive officer, chief operating officer, chief financial officer.[8] and any person in charge of a principal business unit, division or function subject to regulation by the Commission; and, if a limited liability company or limited liability partnership, any director, the president, chief executive officer, chief operating officer, chief financial officer, the manager, managing member or those members vested with management authority for the entity, and any person in charge of a principal business unit, division or function subject to regulation by the Commission. Thus, a registrant would no longer automatically be required to treat every officer as a principal, but only those who met the criteria of the rule.

The principal definition would also include an individual who directly or indirectly, through agreement, holding company, nominee, trust or otherwise: (1) Is the owner of ten percent or more of any class of a firm's securities; (2) is entitled to vote ten percent or more of any class of a firm's voting securities; (3) has the power to sell or direct the sale of ten percent or more of any class of a firm's voting securities; (4) has contributed ten percent or more of a firm's capital (excluding unaffiliated banks and insurance companies); or (5) is entitled to receive ten percent or more of a firm's profits. Further, the principal definition would include an *entity* that is the direct owner of ten percent or more of any class of a firm's securities or that has directly contributed ten percent or more of a firm's capital.[9] These proposed amendments would permit the deletion of Rule 3.10(a)(2)(ii), which has proved somewhat unwieldy in practice.[10]

Finally, the principal definition would continue to include the general provision that defines as a principal any person occupying a similar status or performing similar functions, having the

[5] Rule 3.1(a) defines ''principal'' for purposes of the Commission's Part 3 rules, which govern registration. Rule 4.10(e) defines ''principal'' for purposes of the Commission's Part 4 rules, which apply to the activities of commodity pool operators (''CPOs'') and commodity trading advisors (''CTAs''). The rules are substantially equivalent, although Rule 3.1(a)(1) contains the final clause ''to exercise a controlling influence over its activities which are subject to regulation by the Commission'' while Rule 4.10(e)(1)(i) concludes ''to exercise a controlling influence over the activities of the entity.'' This distinction has not been significant in the Commission's analysis of whether a given person is a principal. The Commission nevertheless proposes to conform these definitions, as detailed herein, to remove any possible ambiguity.

[6] *See, e.g.,* CFTC Rule 3.10(a)(2) (principals must complete a Form 8–R and submit a fingerprint card); Rules 4.24(e)(1), 4.24(f)(1)(v) and 4.24(j)(1)(v), applicable to CPOs, and 4.34(e)(1), 4.34(f)(1)(ii), and 4.34(j)(1)(iv), applicable to CTAs (identity of principals, business background of those principals who participate in making trading or operational decisions or supervise persons so engaged, and information about any conflicts of interest regarding principals must be disclosed in the Disclosure Document); Rules 4.23(b)(2)(ii) and 4.33(b)(2)(ii), applicable to CPOs and CTAs, respectively (recordkeeping requirements for transactions of principals); Rules 4.25(a)(8)(ii)(A), 4.25(b)(2), 4.25(c)(2)(i)(B), 4.25(c)(2)(ii), applicable to CPOs, and Rules 4.35(a)(7)(ii)(A) and 4.35(b), applicable to CTAs (disclosure requirements for performance of accounts or pools owned or controlled by principals).

[7] *See, e.g.,* CFTC Staff Letter No. 76–15, [1975–1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,194 (Office of General Counsel, Aug. 2, 1976) (the term ''individual principals'' includes officers, directors, principal shareholders and any other person who, directly or indirectly, controls the CTA); CFTC Staff Letter No. 95–19, [1994–1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,346 (Division of Trading and Markets, Feb. 24, 1995) (CTA required to list corporate secretary as a principal despite contention that her duties were clerical); CFTC Staff Letter No. 98–29, [1996–1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,312 (Division of Trading and Markets, Apr. 1, 1998) (CTA required to list sixteen employees who were either vice presidents, senior vice presidents or executive vice presidents as principals).

[8] As an indication of the importance of the chief financial officer, the Commission notes that for purposes of filing a Notice of Claim of Exemption (''Notice'') under Rules 4.7, 4.12 or 4.13, if the registrant is organized as a corporation, the rules provide that the chief financial officer may sign the Notice. The Commission also notes that the attestation to the truth and correctness of information contained in a financial report can be made by a chief financial officer. Rule 1.10(d)(4) (applicable to FCMs and IBs).

[9] The portion of the principal definition concerning contribution of capital retains the current provisions of Rule 3.1(a)(3), which does not appear in this release because it is not being amended.

[10] The proposed amendments would also result in the redesignation of Rule 3.10(a)(2)(i) as Rule 3.10(a)(2) and conforming modifications to Rule 3.32(a)(2).

power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over a firm's activities that are subject to regulation by the Commission.[11]

The Commission also proposes to amend Rule 3.1(a) to conform it with certain provisions of Rule 3.32, which governs re-registration and specifies certain events or changes within a firm's management that require a new registration. Absent this proposed amendment, the interplay of Rule 3.32 and Rule 3.1 could create an anomaly when, for example, under Rule 3.1, a firm would not be required to list a person as a principal, but under Rule 3.32 would be required, because of that person, to obtain a new registration.

Thus, to conform to Rule 3.1(a)(1), paragraph (a)(1)(v) of Rule 3.32, addressing corporate registrants, would be amended to include any person who becomes ''the president, chief executive officer, chief operating officer or chief financial officer of a corporate registrant, or becomes in charge of a principal business unit, division or function subject to regulation by the Commission, or comes to occupy a position of similar status or perform a similar function.'' Similarly, with respect to limited liability companies and limited liability partnerships, a new paragraph (a)(1)(vi) would be added so that re-registration would also be required when there is a new person who becomes ''a director, president, chief executive officer, chief operating officer, chief financial officer, manager, managing member or member vested with management authority for the registrant, or * * * in charge of a principal business unit, division or function subject to regulation by the Commission, or comes to occupy a position of similar status or perform a similar function.'' [12] In line with new paragraph (a)(1)(vi) of Rule 3.32, which brings within the ambit of the rule changes affecting the management of a limited liability company or limited liability partnership, Rule 3.32(a)(1)(i) would be amended to delete the word ''corporate'' before ''registrant's voting securities'' so as to permit a broader application of that paragraph to registrants other than corporate registrants. To conform Rule 3.32(a)(1)(v) and (a)(1)(vi) to Rule 3.32(e)(1), the latter would be amended by adding a reference to the former.[13]

In addition, the Commission proposes to amend Rule 4.10(e)(1) to incorporate by reference the definition of ''principal'' in amended Rule 3.1(a). [14] Finally, the Commission proposes to amend Rules 4.24(f)(1)(v), 4.25(a)(8)(ii)(A) and 4.25(c)(2)(i)(B), applicable to CPOs and 4.34(f)(1)(ii) and 4.35(a)(7)(ii)(A), applicable to CTAs, to conform these rules to proposed Rule 3.1(a)(1), as incorporated by reference in amended Rule 4.10(e)(1). Thus, a registrant would only be required to provide business backgrounds and proprietary trading results for those principals who participate in making trading or operational decisions, or supervise persons so engaged, and not all officers.

The Commission's intent in proposing these amendments is to provide a uniform definition and treatment of principals under its rules. The amendments would require the filing of fewer individual registration forms (Forms 8–R) and fingerprint cards, and would also require less disclosure by CPOs and CTAs. The Commission does not intend to alter the application of any other CFTC rule that provides relief from registration requirements. For example, the exemption from registration as an associated person (''AP'') that is available to the chief operating officer, general partner or other person in the supervisory chain-of-command of a registrant under Rule 3.12(h)(1)(iii) would remain intact.[15]

2. Special Procedures Available to Firms Subject to Securities or Banking Regulation

As reflected in the Core Principles, intermediaries and FTs in all CFTC recognized markets, absent an exemption, are and will be required to be registered with the CFTC under the Act. Registration requirements, however, could be eased in several ways, depending on the particular markets on which the intermediary transacts business.

Under the proposed rules, persons who intermediate transactions on or subject to the rules of an RFE must be registered under the Act as FCMs, IBs, CPOs, CTAs, APs of any of the foregoing, or FBs, or qualify for an existing statutory or regulatory exemption from registration.[16] If such persons are required to register as FCMs, they must also become and remain a member of a registered futures association.[17] In addition, persons who trade for their own account on the floor of an exchange must register as FTs.

Persons whose business is limited exclusively to transactions conducted on or subject to the rules of a DTF also would be required to register as FCMs, IBs, CPOs, CTAs, FBs or FTs, if they perform those functions. Registration as an FCM or IB, however, would be simplified for persons that conduct business solely for institutional customers [18] on a DTF, if they were already registered with the Securities and Exchange Commission (''SEC'') in a similar registration category or they were authorized to perform these functions by a federal banking authority. Under the proposed changes to Rule 3.10, such applicants would be

[11] While the Commission recognizes that what constitutes ''a controlling influence'' is best left for determination on a case-by-case basis, such influence would be ascribed to, among others, those persons who have policymaking or managerial authority over the activities of an applicant or registrant that are subject to Commission regulation.

[12] The existing paragraphs (a)(1)(vi) and (a)(1)(vii) of Rule 3.32 would be redesignated as paragraphs (a)(1)(vii) and (a)(1)(viii), respectively.

[13] Re-registration can be avoided by following the procedures in paragraph (e)(1) of Rule 3.32, which require a registrant to file a Form 3–R to amend its Form 7–R, and to include a Form 8–R and fingerprint card for the new officer, manager or member, unless a current Form 8–R is already on file for that person. These documents must be submitted to the NFA prior to the date of the change in personnel, which is not considered effective until the NFA provides the registrant with written approval. Therefore, some advance planning by registrants should make this a relatively straightforward process.

[14] Although Rule 4.10(e) was amended in 1981 to conform more closely to the wording of Rule 3.1(a)(1)–(a)(3), the terminology in the Rules remained slightly different. When Rule 4.10(e)(1) was adopted, the Commission explained that ''[b]ecause the term 'principal' is employed in both Part 3 and Part 4 to obtain similar critical information about certain persons associated with a CPO or a CTA, the Commission has determined to use the same term in both parts. To serve the objectives of Part 4, however, the term 'principal' does not need to be defined as broadly as it is in § 3.1(a).'' 46 FR 26004, 26005 (May 8, 1981). Because the amendments to Rule 3.1(a) proposed herein will restrict the definition of principal so that, for example, not all officers of a corporate registrant will be included, the Commission believes it is no longer appropriate to have different definitions of the term ''principal'' in Parts 3 and 4.

[15] That rule provides an exemption from AP registration for certain principals provided that, among other requirements, the sponsoring firm's revenue from commodity interest related activity for customers is no more than ten percent of its total revenue on an annual basis.

[16] *See, e.g.,* Section 4m(1) of the Act, Commission Rules 3.10(c), 4.13 and 4.14.

[17] Commission Rule 170.15. NFA is currently the only registered futures association. NFA Bylaw 1101 essentially provides that no NFA member may deal with another person with respect to an account, order or transaction where the other person is acting in a capacity that requires registration, unless that other person is also a member of a registered futures association. The combination of Commission Rule 170.15 and NFA Bylaw 1101 therefore requires most registrants to become members of NFA.

[18] The Commission proposes a definition of the term ''institutional customer'' in Rule 1.3(g), which would be the same as the definition of ''eligible participant'' in Rule 35.1(b) that is set forth in one of the Commission's other **Federal Register** notices published today.

registered in the corresponding CFTC registration category (FCM or IB) upon filing notice with the NFA of their intent to undertake such limited activities, together with a certification that they are registered or authorized to engage in a similar function by, and are in good standing with, the SEC or a federal banking authority.[19] This would avoid the need to file CFTC registration forms and fingerprints. A firm acting in the capacity of an FCM would, however, be required to become a member of a registered futures association.[20] Because it would be difficult to track individual sales personnel of these firms without registration forms, individuals acting in the capacity of APs for such FCMs or IBs would not be required to be registered or listed, and would not be subject to proficiency testing or ethics training requirements. Finally, such firms and their salespersons would, of course, remain subject to antifraud provisions.

The Commission believes that this proposed structure is appropriate because (i) firms and individuals involved would be permitted to deal only with institutional customers, (ii) they would be subject to oversight by other federal regulatory authorities, and (iii) the Commission anticipates that they will conduct most of their business in the securities or banking fields, with only a minor portion of their activities involving commodity interests. Nevertheless, the Commission wishes to stress that its reform efforts are an ongoing process, and that it seeks comment on all facets of the proposal.

