

(4) A fit of 0.0000 to -0.0018 inch must be achieved. No fretting is allowed on the impeller after machining.

(5) Due to previous fretting, an impeller with a -1 coupling removed might have to be machined for a -3 coupling. Plating of the impeller ID is not allowed.

(6) Fluorescent penetrant inspect the impeller.

(7) Install a new compressor adaptor coupling, P/N 23076559-2 or -3; or

(8) If a new impeller is installed, then install compressor adaptor coupling, P/N 23076559-1.

(9) Heating of the impeller per the engine overhaul manual is required to install the coupling to achieve the target fit specified in the following Table 3:

TABLE 3.—IMPELLER-TO-COUPLING TARGET FIT

Impeller ID	New Adaptor	Adaptor OD	Fit (Interference)
(i) 0.900 to 0.899 inch .....	23076559-1 .....	0.9000 to 0.9008 inch .....	0.0000 to -0.0018 inch.
(ii) 0.902 to 0.901 inch .....	23076559-2 .....	0.9020 to 0.9028 inch .....	0.0000 to -0.0018 inch.
(iii) 0.904 to 0.903 inch .....	23076559-3 .....	0.9040 to 0.9048 inch .....	0.0000 to -0.0018 inch.

#### Definition

(j) For the purposes of this AD, next access is defined as when the compressor module is separated from the engine and disassembled for any reason.

#### Alternative Methods of Compliance

(k) The Manager, Los Angeles Aircraft Certification Office, has the authority to approve alternative methods of compliance for Alcor, EXTEX, and SAP adaptor couplings addressed in this AD if requested using the procedures found in 14 CFR 39.19. The Manager, Chicago Aircraft Certification Office, has the authority to approve alternative methods of compliance for RRC adaptor couplings addressed in this AD if requested using the procedures found in 14 CFR 39.19.

#### Material Incorporated by Reference

(l) None.

#### Related Information

(m) Alcor SLB No. 814-3-1, Revision C, dated April 28, 2004, EXTEX Alert Service Bulletin T-081, Revision B, dated May 4, 2004, and RRC CEB-A-1392 and CEB-A-1334, dated September 9, 2003, pertain to the subject of this AD.

Issued in Burlington, Massachusetts, on June 25, 2004.

Jay J. Pardee,

Manager, Engine and Propeller Directorate,  
Aircraft Certification Service.

[FR Doc. 04-14945 Filed 6-30-04; 8:45 am]

BILLING CODE 4910-13-P

including the addition of guidance on contract market block trading rules. The Commission is proposing these rule amendments and requesting comment as part of its continuing efforts to update its regulations in light of the Commodity Futures Modernization Act of 2000 ("CFMA").

**DATES:** Comments must be received by August 30, 2004.

**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](mailto:secretary@cftc.gov). Reference should be made to "Proposed Rules for Trading Off the Centralized Market." Comments may also be submitted by connecting to the Federal eRulemaking Portal at <http://www.regulations.gov> and following comment submission instructions.

**FOR FURTHER INFORMATION CONTACT:** Riva Spear Adriance, Associate Deputy Director for Market Review, Division of Market Oversight, Commodity Futures Trading Commission, Three Lafayette Center, 1155 21st Street, NW., Washington, DC 20581. Telephone 202-418-5494; e-mail [radriance@cftc.gov](mailto:radriance@cftc.gov).

#### SUPPLEMENTARY INFORMATION:

#### I. Background

Commission Regulation Section 1.38 (17 CFR 1.38) sets forth a requirement that all purchases and sales of a commodity for future delivery or a commodity option on or subject to the rules of a designated contract market ("DCM") should be executed by open and competitive methods. This "open and competitive" requirement is modified by a proviso that allows transactions to be executed in a "non-competitive" manner if the transaction is in compliance with DCM rules specifically providing for the non-competitive execution of such transactions, and such rules have been

submitted to, and approved by, the Commission.

Since Regulation 1.38 was promulgated,<sup>1</sup> the CFMA was enacted.<sup>2</sup> Federal regulation of commodity futures and option markets was significantly changed by the CFMA, which replaced "one-size-fits-all" regulation with broad, flexible core principles.<sup>3</sup> At the same time, the CFMA modified Section 3 of the Act, such that the purpose of the Act is now, among other things, "to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this Act and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets \* \* \*"<sup>4</sup> The CFMA also specifically expanded the types of transactions that could lawfully be executed off the centralized market. Specifically, the CFMA permits DCMs to establish trading rules that: (1) Authorize the exchange of futures for swaps; or (2) allow a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of a contract market or derivatives clearing organization.<sup>5</sup>

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Parts 1 and 38

#### Execution of Transactions: Regulation 1.38 and Guidance on Core Principle 9

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed rules.

**SUMMARY:** The Commodity Futures Trading Commission ("Commission" or "CFTC") is proposing a number of amendments to its rules concerning trading off the centralized market,

<sup>1</sup> Regulation 1.38 was originally adopted in 1953 by the Commodity Exchange