In order to implement these changes, the text of Rule 3.10 would be revised by redesignating paragraph (a)(1)(i) as (a)(1)(i)(A), and a new paragraph (a)(1)(i)(B) would be added. The new paragraph would provide that an applicant for registration as an FCM or IB that will conduct transactions exclusively on or subject to the rules of a DTF for institutional customers, and who is registered with the SEC as a securities broker or dealer or is a bank or any other financial depository institution subject to regulation by the United States, may apply for registration by filing with NFA notice of its intention to undertake transactions exclusively on or subject to the rules of a DTF for institutional customers, together with a certification of registration and good standing with the appropriate authority or of authorization to engage in such transactions by said authority.

Further, paragraph (d) of Rule 3.10 is proposed to be amended by replacing the existing cross-reference to ''paragraph (a)'' with a conforming cross-reference to ''paragraph (a)(1)(i)(A)'' so that those registrants who choose to follow these newly proposed registration procedures will not be required to file an annual update of the basic registration form for firms, Form 7–R.

The Commission also proposes not to require such ''passported'' registrants to meet the Commission's minimum financial requirements if (i) they meet the appropriate net capital requirements of their primary regulator, (ii) their activities are limited to serving institutional customers trading exclusively on DTFs that do not require compliance with CFTC minimum financial requirements, and (iii) they conform to minimum financial standards and related reporting requirements set by such DTF in its bylaws, rules, regulations or resolutions.[21] In this regard the Commission seeks comment on the propriety of such reforms.

The Commission is therefore proposing to add a new paragraph (iii) to Rule 1.17(a)(2), which currently contains two exemptions from the Rule's adjusted net capital requirements. The new paragraph would provide that the basic minimum financial requirements would not apply to an FCM registered under the new ''passporting'' procedures in proposed Rule 3.10(a)(1)(i)(B) whose business is limited to transacting business on behalf of institutional customers on a DTF, and who conforms to minimum financial standards and related reporting requirements set by such DTF in its bylaws, rules, regulations or resolutions. A conforming amendment would be added to Rule 1.52 by adding a new paragraph (m) to relieve a DTF from the requirement that it adopt minimum adjusted net capital standards that are modeled on those of the Commission with respect to these ''passported'' firms.

The Commission notes that as it proposes to simplify the registration process for SEC registrants that may wish to conduct the limited activities in futures markets described above, it encourages the SEC to consider reciprocal amendments to its rules to accommodate FCMs and IBs that are not now dually registered as securities brokers or dealers, but that may wish to act as intermediaries in the securities markets.

Finally, the Commission is considering updating and making more flexible its standard minimum net capital requirements with respect to FCMs by permitting the application of risk-based net capital requirements. At this time, the Commission is not proposing changes to its requirements in this area. Rather, the Commission wishes to solicit input from commenters regarding the most effective approach to developing changes to these rules.

3. Standard Application Procedures for FCMs and IBs

In order to lower a potential barrier to entry for new firms and to conform CFTC practice more closely with that of the SEC, the Commission proposes to streamline further its current application requirements for the registration of FCMs and IBs. Current Commission Rules 3.10(a)(1)(ii) and 1.10(a)(2) require new applicants for registration as FCMs and IBs to file Form 1–FR–FCM or 1–FR–IB, respectively, with their applications. Pursuant to Rule 1.10(a)(2), these forms must be certified by an independent public accountant.

The Commission is proposing that applicants for registration as FCMs or IBs who raise their own capital to satisfy minimum financial requirements would not be required to provide these certified financial statements with their registration applications.[22] Rather, such applicants would be permitted to file an unaudited financial report indicating satisfaction of the minimum requirements. A firm taking advantage of this new procedure would be subject to an on-site review within six months of registration by the firm's DSRO or, at the DSRO's discretion, a conference between appropriate staff of the firm and the DSRO at the DSRO's offices. This alternative procedure is modeled on similar procedures in the securities industry. An applicant would remain

[19] The Commission will, naturally, consult with other agencies to solicit their views and determine the most appropriate method of effecting this proposal.

[20] *See* Rule 170.15. The Commission may consider not requiring NFA membership in the future if reciprocal arrangements were made by the primary regulators of other financial industry segments to recognize CFTC registration without requiring corresponding SRO membership.

[21] Intermediaries engaged in transactions on DTFs that are not registered or licensed by another regulator would be subject to the CFTC's minimum financial requirements, even if all of the transactions they are involved in occur on or subject to the rules of a DTF. It should also be noted that these rule amendments relate only to intermediaries, and are thus inapplicable to persons who participate in transactions on DTFs solely on a principal-to-principal basis in accordance with DTF rules.

[22] Those IB applicants who do not raise their own capital would continue to be required to file a guarantee agreement entered into with an FCM with their registration application.

free to follow the existing rules concerning the filing of a certified financial statement with its application and thereby delay the initial DSRO review.[23] Appropriate rule changes would be made by adding new paragraphs (a)(2)(i)(C) and (a)(2)(ii)(D) to Rule 1.10.

B. Core Principles Two and Six: Fitness and Supervision

1. Proficiency Testing and Ethics Training for Individual Registrants

The second of the Core Principles for intermediaries identified by the Commission is that intermediaries in commodity interest markets must be and remain fit. This requirement is reflected by various provisions of the Act. Section 4p(a) of the Act permits the Commission to require written proficiency examinations for individual applicants for registration. Section 17(p) of the Act further requires that any futures association registered under the Act must submit to the Commission for approval rules to establish training standards and proficiency testing for persons involved in solicitations of transactions, their supervisors and all persons for whom the association has registration responsibilities. The NFA administers this testing program through the facilities of the National Association of Securities Dealers, Inc. NFA rules that the Commission has approved generally require that all applicants for AP registration present evidence of passage of a proficiency test, the basic test being the National Commodity Futures Examination (commonly known as the ''Series 3 Test''). In keeping with the recommendations of A New Regulatory Framework, the Commission believes that those APs dealing only with institutional customers need not pass a specific proficiency examination, and it would consider an NFA rule change to this effect. The Commission notes that under Sections 4p(a) and 17(p) of the Act and Rule 170.10, NFA is currently allowed to adopt such rules as it may deem appropriate, subject to Commission approval. Therefore, no changes to the Commission's rules are deemed necessary to effect these changes.

Section 4p(b) of the Act requires the Commission to issue regulations requiring new registrants to attend ethics training sessions within six months of registration, and requiring all registrants to attend such training on a periodic basis. The Commission has issued Rule 3.34 to fulfill this statutory mandate. Rule 3.34 specifies the frequency and duration of such training, the suggested curriculum, qualifications of instructors, and the necessary proof of attendance at such classes.

In order to provide flexibility and ease compliance for all registrants, the Commission proposes to delete Rule 3.34. In place of that rule, the Commission proposes to implement Congressional intent through a Statement of Acceptable Practices consistent with its second Core Principle, which requires intermediaries to be and remain fit. The Commission believes that the maintenance of professional ethical standards is a key element of a registrant's fitness. Further, training standards in the field of ethics are relevant to adherence to the sixth Core Principle, requiring adequate supervision of handling accounts by a firm and its personnel. The Commission therefore proposes to issue this Statement of Acceptable Practices as an Appendix to Part 3 of its Rules. The Commission believes that Section 4p(b) of the Act expresses Congressional intent that futures industry professionals remain abreast of their responsibilities to the public under the Act and rules thereunder. The Commission further believes that there can be greater flexibility concerning acceptable practices to achieve this objective than is permitted under the existing rule. For registrants seeking guidance as to the maintenance of proper ethics training procedures in keeping with the purposes of the Core Principles, the Statement of Acceptable Practices would function as a ''safe harbor.''

For instance, under the Statement of Acceptable Practices, registrants may engage in ethics training programs sponsored by the registrants themselves, their DSROs, trade associations or others. The format of such training, whether by personal or recorded instruction, or by circulation of written materials such as legal cases, interpretative letters or advisories, would also be left to the discretion of registrants and DSROs. It would also be permissible to require training on whatever periodic basis the registrant and DSROs deem appropriate. Thus, the Commission would not specify any particular programs or procedures that must be followed.

2. Reforms Relating to Statutory Disqualification From Registration

The grounds for statutory disqualification from registration, which establish fitness standards based upon disciplinary history, are set forth in Sections 8a(2) and (3) of the Act. One of those provisions states that registration can be denied or conditioned based upon, in addition to specific matters such as revocation of a previous registration or a felony conviction, ''other good cause'' (*see* Section 8a(3)(M) of the Act). In an effort to provide greater clarity in this area, the Commission recently revised the ''Guidance Letter'' issued to NFA concerning the treatment of self-regulatory organization (''SRO'') disciplinary actions in assessing the fitness of FBs, FTs or applicants in either category. *See* CFTC Letter No. 00–56 (April 13, 2000); *CFTC Guidance to NFA Concerning Floor Broker and Floor Trader Registration Actions,* [1996–1998 Transfer Binder] Comm. Fut. L. Rep. ¶ 27,202 (Dec. 4, 1997). The Commission considers these letters to be part of its overall regulatory reform efforts and intends to publish both as an accompanying statement when it publishes final rules. The Commission requests comment as to any further changes that should be considered in this area.

C. Core Principal Three: Financial Requirements

1. Trading by Non-Institutional Customers on DTFs

As noted above, the Commission's proposed new regulatory framework contemplates the recognition of a new form of trading facility that is subject to an intermediate degree of regulatory oversight, the DTF. Under the proposed rules, trading on DTFs generally would be limited to futures and options on specified commodities. In addition, DTFs could permit trading on any commodities if trading is limited to qualifying commercial participants.

Thus, although trading on DTFs would generally be limited to institutional or commercial customers, under certain conditions a DTF might permit non-institutional customers to enter into transactions thereon. Because of the lower regulatory protections offered to participants in these markets, and the higher degree of risk associated therewith, the Commission is proposing that such non-institutional customers' business be transacted through FCMs that are more capable of properly maintaining such accounts and handling the associated risk. This is in accordance with the third Core Principle, which requires intermediaries to maintain adequate capital to ensure they are able to meet their obligations to customers. Thus, non-institutional customers who desire to conduct transactions on or subject to the rules of

[23] Of course, a DSRO retains the authority to inspect its member firms at any time.

a DTF would be required to do so through a registered FCM that (1) is a clearing member of at least one designated contract market or RFE, and (2) has a minimum adjusted net capital of at least $20 million (the basic minimum requirement for FCMs is $250,000). The Commission notes that this would not prevent a DTF from including any similar or greater restrictions in its own rules or bylaws. Further, in order to provide guidance to such customers and their FCMs, NFA will issue a Statement of Acceptable Practices regarding additional disclosures to be made to non-institutional customers trading on DTFs and on related issues involving price dissemination. The Commission presumes that this would be forthcoming as DTFs come into existence. Since DTFs do not yet exist, and it is not known how such institutions would choose to operate, the Commission believes that it is premature at this time to propose a Statement of Acceptable Practices in this area.

Therefore, the Commission proposes to amend Rule 1.17, to add a new paragraph (a)(1)(ii) and to redesignate current paragraph (a)(1)(ii) as (a)(1)(iii). The new paragraph (a)(1)(ii) would provide that an FCM engaged in soliciting or accepting orders and customer funds related thereto from a non-institutional customer for the purchase or sale of any commodity for future delivery on or subject to the rules of a DTF must be a clearing member of a contract market or an RFE and must maintain adjusted net capital at least equal to the greater of $20 million or the other amounts specified in Rule 1.17.

2. Segregation of Funds

The futures industry has a long history of keeping customer funds safe. The Commission believes that segregation of customer funds has worked well and should continue to be required for the funds of all customers trading on an RFE and the funds of all non-institutional customers trading on a DTF that permits such customers. Nevertheless, the Commission is considering whether, and under what circumstances, to permit other customers to ''opt out'' of segregation. Before proposing any rule changes in this area, however, the Commission seeks comment as to how, if at all, this change should be implemented. Commenters may wish to address several issues in this area, including:

- Whether opting out of segregation should be permitted;
- If so, whether it should be limited to the accounts of institutional customers;
- Where such non-segregated funds should be held;
- How such funds would be accounted for, especially for purposes of establishing minimum capital requirements, and computing a firm's adjusted net capital;
- How accounts that have opted out of segregation would be treated under Part 190 of the Commission's rules, and under the Bankruptcy Code;
- What the effects of similar practices have been in other jurisdictions; and
- What an FCM's disclosure obligations should be in this area.

The Commission notes that certain industry participants have also suggested that the Commission revise its regulations to permit FCMs to maintain, in the same customer segregated account, various instruments, such as over-the-counter (''OTC'') derivatives, equity securities, and other cash market positions, as well as the funds used for the purpose of securing or margining such products and positions. The Commission notes that, pursuant to its authority under the second proviso of Section 4d(2) of the Act,[24] it has previously permitted futures and securities options to be held in the same customer segregated account pursuant to cross-margining arrangements.[25] The Commission believes that, under Section 4d(2) of the Act, the segregation requirements could be modified to permit such additional instruments and funds to be held in a single segregated account at both the FCM and the clearing organization level. As with the concept of ''opting out'' of segregation, the Commission believes, however, that further consideration is necessary in this area before a formal proposal can be made. Therefore, the Commission seeks comment as to how such changes might be implemented. Commenters may wish to address several issues in this area, including:

- What protections would be necessary in order to permit FCMs and clearing organizations to maintain, in the same customer segregated account, additional instruments and products and the funds used for the purpose of securing or margining such instruments and products;
- Whether such practices should be limited to the accounts of institutional customers;
- Whether, if this is permitted, it would be desirable to permit ''opting out'' of segregation;
- How such funds would be accounted for, especially for purposes of establishing minimum capital requirements and computing a firm's adjusted net capital;
- How such accounts would be treated under Part 190 of the Commission's Rules, and under the Bankruptcy Code;
- What the effects of similar practices have been in other jurisdictions; and
- What an FCM's disclosure obligations should be in this area.

3. Investment of Customer Funds

The Commission also is proposing to amend Rule 1.25, which sets forth the types of instruments in which FCMs and clearing organizations are permitted to invest (the permitted investments) cash segregated for the benefit of regulated commodity customers pursuant to Section 4d(2) of the Act. Currently, Rule 1.25 permits an FCM or clearing organization to invest segregated funds only in obligations of the U.S., in general obligations of any State or of any political subdivison thereof, or in obligations fully guaranteed as to principal and interest by the U.S. The Commission believes that an expanded list of permitted investments could enhance the yield available to FCMs, clearing organizations and their customers, without compromising the safety of customer funds.

Subject to specific risk-limiting features contained in the proposal, the following additional investments would be permitted: (1) Obligations issued by any agency sponsored by the United States; (2) certificates of deposit issued by a bank, as defined in Section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation; (3) commercial paper; (4) corporate notes; and (5) interests in money market mutual funds. In addition, it is proposed than an FCM or a clearing organization may both buy and sell the permitted investments pursuant to agreements for resale or repurchase of the instruments.

The proposal includes several provisions intended to minimize credit risk, volatility risk and liquidity risk. These features include: (i) A requirement that the investments be highly-rated by a nationally-recognized statistical rating agency (NRSRO), except for U.S. government securities and those money market mutual funds that are not required to be rated; (ii) a requirement that the dollar-weighted

---

[24] 7 U.S.C. 6d(2) (1994).

[25] *See, e.g.,* Commission Order, In the Matter of the Chicago Mercantile Exchange Proposal to Expand its Cross-Margining Program with the Options Clearing Corporation to Include the Cross-Exchange Net Margining of the Positions of Market Professionals, (November 26, 1991), reprinted in 56 FR 61404 (December 3, 1991); Commission Order, In the Matter of The Intermarket Clearing Corporation Proposal to Expand its Cross-Margining Program with the Options Clearing Corporation to Include the Cross-Exchange Net Margining of the Positions of Market Professionals (November 26, 1991), reprinted in 56 FR 61406 (December 3, 1991). For each of these programs, the SEC approved parallel rules of the Options Clearing Corporation.

average of the time remaining to maturity of the debt securities held in the segregated portfolio not exceed 24 months, excluding investment in money market mutual funds; (iii) concentration limits on the percentage of the portfolio that may be comprised of the securities of individual issuers; (iv) specific prohibitions against leverage, embedded derivatives, and options; and (v) a requirement that the daily value and gains and losses on each investment be recorded in the records of the FCM or clearing organization. The Commission recognizes that events beyond the control of an FCM or clearing organization could cause a portfolio to exceed the time-to-maturity and concentration requirements. Accordingly, the Commission would permit portfolios to be adjusted within a reasonable period of time to meet these requirements. The Commission plans to modify the segregation computation schedule, which is prepared by FCMs every day, to reflect changes in value of the investments.

As noted above, in addition to expanding the list of permitted investments, the proposal would allow investments to be bought and sold pursuant to agreements for repurchase or resale of the instruments. These transactions are usually simply referred to as ''repurchase transactions.'' This part of the proposal essentially incorporates Division of Trading and Markets Financial and Segregation Interpretation No. 2–1 (Interp. 2–1) [26] with three significant modifications. First, in order to increase the liquidity of the segregated portfolio, repurchase transactions will be permitted for the first time. (Interp. 2–1 currently only permits reverse repurchase transactions.) Second, the 180-day cap on the time-to-maturity of collateral subject to reverse repurchase agreements, contained in footnote No. 13 of Interp. 2–1, has been deleted. The Commission has been persuaded by comment received regarding Interp. 2–1 that collateral of any maturity would serve adequately, subject to other regulatory protections in place such as capital charges. Third, the Depository Trust Corporation has been added as a permitted depository for securities. If this rule proposal is adopted by the Commission, it will take the place of Interp. 2–1, which will be rescinded.

The Commission notes that the specific safeguards applicable to the permitted investments set forth in Rule 1.25 will not be the only protections in place. The Commission's proposed Rule 1.25 would take its place as part of a broad set of protections built into the system intended to guard against financial risk at FCMs. First, FCMs generally must meet the Commission's net capital and segregation requirements, as well as SRO requirements. An FCM that is a contract market clearing member also will likely have capital requirements that are higher than those set by the Commission. Second, Commission regulations require firms to keep current books and records, prepare a daily segregation computation and a formal, monthly capital calculation, among other things. Further, an early-warning system requires FCMs to report certain events to the Commission and the SROs. These requirements serve as elements of the overall system of controls to protect segregated funds.

The Commission recognizes that some adjustments may be desirable before the proposal is adopted in final form. Accordingly, the Commission seeks industry and public comment on a number of issues:

- Whether the proposed list of investments is appropriate for segregated funds investments, considering the primary objective of safety of principal;
- Whether the proposed list of investments would create any risks that are not properly contained by the risk-limiting features of the proposed rule and, if so, what additional features should be provided for in the rule;
- The proposed rule contains credit-rating standards and a cap on the dollar-weighted average for the time-to-maturity of investments held in the portfolio. The Commission notes that certain types of structured notes may have significant prepayment and other risks, because they offer a large variety of payment obligations and, therefore, present substantial market and liquidity risks in addition to credit risk. Does the rule sufficiently address this type of exposure?;
- Whether the proposed standards for money market funds are appropriate;
- Whether there are other categories of funds that could be included, and, if so, pursuant to what standards; and
- As is currently the case under Interp. 2–1, the proposed rule limits the permitted counterparties in purchases or sales of securities subject to a repurchase agreement. The Commission requests comment on whether the class of permitted counterparties should be expanded and, if so, to what extent.

The Commission is also proposing to amend Rules 1.20(a) and 1.26(a) to eliminate the requirement that an FCM obtain a written acknowledgment, from each clearing organization where the FCM has deposited customer funds or instruments purchased with customer funds, that the clearing organization was informed that the customer funds or instruments purchased with customer funds and deposited therein belong to customers and are being held in accordance with the provisions of the Act and rules thereunder. The proposed elimination of the requirement that an FCM obtain a clearing organization acknowledgment is conditioned upon the clearing organization's adoption and submission to the Commission of rules that provide for the segregation as customer funds, in accordance with all relevant provisions of the Act and the rules and orders promulgated thereunder, of all funds held on behalf of customers and all instruments purchased with customer funds. These proposed rule amendments would codify a staff no-action letter issued three years ago.[27] An FCM's obligation to obtain written acknowledgments from banks, trust companies and other FCMs, and a clearing organization's obligation to obtain written acknowledgments from banks and trust companies, concerning the treatment of customer funds would be unaffected.

D. Core Principle Four: Risk Disclosure and Account Statements

As reflected in the fourth Core Principle, the disclosure of risks by intermediaries is an important customer protection. Over the years, however, certain persons have suggested that customers would be better protected by receiving risk disclosures more attuned to their relative level of sophistication and to the particular instruments they trade. Other commenters have suggested that disclosure obligations could be simplified and streamlined.

In keeping with these observations, the Commission proposes that non-institutional customers continue to receive the risk disclosures regarding futures and options trading that are currently required. Thus, intermediaries will continue to be required to obtain prior acknowledgement by non-institutional customers of their receipt of the basic risk disclosure statements relating to futures and options in accordance with Rules 1.55 and 33.7.

The Commission is proposing that the account opening process be streamlined, however, in certain areas. The Commission would permit certain required disclosures, such as those concerning consent to allow cross-trades or to transfer funds out of segregated accounts to another account (such as a money market account), to be included in a customer agreement and acknowledged through a ''single

[26] 1 Comm. Fut. L. Rep. ¶ 7112A (December 15, 1993).

[27] CFTC Staff Letter No. 97–45, [1996–1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,085 (May 5, 1997).

signature'' (which could include an electronic signature as provided for in recently-adopted Commission Rules 1.3(tt) and 1.4),[28] rather than the multiple signatures that are currently required.[29] In order to enhance the ''single-signature'' format for account opening agreements, the Commission would amend Rules 1.55(d)(1) and (2) by expanding the list of disclosures and consents that may be provided in a single document and acknowledged with a single signature to include: (1) The disclosures required by new Rule 1.33(g) (relating to electronic transmission of statements); [30] (2) the consent referenced in Rule 155.3(b)(2) (relating to customer permission for FCMs to take the opposite side of an order); and (3) a provision for preauthorization of transfers of funds from a customer's segregated account to another account of that customer. Disclosure concerning arbitration of disputes, however, would continue to require a separate signed acknowledgment by non-institutional customers, pursuant to proposed new Rule 166.5 (this proposed new rule would replace and is modeled on current Rule 180.3).[31] The Commission specifically requests comment on whether to continue to require a separate signed acknowledgment by non-institutional customers of a pre-dispute arbitration agreement.

In contrast, for institutional customers, as provided in Rule 1.55(f), there would continue to be no specific disclosure requirements.[32] Because the definition of institutional customer referred to above would include governmental entities, these entities would not be required to receive and to acknowledge a disclosure statement. This reverses the position that the Commission took when it last amended its risk disclosure rules two years ago.[33]

Finally, the Commission is considering developing more streamlined disclosure requirements for domestic exchange-traded options under Rule 33.7. The Commission therefore seeks comments regarding how such disclosure may be more effectively presented to customers while reducing the associated burdens on registrants.

E. Core Principle Five: Trading Standards

Under the Core Principles, intermediaries and their affiliated persons are prohibited from misusing knowledge of their customers' orders. Currently, FCMs and IBs are required to establish and to maintain supervisory procedures to assure that neither they nor any affiliated persons (as defined in Rule 155.1) abuse their knowledge of customer orders to the customer's disadvantage. These rules have proven effective in the Commission's efforts to curb such practices as ''front-running,'' ''trading ahead,'' ''bucketing,'' taking the opposite side of customer orders, or improper disclosure of customer orders to third parties. Indeed, the Commission has found that these rules have generated few comments from industry professionals. The Commission therefore proposes that Rules 155.1, 155.3 and 155.4 will continue to apply to intermediation of trades at contract markets, RFEs, and for non-institutional customers' trades at DTFs. *See* proposed new Rule 155.6(a).

For intermediation of trades by institutional customers at DTFs, the Commission is proposing a new Rule 155.6(b) setting forth a general standard of practice in this area. The rule would simply parallel the language of the Core Principle prohibiting the misuse of knowledge of customer orders. Although the proposed new Rule 155.6(b) would not include as much detail as the current trading standards rules, it is nevertheless intended to proscribe the same trade practice abuses as Rules 155.1–155.5. Such practices as ''front-running,'' ''trading ahead,'' ''bucketing,'' taking the opposite side of customer orders, or disclosure of customer orders to third parties, would thus be deemed to be misuse of knowledge of customer orders and violations of Rule 155.6. The Commission will consider the development of a Statement of Acceptable Practices to be issued at a later date, with the consultation of DTFs, regarding appropriate procedures that should be employed in order to ensure compliance with the general standard.[34]

F. Core Principle Seven: Reporting Requirements

The Commission has found that its reporting system provides a valuable bulwark against illegitimate trade practices. Accordingly, the Commission would continue, and apply to intermediaries on RFEs, its large trader reporting requirements. Thus, FCMs would be required to report to the Commission and RFEs information that permits the identification of concentrations of positions and market composition on a routine and nonroutine basis, and information to detect manipulation, price distortion and disruptions of the delivery or cash settlement process.

With respect to intermediaries transacting business on DTFs, however, because of the nature of the instruments traded or the limited access granted thereto for non-institutional traders, the Commission would reduce its reporting requirements. Such intermediaries would only be subject to large trader reporting requirements by special call. These proposed reforms are detailed elsewhere in today's **Federal Register**.

[28] 65 FR 12466 (March 9, 2000).

[29] This would reverse existing Commission policy. *See* 58 FR 17495, 17499 (April 5, 1993).

[30] *See* proposed changes to Rule 1.33, below.

[31] Part 180 is proposed to be deleted in its entirety, as detailed elsewhere in today's **Federal Register**. The Commission is also proposing to add a new Rule 166.5 to govern the use of pre-dispute arbitration agreements for customer claims and grievances arising out of transactions executed on or subject to the rules of a contract market, an RFE or a DTF. Proposed Rule 166.5 restates current Rule 180.3, while taking into account the additional trading facilities that may be available to customers. Proposed Rule 166.5 also expands the use of the ''single-signature'' format for account opening agreements to include, in addition to entities that are excluded from the definition of a commodity pool operator under Rule 4.5 and ''qualified eligible participants'' as defined in Rule 4.7, institutional customers as defined in proposed Rule 1.3(g) and ''qualified eligible clients'' as defined in Rule 4.7. Since certain of the persons currently eligible to use the single signature format are included within the proposed definition of institutional customer, the provisions of proposed Rule 166.5(c)(2) contain modifications of rule 180.3(b)(2) so as to avoid duplication. The Commission is also proposing to include within the group of persons who need not separately endorse the provisions of a pre-dispute arbitration agreement persons other than those who would be defined as institutional customers. The Commission is making this proposal because the institutional customer definition would not include all of those now eligible for the single signature treatment under Rule 180.3(b)(2) (*e.g.*, a foreign insurance company or a qualified eligible participant) and the Commission does not intend to restrict, but rather intends to expand, this aspect of the rule. The proposed rule further recognizes that a registered futures association may be authorized to act as a decision-maker in customer dispute resolution proceedings involving floor brokers that are not members of the registered futures association and makes additional stylistic changes designed to make the rule more readable.

[32] In this regard, the Commission would, with industry input, issue a Statement of Acceptable Practices on disclosure to institutional customers at a later date.

[33] 63 FR 8566, 8568 (February 20, 1998). Particular governmental entities and trade associations for such entities are, of course, free to establish their own restrictions concerning futures trading through statute, regulation or Statements of Acceptable Practices.

[34] As noted above, the DTF is at this point a proposed new institution, and it is not known how such institutions would choose to operate. Such institutions may choose to sponsor trading in a traditional open-outcry pit trading system with natural persons acting as FBs or FTs. On the other hand, some DTFs may choose a purely automated, electronic trading format, or a combination of open outcry and electronic trading. Because it cannot be known at this time how such entities will choose to organize themselves, and what policies they will wish to pursue, the Commission is not at this time issuing a Statement of Acceptable Practices in this area.

G. Core Principal Eight: Recordkeeping

1. General

The Core Principles maintain that all registrants must keep full books and records of their activities related to their business. Thus, the Commission would maintain recordkeeping requirements as they relate to intermediaries, while considering whether greater use may be made of information technology in this regard. The Commission notes that Rule 1.31 was recently revised to provide for enhanced electronic recordkeeping similar to SEC recordkeeping requirements. *See* 64 FR 36568 (July 7, 1999); 64 FR 28735 (May 27, 1999). The Commission seeks comments regarding Rule 1.31 and on how greater use of information technology may be made in the future for recordkeeping purposes.

2. Customer Account Statements; Close-Out of Offsetting Positions

In keeping with changes in technology and commercial practices, the Commission is proposing to codify its previous Advisory relating to the electronic transmission of account statements, 62 FR 31507 (June 10, 1997), in a new Rule 1.33(g). Thus, an FCM would be permitted, with customer consent, to deliver required confirmation, purchase-and-sale, and monthly account statements electronically in lieu of mailing a paper copy. In keeping with the above-referenced Advisory, FCMs would need only to retain the daily confirmation statement as of the end of the trading session, provided that it reflects all trades made during that session, to satisfy recordkeeping obligations.

Proposed Rule 1.33(g) also provides, as did the above-referenced Advisory, that an FCM must, prior to the transmission of any statement by means of electronic media, disclose (1) The electronic medium or source through which statements will be delivered, (2) the duration, whether indefinite or not, of the period during which consent will be effective, (3) any charges for such service, (4) the information that will be delivered electronically, and (5) that consent to electronic delivery may be revoked at any time. In the case of a non-institutional customer, an FCM must obtain the non-institutional customer's signed consent acknowledging disclosure of this information prior to the transmission of any statement by means of electronic media. This acknowledgment can be included in a customer account agreement and acknowledged through a single signature in accordance with Rule 1.55. Institutional customers would not need to provide written consent, and the Commission recommends that FCMs confirm procedures relating to electronic transmission of statements to institutional customers as described in the above-referenced Advisory. The Commission specifically requests comment, however, as to whether FCMs may treat non-institutional customers in the same manner as institutional customers are proposed to be treated in this area. Any statement required to be furnished to a person other than a customer in accordance with paragraph (d) of Rule 1.33 would also be permitted to be furnished by electronic media.

The Commission also proposes to revise Rule 1.46 so that its general standard would function as a default rule in the absence of instruction by a customer or account controller. The Rule currently requires, absent one of several exceptions, that an FCM close out offsetting positions on a first-in, first-out basis, looking across all accounts it carries for the same customer.[35] Under the proposed rule, any customer or account controller could instruct the FCM otherwise, so that offsetting positions could be held open or closed out on other than a first-in, first-out basis. CPOs and CTAs would be required to disclose if they operate in this fashion, by amending Rules 4.24(h)(2) (which applies to CPOs) and 4.34(h) (which applies to CTAs) to include reference to the CPO's or CTA's instructions to FCMs concerning application of offsetting positions pursuant to Rule 1.46.

In order to implement this revision of Rule 1.46, the Commission proposes to amend the rule by inserting, after the words ''omnibus accounts'' in paragraph (a), the phrase ''or where the customer or account controller has instructed otherwise.'' Rule 1.46 also would be amended by revising paragraph (e) to correspond to proposed new Rule 1.33(g) (the substance of the current paragraph (e) of Rule 1.46 would be deleted because it currently relates back to paragraph (d)(6), which is being removed and reserved) to read: ''The statements required by paragraph (a) of this section may be furnished to the customer or the person described in § 1.33(d) by means of electronic transmission, in accordance with § 1.33(g).''

[35] An FCM must take into consideration positions in separate accounts of the same customer that it is carrying in applying Rule 1.46. 57 FR 55082, 55083 n. 2 (November 24, 1992), *citing* U.S. Department of Agriculture, Commodity Exchange Authority Administrative Determination No. 134 (May 25, 1948).

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA''), 5 U.S.C. 601 *et seq.* (1994 & Supp. II 1996), requires federal agencies, in proposing rules, to consider the impact of those rules on small businesses. The rule amendments discussed herein would affect FCMs, IBs, CPOs, CTAs, FBs, FTs, leverage transaction merchants (''LTMs'') and agricultural trade option merchants (''ATOMs''), as well as principals thereof. The Commission has previously established certain definitions of ''small entities'' to be used by the Commission in evaluating the impact of its rules on small entities in accordance with the RFA.[36] The Commission has previously determined that registered FCMs, CPOs, LTMs and ATOMs are not small entities for the purpose of the RFA.[37] With respect to IBs, CTAs, FBs and FTs, the Commission has stated that it is appropriate to evaluate within the context of a particular rule proposal whether some or all of the affected entities should be considered small entities and, if so, to analyze the economic impact on them of any rule.

The amendments proposed herein would not require any registrant to change its current method of doing business. For many registrants, the proposed revisions should decrease the number of persons within the registrant's organization who would be considered principals under the CFTC rules. Further, the proposed revisions should reduce, rather than increase, the regulatory requirements that apply to registrants and applicants for registration, regardless of size. Accordingly, pursuant to 5 U.S.C. 605(b), the Chairman, on behalf of the Commission, certifies that these proposed amendments will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

As required by the Paperwork Reduction Act of 1995 [44 U.S.C. 3507(d)], the Commission has submitted a copy of these proposed amendments to its rules to the Office of Management and Budget for its review.

Collection of Information

Rules Relating to the Operations and Activities of Commodity Pool Operators and Commodity Trading Advisors and to Monthly Reporting by Futures

[36] 47 FR 18618–18621 (April 30, 1982).

[37] 47 FR 18619–18620 (discussing FCMs and CPOs); 54 FR 19556, 19557 (May 8, 1989) (discussing LTMs); and 63 FR 18821, 18830 (April 16, 1998) (discussing ATOMs).

Commission Merchants, OMB Control Number 3038–0005.

The Commission believes that the amendments to Part 4 of its regulations impose no burden. While these proposed rule amendments have no burden, the group of rules (3038–0005) of which the rules proposed to be amended are a part, has the following burden:

Average burden hours per response: 7.25.

Number of respondents: 7,362.

Frequency of response: Monthly, Quarterly, Annually, On Occasion.

Rules Pertaining to Contract Markets and Their Members, OMB Control Number 3038–0022.

The Commission believes that the amendments to Parts 1 and 155 of its regulations impose no burden. While these proposed rule amendments have no burden, the group of rules (3038–0022) of which the rules proposed to be amended are a part, has the following burden:

Average burden hours per response: 2.

Number of respondents: 15,894.

Frequency of response: On Occasion.

Rules, Regulations and Forms for Domestic and Foreign Futures and Options Relating to Registration with the Commission, OMB Control Number 3038–0023.

The expected effect of the proposed amended rule will be to reduce the burden previously approved by OMB for this collection by 5,521.8 hours.

Specifically: The burden associated with Commission Rule 3.10(a) as applied to FCMs is expected to be decreased by 2 hours:

Estimated number of respondents (after proposed amendment): 6.

Annual responses by each respondent: 1.

Estimated average hours per response: 0.5.

Annual reporting burden: 3 hours.

The burden associated with Commission Rule 3.10(a) as applied to IBs is expected to be decreased by 54.8 hours:

Estimated number of respondents (after proposed amendment): 343.

Annual responses by each respondent: 1.

Estimated average hours per response: 0.4.

Annual reporting burden: 137.2 hours.

The burden associated with Form 8-R is expected to be decreased by 132 hours:

Estimated number of respondents (after proposed amendment): 2,400.

Annual responses by each respondent: 1.

Estimated average hours per response: 0.33.

Annual reporting burden: 792 hours.

The burden associated with Commission Rule 3.32 is expected to be decreased by 1 hour:

Estimated number of respondents (after proposed amendment): 10.

Annual responses by each respondent: 1.

Estimated average hours per response: 0.2.

Annual reporting burden: 2 hours.

The recordkeeping and reporting burdens associated with Commission Rule 3.34 are expected to be decreased by 5,332 hours:

Estimated number of respondents (after proposed amendment): 0.

Annual responses by each respondent: 0.

Estimated average hours per response: 0.

Annual reporting burden: 0 hours.

Regulations and Forms Pertaining to the Financial Integrity of the Marketplace, OMB Control Number 3038–0024.

The expected effect of the proposed amended rule will be to reduce the burden previously approved by OMB for this collection by 7.5 hours.

Specifically: The burden associated with Commission Rule 1.10 is expected to be decreased by 7.5 hours:

Estimated number of respondents (after proposed amendment): 15.

Annual responses by each respondent: 1.

Estimated average hours per response: 1.

Annual reporting burden: 15 hours.

Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street NW., Washington, DC 20581, (202) 418–5160.

Persons wishing to comment on the information collection requirements that would be required by these proposed rules should contact the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, Attn: Desk Officer for the Commodity Futures Trading Commission.

The Commission considers comments by the public on this proposed collection of information in—

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- Evaluating the accuracy of the Commission's estimate of the burden of the proposed collection of information including the validity of the methodology and assumptions used;
- Enhancing the quality, utility, and clarity of the information to be collected; and
- Minimizing the burden of the collection of the information on those who are to respond, including through the use of appropriate automated, electronic, mechanical or other technological collection techniques or other forms of information technology, *e.g.* permitting electronic submissions of responses.

OMB is required to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the Commission on the proposed regulations.

Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street NW, Washington, DC 20581 (202) 418–5160.

Lists of Subjects

17 CFR Part 1

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

17 CFR Part 3

Administrative practice and procedure, Brokers, Commodity futures, Reporting and recordkeeping requirements, Registration, Principals.

17 CFR Part 4

Advertising, Commodity futures, Consumer protection, Reporting and recordkeeping requirements, Principals, Commodity pool operators, Commodity trading advisors, Disclosure.

17 CFR Part 140

Authority delegations (Government agencies), Conflict of interests, Organization and functions (Government agencies).

17 CFR Part 155

Brokers, Commodity futures, Reporting and recordkeeping requirements.

17 CFR Part 166

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act, and in particular, Sections 2, 4b, 4d, 4f, 4m, 4n, 8a, and 19 thereof, 7 U.S.C. 2, 6b, 6d,

6f, 6m, 6n, 12a and 23, the Commission hereby proposes to amend Parts 1, 3, 4, 140, 155 and 166 of 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 1.3 is proposed to be amended by adding a new paragraph (g) to read as follows:

§ 1.3 Definitions.

* * * * *

(g) *Institutional customer*. This term has the same meaning as ''eligible participant'' as defined in § 35.1(b) of this chapter.

* * * * *

3. Section 1.10 is proposed to be amended as follows:

a. Revising paragraph (a)(2)(i)(B);

b. Adding paragraph (a)(2)(i)(C);

c. Designating the undesignated paragraph following paragraph (a)(2)(i)(B) as paragraph (a)(2)(i)(D) and revising it;

d. Designating the undesignated paragraph following paragraph (a)(2)(ii)(C) as paragraph (a)(2)(ii)(E) and revising it;

e. Redesignating paragraph (a)(2)(ii)(C) as (a)(2)(ii)(D) and revising it; and

f. Adding a new paragraph (a)(2)(ii)(C).

The revisions and additions read as follows:

§ 1.10 Financial reports of futures commission merchants and introducing brokers.

(a) * * *

(2) * * *

(i) * * *

(B) A Form 1–FR–FCM as of a date not more than 17 business days prior to the date on which such report is filed and a Form 1–FR–FCM certified by an independent public accountant in accordance with § 1.16 as of a date not more than one year prior to the date on which such report is filed; or

(C) A Form 1–FR–FCM, *Provided however*, that such applicant shall be subject to a review by the applicant's designated self-regulatory organization within six months of being granted registration.

(D) Each such person must include with such financial report a statement describing the source of his current assets and representing that his capital has been contributed for the purpose of operating his business and will continue to be used for such purpose.

(ii) * * *

(C) A Form 1–FR–IB, *Provided however*, that such applicant shall be subject to a review by the applicant's designated self-regulatory organization within six months of registration; or

(D) A guarantee agreement.

(E) Each person filing in accordance with paragraphs (a)(2)(ii) (A), (B) or (C) of this section must include with such financial report a statement describing the source of his current assets and representing that his capital has been contributed for the purpose of operating his business and will continue to be used for such purpose.

* * * * *

4. Section 1.17 is proposed to be amended by redesignating paragraph (a)(1)(ii) as (a)(1)(iii) and by adding new paragraphs (a)(1)(ii) and (a)(2)(iii) to read as follows:

§ 1.17 Minimum financial requirements for futures commission merchants and introducing brokers.

(a) * * *

(1) * * *

(ii) Each person registered as a futures commission merchant engaged in soliciting or accepting orders and customer funds related thereto for the purchase or sale of any commodity for future delivery on or subject to the rules of a derivatives transaction facility from any non-institutional customer must be a clearing member of a designated contract market or recognized futures exchange, and must maintain adjusted net capital in the amount of the greater of $20,000,000 or the amounts otherwise specified in paragraph (a)(1)(i) of this section.

* * * * *

(2) * * *

(iii) The requirements of paragraph (a)(1) of this section shall not be applicable if the registrant is a futures commission merchant or introducing broker registered in accordance with § 3.10(a)(1)(i)(B) of this chapter, whose business is limited to transacting business on behalf of institutional customers on a derivatives transaction facility, and who conforms to minimum financial standards and related reporting requirements set by such derivatives transaction facility in its bylaws, rules, regulations or resolutions.

* * * * *

5. Section 1.20 is proposed to be amended by revising paragraphs (a) and (c) to read as follows:

§ 1.20 Customer funds to be segregated and separately accounted for.

(a) All customer funds shall be separately accounted for and segregated as belonging to commodity or option customers. Such customer funds when deposited with any bank, trust company, clearing organization or another futures commission merchant shall be deposited under an account name which clearly identifies them as such and shows that they are segregated as required by the Act and this part. Each registrant shall obtain and retain in its files for the period provided in § 1.31 a written acknowledgment from such bank, trust company, clearing organization, or futures commission merchant, that it was informed that the customer funds deposited therein are those of commodity or option customers and are being held in accordance with the provisions of the Act and this part: *Provided, however*, that an acknowledgment need not be obtained from a clearing organization that has adopted and submitted to the Commission rules that provide for the segregation as customer funds, in accordance with all relevant provisions of the Act and the rules and orders promulgated thereunder, of all funds held on behalf of customers. Under no circumstances shall any portion of customer funds be obligated to a clearing organization, any member of a contract market, a futures commission merchant, or any depository except to purchase, margin, guarantee, secure, transfer, adjust or settle trades, contracts or commodity option transactions of commodity or option customers. No person, including any clearing organization or any depository, that has received customer funds for deposit in a segregated account, as provided in this section, may hold, dispose of, or use any such funds as belonging to any person other than the option or commodity customers of the futures commission merchant which deposited such funds.

* * * * *

(c) Each futures commission merchant shall treat and deal with the customer funds of a commodity customer or of an option customer as belonging to such commodity or option customer. All customer funds shall be separately accounted for, and shall not be commingled with the money, securities or property of a futures commission merchant or of any other person, or be used to secure or guarantee the trades, contracts or commodity options, or to secure or extend the credit, of any person other than the one for whom the same are held: *Provided, however*, That customer funds treated as belonging to

the commodity or option customers of a futures commission merchant may for convenience be commingled and deposited in the same account or accounts with any bank or trust company, with another person registered as a futures commission merchant, or with a clearing organization, and that such share thereof as in the normal course of business is necessary to purchase, margin, guarantee, secure, transfer, adjust, or settle the trades, contracts or commodity options of such commodity or option customers or resulting market positions, with the clearing organization or with any other person registered as a futures commission merchant, may be withdrawn and applied to such purposes, including the payment of premiums to option grantors, commissions, brokerage, interest, taxes, storage and other fees and charges, lawfully accruing in connection with such trades, contracts or commodity options: *Provided, further*, That customer funds may be invested in instruments described in § 1.25.

6. Section 1.25 is proposed to be revised to read as follows:

§ 1.25 Investment of customer funds.

(a) *Permitted investments.* (1) Subject to the terms and conditions set forth in this section, a futures commission merchant or a clearing organization may invest customer funds in the following instruments (permitted investments):

(i) Obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. government securities);

(ii) General obligations of any State or of any political subdivision thereof (municipal securities);

(iii) Obligations issued by any agency sponsored by the United States (government sponsored agency securities);

(iv) Certificates of deposit issued by a bank (certificates of deposit) as defined in section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation;

(v) Commercial paper;

(vi) Corporate notes; and

(vii) Interests in money market mutual funds.

(2) In addition, a futures commission merchant or a clearing organization may buy and sell the permitted investments listed in paragraphs (a)(1)(i) through (vii) of this section pursuant to agreements for resale or repurchase of the instruments, in accordance with the provisions of paragraph (d) of this section.

(b) *General terms and conditions.* A futures commission merchant or a clearing organization is required to manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity and according to the following specific requirements.

(1) *Ratings*—(i) *Initial requirement.* Instruments that are required to be rated by this section must be rated by a nationally recognized statistical rating organization (NRSRO), as that term is defined in § 270.2a–7 of this title. Ratings are required for permitted investments as follows:

(A) U.S. government securities need not be rated;

(B) Municipal securities, government sponsored agency securities, certificates of deposit, commercial paper, and corporate notes, except notes that are asset-backed, must have the highest short-term rating of an NRSRO or one of the two highest long-term ratings of an NRSRO;

(C) Corporate notes that are asset-backed must have the highest rating of an NRSRO; and

(D) Money market mutual funds that are rated by an NRSRO must be rated at the highest rating of the NRSRO or, if the fund is not rated, investments made by the fund must comply with the requirements applicable to direct investments under this section.

(ii) *Effect of downgrade.* If an NRSRO lowers the rating of an instrument that was previously a permitted investment to below the minimum rating required under this section, the value of the instrument recognized for segregation purposes will be the lesser of:

(A) The current market value of the instrument; or

(B) The market value of the instrument on the business day preceding the downgrade, reduced by 20 percent of that value for each business day that has elapsed since the downgrade.

(2) *Restrictions on instrument features.* (i) With the exception of money market mutual funds, no permitted investment may contain an embedded derivative of any kind, including but not limited to a call option, put option, or collar, cap or floor on interest paid.

(ii) No instrument may contain interest-only payment features.

(iii) No instrument may provide payments linked to a commodity, currency, reference instrument, index, or benchmark except as provided in paragraph (b)(2)(iv) of this section.

(iv) Variable-rate securities are permitted, provided the interest rates paid correlate closely and on an unleveraged basis to a benchmark of either the Federal Funds target or effective rate, the prime rate, the three-month Treasury Bill rate, or the one-month or three-month LIBOR rate.

(v) Certificates of deposit, if negotiable, must be able to be liquidated within one business day or, if not negotiable, must be redeemable at the issuing bank within one business day, with any penalty for early withdrawal limited to any accrued interest earned.

(3) *Concentration.* (i) The aggregate investment in U.S. government securities or in money market mutual funds shall not be subject to a concentration limit.

(ii) The aggregate investment in the securities of any one issuer, or related issuers, of government sponsored agency securities shall not exceed 25 percent of the total assets held in segregation by the futures commission merchant or the clearing organization. Securities issued by an entity that directly or indirectly constitute an interest in securities issued by a government sponsored agency shall be combined and treated as the securities of a single issuer for the purpose of determining the concentration limit.

(iii) The aggregate investment in the obligations of any one issuer, or related issuers, of any permitted investments, other than U.S. government securities, money market mutual funds, and government sponsored agency instruments, may not exceed five percent of the total assets held in segregation by the futures commission merchant or the clearing organization.

(4) *Time-to-maturity.* Except for investments in money market mutual funds, the dollar-weighted average of the time-to-maturity of the portfolio, as that average is computed pursuant to § 270.2a–7 of this title, may not exceed 24 months.

(5) *Investments in instruments issued by affiliates.* (i) Except as provided in paragraph (b)(5)(ii) of this section, a futures commission merchant shall not invest customer funds in obligations of an entity affiliated with the futures commission merchant, and a clearing organization shall not invest customer funds in obligations of an entity affiliated with the clearing organization. An affiliate includes parent companies, including all entities through the ultimate holding company, subsidiaries to the lowest level, and companies under common ownership of such parent company or affiliates.

(ii) A futures commission merchant or clearing organization may invest customer funds in a fund affiliated with that futures commission merchant or clearing organization provided that the

fund itself does not invest in any instrument issued by the futures commission merchant, clearing organization or affiliate thereof.

(6) *Recordkeeping.* A futures commission merchant and a clearing organization shall prepare and maintain a record that will show for each business day with respect to each type of investment made pursuant to this section, the following information:

(i) The type of instruments in which customer funds have been invested;

(ii) The original cost of the instruments; and

(iii) The current market value of the instruments.

(c) *Money market mutual funds.* The following provisions will apply to the investment of customer funds in money market mutual funds (the fund).

(1) Generally, the fund must be registered with the Securities and Exchange Commission as a money market mutual fund, in compliance with applicable requirements. A fund sponsor, however, may petition the Commission for an exemption from this requirement. The Commission may grant such an exemption provided that the fund can demonstrate that it will operate in a manner designed to preserve principal and to maintain liquidity. The application for exemption must describe how the fund's structure, operations and financial reporting are expected to differ from the requirements contained in § 270.2a–7 of this title and the risk-limiting provisions for direct investments contained in this section. The fund must also specify the information that the fund would make available to the Commission on an ongoing basis.

(2) The fund must be sponsored by a federally-regulated financial institution, a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, except for a fund exempted in accordance with paragraph (c)(1) of this section.

(3) A futures commission merchant or clearing organization shall hold its shares of the fund in a custody account in accordance with § 1.26(a). If the futures commission merchant or the clearing organization holds its shares of the fund with the fund's shareholder servicing agent, the sponsor of the fund and the fund itself are required to provide the acknowledgment letter required by § 1.26.

(4) The net asset value of the fund must be computed daily by 9 a.m. of each business day and made available to the futures commission merchant or clearing organization by that time.

(5) An interest in a fund must be able to be liquidated by the business day following a request to liquidate by the futures commission merchant or clearing organization.

(6) The agreement pursuant to which the futures commission merchant or clearing organization has acquired and is holding its interest in a fund must contain no provision that would prevent the pledging or transferring of shares.

(d) *Repurchase and reverse repurchase agreements.* A futures commission merchant or clearing organization may buy and sell the permitted investments pursuant to agreements for resale or repurchase of the securities (repurchase transactions), provided the agreements for resale or repurchase conform to the following requirements:

(1) The securities are specifically identified by coupon rate, par amount, market value, maturity date, and CUSIP number.

(2) Counterparties are limited to a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, a securities broker or dealer, or a government securities broker or government securities dealer registered with the Securities and Exchange Commission or which has filed notice pursuant to section 15C(a) of the Government Securities Act of 1986.

(3) The transaction is made pursuant to a written agreement signed by the parties to the agreement, which is consistent with the conditions set forth in paragraphs (d)(1) through (d)(11) of this section and which states that the parties thereto intend the transaction to be treated as a purchase and sale of securities.

(4) The term of the agreement is no more than one business day, or reversal of the transaction is possible on demand.

(5) The securities transferred under the agreement are held in a safekeeping account with a bank as referred to in paragraph (d)(2) of this section, a clearing organization or the Depository Trust Corporation in an account that complies with the requirements of § 1.26.

(6) The futures commission merchant or the clearing organization may not use securities received under the agreement in another similar transaction and may not otherwise hypothecate or pledge such securities, except securities may be pledged on behalf of customers at another futures commission merchant or clearing organization. Substitution of securities is allowed, *provided, however,* that:

(i) The qualifying securities being substituted and original securities are specifically identified by date of substitution, market values substituted, coupon rates, par amounts, maturity dates and CUSIP numbers;

(ii) Substitution is made on a ''delivery versus delivery'' basis; and

(iii) The market value of the substituted securities is at least equal to that of the original securities.

(7) The transfer of securities is made on a delivery versus payment basis in immediately available funds. The transfer is not recognized as accomplished until the funds and/or securities are actually received by the custodian of the futures commission merchant's or clearing organization's customer funds or securities purchased on behalf of customers. The transfer or credit of securities covered by the agreement to the futures commission merchant's or clearing organization's customer segregated custodial account is made simultaneously with the disbursement of funds from the futures commission merchant's or clearing organization's customer segregated cash account at the custodian bank. On the sale or resale of securities, the futures commission merchant's or clearing organization's customer segregated cash account at the custodian bank must receive same-day funds credited to such segregated account simultaneously with the delivery or transfer of securities from the customer segregated custodial account.

(8) A written confirmation to the futures commission merchant or clearing organization specifying the terms of the agreement and a safekeeping receipt are issued immediately upon entering into the transaction and a confirmation to the futures commission merchant or clearing organization is issued once the transaction is reversed.

(9) The transactions effecting the agreement are recorded in the record required to be maintained under § 1.27 of investments of customer funds, and the securities subject to such transactions are specifically identified in such record as described in paragraph (d)(1) of this section and further identified in such record as being subject to repurchase and reverse repurchase agreements.

(10) An actual transfer of securities by book entry is made consistent with Federal or State commercial law, as applicable. At all times, securities received subject to an agreement are reflected as ''customer property.''

(11) The agreement makes clear that, in the event of the bankruptcy of the futures commission merchant or clearing organization, any securities purchased with customer funds that are subject to an agreement may be immediately transferred. The agreement also makes clear that, in the event of a futures commission merchant or clearing organization bankruptcy, the counterparty has no right to compel liquidation of securities subject to an agreement or to make a priority claim for the difference between current market value of the securities and the price agreed upon for resale of the securities to the counterparty, if the former exceeds the latter.

(e) A futures commission merchant shall not be prohibited from directly depositing unencumbered securities of the type specified in this section, which it owns for its own account, into a segregated safekeeping account or from transferring any such securities from a segregated account to its own account, up to the extent of its residual financial interest in customers' segregated funds; provided, however, that such investments, transfers of securities, and disposition of proceeds from the sale or maturity of such securities are recorded in the record of investments required to be maintained by § 1.27. All such securities may be segregated in safekeeping only with a bank, trust company, clearing organization, or other registered futures commission merchant. Furthermore, for purposes of §§ 1.25, 1.26, 1.27, 1.28 and 1.29, investments permitted by § 1.25 that are owned by the futures commission merchant and deposited into such a segregated account shall be considered customer funds until such investments are withdrawn from segregation.

7. Section 1.26 is proposed to be revised to read as follows:

§ 1.26 Deposit of instruments purchased with customer funds.

(a) Each futures commission merchant who invests customer funds in instruments described in § 1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers. Such instruments, when deposited with a bank, trust company, clearing organization or another futures commission merchant, shall be deposited under an account name which clearly shows that they belong to commodity or option customers and are segregated as required by the Act and this part. Each futures commission merchant upon opening such an account shall obtain and retain in its files an acknowledgment from such bank, trust company, clearing organization or other futures commission merchant that it was informed that the instruments belong to commodity or option customers and are being held in accordance with the provisions of the Act and this part. *Provided, however,* that an acknowledgment need not be obtained from a clearing organization that has adopted and submitted to the Commission rules that provide for the segregation as customer funds, in accordance with all relevant provisions of the Act and the rules and orders promulgated thereunder, of all funds held on behalf of customers and all instruments purchased with customer funds. Such acknowledgment shall be retained in accordance with § 1.31. Such bank, trust company, clearing organization or other futures commission merchant shall allow inspection of such obligations at any reasonable time by representatives of the Commission.

(b) Each clearing organization which invests money belonging or accruing to commodity or option customers of its clearing members in instruments described in § 1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers. Such instruments, when deposited with a bank or trust company, shall be deposited under an account name which will clearly show that they belong to commodity or option customers and are segregated as required by the Act and this part. Each clearing organization upon opening such an account shall obtain and retain in its files a written acknowledgment from such bank or trust company that it was informed that the instruments belong to commodity or option customers of clearing members and are being held in accordance with the provisions of the Act and this part. Such acknowledgment shall be retained in accordance with § 1.31. Such bank or trust company shall allow inspection of such instruments at any reasonable time by representatives of the Commission.

§§ 1.27, 1.28 and 1.29 [Amended]

8. Sections 1.27, 1.28 and 1.29 are proposed to be amended by revising the word ''obligations'' to read ''instruments'' each time it appears.

9. Section 1.33 is proposed to be amended by adding a new paragraph (g) to read as follows:

§ 1.33 Monthly and confirmation statements.

* * * * *

(g) *Electronic transmission of statements.* (1) The statements required by this section, and by § 1.46, may be furnished to anyt customer by means of electronic media if the customer so requests, *Provided, however,* that a futures commission merchant must, prior to the transmission of any statement by means of electronic media, disclose the electronic medium or source through which statements will be delivered, the duration, whether indefinite or not, of the period during which consent will be effective, any charges for such service, the information that will be delivered by such means, and that consent to electronic delivery may be revoked at any time.

(2) In the case of a non-institutional customer, a futures commission merchant must obtain the non-institutional customer's signed consent acknowledging disclosure of the information set forth in paragraph (g)(1) of this section prior to the transmission of any statement by means of electronic media.

(3) Any statement required to be furnished to a person other than a customer in accordance with paragraph (d) of this section may be furnished by electronic media.

(4) A futures commission merchant who furnishes statements to any customer by means of electronic media must retain a daily confirmation statement for such customer as of the end of the trading session, reflecting all transactions made during that session for the customer, in accordance with § 1.31.

10. Section 1.46 is proposed to be amended as follows:

a. By revising paragraph (a), introductory text,

b. By removing and reserving paragraphs (d)(4) through (d)(7),

c. By removing paragraph (d)(9) and

d. By revising paragraph (e) to read as follows:

§ 1.46 Application and closing out of offsetting long and short positions.

(a) *Application of purchases and sales.* Except with respect to purchases or sales which are for omnibus accounts, or where the customer has instructed otherwise, any futures commission merchant who, on or subject to the rules of a contract market:

* * * * *

(e) The statements required by paragraph (a) of this section may be furnished to the customer or the person described in § 1.33(d) by means of electronic transmission, in accordance with § 1.33(g).

11. Section 1.52 is proposed to be amended by adding a new paragraph (m) to read as follows:

§ 1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements.

* * * * *

(m) Nothing in this section shall apply to the activities of a derivatives transaction facility or the minimum adjusted net capital requirements it may require of persons operating thereon pursuant to § 1.17(a)(2)(iii).

12. Section 1.55 is proposed to be amended by revising paragraphs (d) and (f) to read as follows:

§ 1.55 Distribution of ''Risk Disclosure Statement'' by futures commission merchants and introducing brokers.

* * * * *

(d) Any futures commission merchant, or in the case of an introduced account any introducing broker, may open a commodity futures account for a customer without obtaining the separate acknowledgments of disclosure and elections required by this section and by § 1.33(g), and by §§ 33.7, 155.3(b)(2), and 190.06 of this chapter, provided that:

(1) Prior to the opening of such account, the futures commission merchant or introducing broker obtains an acknowledgment from the customer, which may consist of a single signature at the end of the futures commission merchant's or introducing broker's customer account agreement, or on a separate page, of the disclosure statements and elections specified in this section and § 1.33(g), and in §§ 33.7, 155.3(b)(2), and 190.06 of this chapter, and which may include authorization for the transfer of funds from a segregated customer account to another account of such customer, as listed directly above the signature line, provided the customer has acknowledged by check or other indication next to a description of each specified disclosure statement or election that the customer has received and understood such disclosure statement or made such election;

(2) The acknowledgment referred to in paragraph (d)(1) of this section must be accompanied by and executed contemporaneously with delivery of the disclosures and elective provisions required by this section and § 1.33(g), and by §§ 33.7, 155.3(b)(2), and 190.06 of this chapter.

* * * * *

(f) A futures commission merchant or, in the case of an introduced account an introducing broker, may open a commodity futures account for an institutional customer without furnishing such institutional customer the disclosure statements or obtaining the acknowledgements required under paragraph (a) of this section, §§ 1.33(g) and 1.65(a)(3), and §§ 30.6(a), 33.7(a), 155.3(b)(2), and 190.10(c) of this chapter.

* * * * *

PART 3—REGISTRATION

13. The authority citation for Part 3 is revised to read as follows:

Authority: 5 U.S.C. 522, 522b; 7 U.S.C. 1a, 2, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6n, 6o, 6p, 8, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21, 23.

14. Section 3.1 is proposed to be amended by revising paragraphs (a)(1) and (a)(2) to read as follows:

§ 3.1 Definitions.

(a) * * *

(1) If the entity is organized as a sole proprietorship, the proprietor; if a partnership, any general partner; if a corporation, any director, the president, chief executive officer, chief operating officer, chief financial officer, and any person in charge of a principal business unit, division or function subject to regulation by the Commission; if a limited liability company or limited liability partnership, any director, the president, chief executive officer, chief operating officer, chief financial officer, the manager, managing member or those members vested with the management authority for the entity, and any person in charge of a principal business unit, division or function subject to regulation by the Commission; and, in addition, any 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 entity's activities that are subject to regulation by the Commission;

(2)(i) Any individual who directly or indirectly, through agreement, holding company, nominee, trust or otherwise, is the owner of ten percent or more of the outstanding shares of any class of stock, is entitled to vote or has the power to sell or direct the sale of ten percent or more of any class of voting securities, or is entitled to receive ten percent or more of the profits; or

(ii) Any person other than an individual that is the direct owner of ten percent or more of any class of securities; or

* * * * *

15. Section 3.10 is proposed to be amended by revising paragraph (a)(1)(i), by redesignating paragraph (a)(2)(i) as paragraph (a)(2), by removing paragraph (a)(2)(ii), and by revising paragraph (d) to read as follows:

§ 3.10 Registration of futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.

(a) *Application for Registration.*

(1)(i)(A) Except as provided in paragraph (a)(1)(i)(B) of this section, application for registration as a futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant must be on Form 7–R, completed and filed with the National Futures Association in accordance with the instructions thereto.

(B) An applicant for registration as a futures commission merchant or introducing broker that will conduct transactions exclusively on or subject to the rules of a derivatives transaction facility for institutional customers, and which is registered with the Securities and Exchange Commission as a securities broker or dealer, or is a bank or any other financial depository institution subject to regulation by the United States, may apply for registration by filing with the National Futures Association notice of its intention to undertake transactions exclusively on or subject to the rules of a derivatives transaction facility for institutional customers, together with a certification of registration and good standing with the appropriate authority or of authorization to engage in such transactions by said authority.

* * * * *

(d) *Annual filing.* Any person registered as a futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant in accordance with paragraph (a)(1)(i)(A) of this section must file with the National Futures Association a Form 7–R, completed in accordance with the instructions thereto, annually on a date specified by the National Futures Association. The failure to file the Form 7–R within thirty days following such date shall be deemed to be a request for withdrawal from registration. On at least thirty days written notice, and following such action, if any, deemed to be necessary by the Commission or the National Futures Association, the National Futures Association may grant the request for withdrawal from registration.

16. Section 3.32 is proposed to be amended as follows:

a. Adding paragraphs (a)(1)(i)(A) and (B);

b. Revising paragraphs (a)(1)(ii) and (a)(1)(v);

c. Redesignating paragraphs (a)(1)(vi)and (a)(1)(vii) as paragraphs (a)(1)(vii) and (a)(1)(viii), respectively;

d. Adding a new paragraph (a)(1)(vi);

e. Revising paragraph (a)(2)(i); and

f. Revising paragraph (e)(1).

The revisions and additions read as follows:

§ 3.32 Changes requiring new registration; addition of principals.

(a)(1) * * *

(i) * * *

(A) As an individual, directly or indirectly, through agreement, holding company, nominee, trust or otherwise, becomes the owner of ten percent or more of the outstanding shares of any class of stock or acquires the right to vote or the power to sell or to direct the sale of ten percent or more of the registrant's voting securities;

(B) Any person other than an individual that becomes the direct owner of ten percent or more of any class of a registrant's securities;

(ii) As an individual becomes entitled to receive ten percent or more of the registrant's profits;

* * * * *

(v) Becomes the president, chief executive officer, chief operating officer or chief financial officer of the corporate registrant, or becomes in charge of a principal business unit, division or function subject to regulation by the Commission, or comes to occupy a position of similar status or perform a similar function;

(vi) Becomes a director, president, chief executive officer, chief operating officer, chief financial officer, manager, managing member or a member vested with the management authority for the registrant or becomes in charge of a principal business unit, division or function subject to regulation by the Commission, or comes to occupy a position of similar status or perform a similar function in the case of a limited liability company or limited liability partnership;

* * * * *

(2)(i) If a person becomes a principal of the registrant because of an event described in paragraph (a)(1)(i)(B) of this section, the registrant's registration shall not be deemed to terminate and a new Form 7–R need not be filed: *Provided, however,* that within twenty days of the occurrence of the event described in paragraph (a)(1)(i)(B) of this section, the registrant must notify the National Futures Association of the name of such added principal on Form 3–R and must file written certifications with the National Futures Association stating:

(A) The ultimate day-to-day control of the registrant remains the same,

(B) The addition of the new principal will not affect the conduct or the day-to-day operations of the registrant, and

(C) The insertion of the new principal into the chain of ownership is not being done for the purpose, and will not have the effect, of limiting any liability of the registrant.

* * * * *

(e)(1) Except where a registrant chooses to file an application pursuant to paragraph (d) of this section, if applicable, in the event of a change as described in paragraph (a)(1)(v) or (a)(1)(vi) of this section, a new registration will not be required if the registrant submits a written notice on Form 3–R to the National Futures Association prior to the date of such change in control (and such change does not occur until the registrant receives written approval from the National Futures Association) and includes with such notice a Form 8–R, completed in accordance with the instructions thereto and executed by the person referred to in paragraph (a)(1)(v) or (a)(1)(vi) of this section. The Form 8–R for such individual must be accompanied by the fingerprints of that individual on a fingerprint card provided for that purpose by the National Futures Association: *Provided, however,* That a fingerprint card need not be provided under this paragraph for any individual who has a current Form 8–R on file with the National Futures Association or the Commission.

* * * * *

§ 3.34 [Removed]

17. Section 3.34 is proposed to be removed.

18. Part 3 is proposed to be amended by adding Appendix B to read as follows:

Appendix B to Part 3—Statement of Acceptable Practices With Respect to Ethics Training

(a) The provisions of Section 4p(b) of the Act (7 U.S.C. 6p(b) (1994)) set forth requirements regarding training of registrants as to their responsibilities to the public. This section requires the Commission to issue regulations requiring new registrants to attend ethics training sessions within six months of registration, and all registrants to attend such training on a periodic basis. Consistent with the will of Congress, the Commission believes that a Core Principle for all persons intermediating transactions in recognized multilateral trade execution facilities is fitness. The awareness and maintenance of professional ethical standards are essential elements of a registrant's fitness. Further, the use of ethics training programs is relevant to a registrant's maintenance of adequate supervision, itself a Core Principle, and a requirement under Rule 166.3.

(b)(1) The Commission recognizes that technology has provided new, faster means of sharing and distributing information. In view of the foregoing, the Commission has chosen to allow registrants to develop their own ethics training programs. Nevertheless, futures industry professionals may want guidance as to the role of ethics training. Registrants may wish to consider what ethics training should be retained, its format, and how it might best be implemented. Therefore, the Commission finds it appropriate to issue this Statement of Acceptable Practices regarding appropriate training for registrants, as interpretative guidance for intermediaries on fitness and supervision. Commission registrants may look to this Statement of Acceptable Practices as a ''safe harbor'' concerning acceptable procedures in this area.

(2) The Commission believes that section 4p(b) of the Act reflects an intent by Congress that industry professionals be aware, and remain abreast, of their continuing obligations to the public under the Act and the regulations thereunder. The text of the Act provides guidance as to the nature of these responsibilities. As expressed in section 4p(b) of the Act, personnel in the industry have an obligation to the public to observe the Act, the rules of the Commission, the rules of any appropriate self-regulatory organizations or contract markets (which would also include recognized futures exchanges and recognized derivatives transactions facilities), or other applicable federal or state laws or regulations. Further, section 4p(b) acknowledges that registrants have an obligation to the public to observe ''just and equitable principles of trade.''

(3) Additionally, section 4p(b) reflects Congress' intent that registrants and their personnel retain an up-to-date knowledge of these requirements. The Act requires that registrants receive training on a periodic basis. Thus, it is the intent of Congress that Commission registrants remain current with regard to the ethical ramifications of new technology, commercial practices, regulations, or other changes.

(c) The Commission believes that training should be focused to some extent on a person's registration category, although there will obviously be certain principles and issues common to all registrants and certain general subjects that should be taught. Topics to be addressed include:

(1) An explanation of the applicable laws and regulations, and the rules of self-regulatory organizations or contract markets, recognized futures exchanges and derivatives transaction facilities;

(2) The registrant's obligation to the public to observe just and equitable principles of trade;

(3) How to act honestly and fairly and with due skill, care and diligence in the best interests of customers and the integrity of the market;

(4) How to establish effective supervisory systems and internal controls;

(5) Obtaining and assessing the financial situation and investment experience of customers;

(6) Disclosure of material information to customers; and

(7) Avoidance, proper disclosure and handling of conflicts of interest.

(d) An acceptable ethics training program would apply to all of a firm's associated persons and its principals to the extent they are required to register as associated persons. Additionally, personnel of firms that rely on their registration with other regulators, such as the Securities and Exchange Commission, should be provided with ethics training to the extent the Act and the Commission's regulations apply to their business.

(e) As to the providers of such training, the Commission believes that classes sponsored by independent persons, firms, or industry associations would be acceptable. It would also be permissible to conduct in-house training programs. Further, registrants should ascertain the credentials of any ethics training providers they retain. Thus, persons who provide ethics training should be required to provide proof of satisfactory completion of the proficiency testing requirements applicable to the registrant and evidence of three years of relevant industry or pedagogical experience in the field. This industry experience might include the practice of law in the fields of futures or securities, or employment as a trader or risk manager at a brokerage or end-user firm. Likewise, the Commission believes that registrants should employ as ethics training providers only those persons they reasonably believe in good faith are not subject to any investigations or to bars to registration or to service on a self-regulatory organization governing board or disciplinary panel.

(f)(1) With regard to the frequency and duration of ethics training, it is permissible for a firm to require training on whatever periodic basis and duration the registrant (and relevant self-regulatory organizations) deems appropriate. It may even be appropriate not to require any such specific requirements as, for example, where ethics training could be termed ongoing. For instance, a small entity, sole proprietorship, or even a small section in an otherwise large firm, might satisfy its obligation to remain current with regard to ethics obligations by distribution of periodicals, legal cases, or advisories. Use of the latest information technology, such as Internet websites, can be useful in this regard. In such a context, there would be no structured classes, but the goal should be a continuous awareness of changing industry standards. A corporate culture to maintain high ethical standards should be established on a continuing basis.

(2) On the other hand, larger firms which transact business with a larger segment of the public may wish to implement a training program that requires periodic classwork. In such a situation, the Commission believes it appropriate for registrants to maintain such records as evidence of attendance and of the materials used for training. In the case of a floor broker or floor trader, the applicable contract market, recognized futures exchange or derivatives transaction facility should maintain such evidence on behalf of its member. This evidence of ethics training could be offered to demonstrate fitness and overall compliance during audits by self-regulatory organizations, and during reviews of contract market, recognized futures exchange or derivatives transaction facility operations.

(g) The methodology of such training may also be flexible. Recent innovations in information technology have made possible new, fast, and cost-efficient ways for registrants to maintain their awareness of events and changes in the commodity interest markets. In this regard, the Commission recognizes that the needs of a firm will vary according to its size, personnel, and activities. No format of classes will be required. Rather, such training could be in the form of formal class lectures, video presentation, Internet transmission, or by simple distribution of written materials. These options should provide sufficiently flexible means for adherence to Congressional intent in this area.

(h) Finally, it should be noted that self-regulatory organizations and industry associations will have a significant role in this area. Such organizations may have separate ethics and proficiency standards, including ethics training and testing programs, for their own members.

PART 4—COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

19. 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.

20. Section 4.10 is proposed to be amended by revising paragraph (e)(1) to read as follows:

§ 4.10 Definitions.

* * * * *

(e)(1) *Principal,* when referring to a person that is a principal of a particular entity, shall have the same meaning as the term principal under § 3.1(a) of this chapter.

* * * * *

21. Section 4.24 is proposed to be amended by revising paragraphs (f)(1)(v) and (h)(2) to read as follows:

§ 4.24 General Disclosures required.

* * * * *

(f) * * *

(1) * * *

(v) Each principal of the foregoing persons who participates in making trading or operational decisions for the pool or who supervises persons so engaged.

* * * * *

(h) * * *

(2) A description of the trading and investment programs and policies that will be followed by the offered pool, including the method chosen by the pool operator concerning how futures commission merchants carrying the pool's accounts shall treat offsetting positions pursuant to § 1.46 of this chapter, if the method is other than to close out all offsetting positions or to close out offsetting positions on other than a first-in, first-out basis, 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;

* * * * *

22. Section 4.34 is proposed to be amended by revising paragraphs (f)(1)(ii) and (h) to read as follows:

§ 4.34 General Disclosures required.

* * * * *

(f) * * *

(1) * * *

(ii) Each principal of the trading advisor who participates in making trading or operational decisions for the trading advisor or supervises persons so engaged.

* * * * *

(h) *Trading program.* A description of the trading program, which must include the method chosen by the commodity trading advisor concerning how futures commission merchants carrying accounts it manages shall treat offsetting positions pursuant to § 1.46 of this chapter, if the method is other than to close out all offsetting positions or to close out offsetting positions on other than a first-in, first-out basis, and 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.

* * * * *

PART 140—ORGANIZATION, FUNCTIONS AND PROCEDURES OF THE COMMISSION

23. The authority citation for Part 140 continues to read as follows:

Authority: 7 U.S.C. 4a, 12a.

24. Section 140.91 is proposed to be amended by adding a new paragraph (a)(7) to read as follows:

§ 140.91 Delegation of authority to the Director of the Division of Trading and Markets.

(a) * * *

(7) All functions reserved to the Commission in § 1.25 of this chapter.

* * * * *

PART 155—TRADING STANDARDS

25. The authority citation for Part 155 continues to read as follows:

Authority: 7 U.S.C. 6b, 6c, 6g, 6j and 12a unless otherwise noted.

26. Sections 155.2, 155.3, 155.4 and 155.5 are proposed to be amended by adding the words ''or recognized futures exchange'' after the words ''contract market'' each time they appear.

27. Section 155.6 is proposed to be added to read as follows:

§ 155.6. Trading Standards for the Transaction of Business on Derivatives Transaction Facilities.

(a) A futures commission merchant, or affiliated person thereof, transacting business on behalf of a non-institutional customer on a derivatives transaction facility shall comply with the provisions of § 155.3.

(b) No futures commission merchant, introducing broker or affiliated person thereof shall misuse knowledge of any institutional customer's order for execution on a derivatives transaction facility.

PART 166—CUSTOMER PROTECTION RULES

28. The authority citation for Part 166 is proposed to be amended to read as follows:

Authority: 7 U.S.C. 1a, 2, 4, 6b, 6c, 6d, 6g, 6h, 6k, 6l, 6o, 7a, 12a, 21 and 23, unless otherwise noted.

29. Section 166.5 is proposed to be added to read as follows:

§ 166.5 Dispute settlement procedures.

(a) *Definitions.*

(1) The term *claim or grievance* as used in this section shall mean any dispute that

(i) Arises out of any transaction executed on or subject to the rules of a contract market, a recognized futures exchange or a derivatives transaction facility,

(ii) Is executed or effected through a member of such facility, a participant transacting on or through such facility or an employee of such facility, and

(iii) Does not require for adjudication the presence of essential witnesses or third parties over whom the facility does not have jurisdiction and who are not otherwise available.

(iv) The term claim or grievance does not include disputes arising from cash market transactions that are not a part of or directly connected with any transaction for the purchase or sale of any commodity for future delivery or commodity option.

(2) The term *customer* as used in this section includes an option customer (as defined in § 1.3(jj) of this chapter) and any person for or on behalf of whom a member of a contract market, a recognized futures exchange or a derivatives transaction facility or a participant transacting on or through such market, exchange or facility effects a transaction on or through such market, exchange or facility, except another member of or participant in such market, exchange or facility.

(3) The term *Commission registrant* as used in this section means a person registered under the Act as a futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor, or associated person.

(b) *Voluntariness.* The use by customers of dispute settlement procedures shall be voluntary as provided in paragraph (c) of this section.

(c) *Pre-Dispute Arbitration Agreements.* No Commission registrant shall enter into any agreement or understanding with a customer in which the customer agrees, prior to the time a claim or grievance arises, to submit such claim or grievance to any settlement procedure except as follows:

(1) Signing the agreement must not be made a condition for the customer to utilize the services offered by the Commission registrant.

(2) If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the cautionary language and provisions specified in this section. A futures commission merchant or introducing broker may obtain such endorsement as provided in § 1.55(d) of this chapter for the following classes of customers only:

(i) An institutional customer as defined in § 1.3(g) of this chapter;

(ii) A plan defined as a government plan or church plan in section 3(32) or section 3(33) of title I of the Employee Retirement Income Security Act of 1974, or a foreign person performing a similar role or function subject as such to comparable foreign regulation; and

(iii) A person who is a ''qualified eligible participant'' or a ''qualified eligible client'' as defined in § 4.7 of this chapter.

(3) The agreement may not require the customer to waive the right to seek reparations under section 14 of the Act and part 12 of this chapter. Accordingly, the customer must be advised in writing that he or she may seek reparations under section 14 of the Act by an election made within 45 days after the Commission registrant notifies the customer that arbitration will be demanded under the agreement. This notice must be given at the time when the Commission registrant notifies the customer of an intention to arbitrate. The customer must also be advised that if he or she seeks reparations under section 14 of the Act and the Commission declines to institute reparation proceedings, the claim or grievance will be subject to the pre-existing arbitration agreement and must also be advised that aspects of the claim or grievance that are not subject to the reparations procedure (*i.e.*, do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the pre-existing arbitration agreement.

(4) The agreement must advise the customer that, at such time as he or she may notify the Commission registrant that he or she intends to submit a claim to arbitration, or at such time as such person notifies the customer of its intent to submit a claim to arbitration, the customer will have the opportunity to elect a qualified forum for conducting the proceeding.

(5) *Election of forum.* (i) Within ten business days after receipt of notice from the customer that he or she intends to submit a claim to arbitration, or at the time a Commission registrant notifies the customer of its intent to submit a claim to arbitration, the Commission registrant must provide the customer with a list of organizations whose procedures meet Acceptable Practices established by the Commission for customer dispute resolution, together with a copy of the rules of each forum listed. The list must include:

(A) The contract market, recognized futures exchange or derivatives transaction facility, if available, upon which the transaction giving rise to the dispute was executed or could have been executed;

(B) A registered futures association; and

(C) At least one other organization that will provide the customer with the opportunity to select the location of the arbitration proceeding from among several major cities in diverse geographic regions and that will provide the customer with the choice of a panel or other decision-maker composed of at least one or more persons, of which at least a majority are not members or associated with a member of the contract market, recognized futures exchange or derivatives transaction facility or employee thereof, and that are not otherwise associated with the contract market, recognized futures exchange or derivatives transaction

facility (mixed panel): *Provided, however,* that the list of qualified organizations provided by a Commission registrant that is a floor broker need not include a registered futures association unless a registered futures association has been authorized to act as a decision-maker in such matters.

(ii) The customer shall, within forty-five days after receipt of such list, notify the opposing party of the organization selected. A customer's failure to provide such notice shall give the opposing party the right to select an organization from the list.

(6) *Fees.* The agreement must acknowledge that the Commission registrant will pay any incremental fees that may be assessed by a qualified forum for provision of a mixed panel, unless the arbitrators in a particular proceeding determine that the customer has acted in bad faith in initiating or conducting that proceeding.

(7) *Cautionary Language.* The agreement must include the following language printed in large boldface type:

THREE FORUMS EXIST FOR THE RESOLUTION OF COMMODITY DISPUTES: CIVIL COURT LITIGATION, REPARATIONS AT THE COMMODITY FUTURES TRADING COMMISSION (CFTC) AND ARBITRATION CONDUCTED BY A SELF-REGULATORY OR OTHER PRIVATE ORGANIZATION.

THE CFTC RECOGNIZES THAT THE OPPORTUNITY TO SETTLE DISPUTES BY ARBITRATION MAY IN SOME CASES PROVIDE MANY BENEFITS TO CUSTOMERS, INCLUDING THE ABILITY TO OBTAIN AN EXPEDITIOUS AND FINAL RESOLUTION OF DISPUTES WITHOUT INCURRING SUBSTANTIAL COSTS. THE CFTC REQUIRES, HOWEVER, THAT EACH CUSTOMER INDIVIDUALLY EXAMINE THE RELATIVE MERITS OF ARBITRATION AND THAT YOUR CONSENT TO THIS ARBITRATION AGREEMENT BE VOLUNTARY.

BY SIGNING THIS AGREEMENT, YOU: (1) MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW; AND (2) ARE AGREEING TO BE BOUND BY ARBITRATION OF ANY CLAIMS OR COUNTERCLAIMS WHICH YOU OR [NAME] MAY SUBMIT TO ARBITRATION UNDER THIS AGREEMENT. YOU ARE NOT, HOWEVER, WAIVING YOUR RIGHT TO ELECT INSTEAD TO PETITION THE CFTC TO INSTITUTE REPARATIONS PROCEEDINGS UNDER SECTION 14 OF THE COMMODITY EXCHANGE ACT WITH RESPECT TO ANY DISPUTE THAT MAY BE ARBITRATED PURSUANT TO THIS AGREEMENT. IN THE EVENT A DISPUTE ARISES, YOU WILL BE NOTIFIED IF [NAME] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION. IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXCHANGE ACT IS INVOLVED AND IF YOU PREFER TO REQUEST A SECTION 14 ''REPARATIONS'' PROCEEDING BEFORE THE CFTC, YOU WILL HAVE 45 DAYS FROM THE DATE OF SUCH NOTICE IN WHICH TO MAKE THAT ELECTION.

YOU NEED NOT SIGN THIS AGREEMENT TO OPEN OR MAINTAIN AN ACCOUNT WITH [NAME]. SEE 17 CFR 166.5.

(d) *Enforceability.* A dispute settlement procedure may require parties utilizing such procedure to agree, under applicable state law, submission agreement or otherwise, to be bound by an award rendered in the procedure, provided that the agreement to submit the claim or grievance to the procedure was made in accordance with paragraph (c) of this section or that the agreement to submit the claim or grievance was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(e) *Time limits for submission of claims.* The dispute settlement procedure established by a contract market, recognized futures exchange or derivatives transaction facility shall not include any unreasonably short limitation period foreclosing submission of customers' claims or grievances or counterclaims.

(f) *Counterclaims.* A procedure established by a contract market, recognized futures exchanges or derivatives transaction facility under the Act for the settlement of customers' claims or grievances against a member or employee thereof may permit the submission of a counterclaim in the procedure by a person against whom a claim or grievance is brought. The contract market, recognized futures exchanges or derivatives transaction facility may permit such a counterclaim where the counterclaim arises out of the transaction or occurrence that is the subject of the customer's claim or grievance and does not require for adjudication the presence of essential witnesses, parties or third persons over whom the contract market, recognized futures exchanges or derivatives transaction facility does not have jurisdiction. Other counterclaims are permissible only if the customer agrees to the submission after the counterclaim has arisen, and if the aggregate monetary value of the counterclaim is capable of calculation.

Issued in Washington, DC on June 8, 2000, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 00–14915 Filed 6–21–00; 8:45 am]

BILLING CODE 6351–01–U

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 39

RIN 3038–AB57

A New Regulatory Framework for Clearing Organizations

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed Rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission) is proposing a new Part 39 of its rules that would apply to clearing organizations, as defined in the proposed rules. This proposal, centered on broad, flexible, core principles, is part of an initiative described in separate companion releases published in this edition of the **Federal Register** proposing a new regulatory framework applicable to multilateral transaction execution facilities and market intermediaries, in addition to clearing organizations. These notices propose far-reaching and fundamental changes to modernize Federal regulation of commodity futures and option markets.

DATE: Comments must be received by August 7, 2000.

ADDRESSES: Comments should be sent to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581, attention: Office of the Secretariat. Comments may be sent by facsimile transmission to (202) 418–5521 or, by e-mail to secretary@cftc.gov. Reference should be made to ''clearing organizations reinvention.''

FOR FURTHER INFORMATION CONTACT: Paul M. Architzel, Chief Counsel, Division of Economic Analysis, Alan L. Seifert, Deputy Director, Division of Trading and Markets, or Lois J. Gregory, Special Counsel, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581. Telephone (202) 418–5260 or e-mail [PArchitzel@cftc.gov], [ASeifert@cftc.gov], or [LGregory@cftc.gov].

SUPPLEMENTARY INFORMATION: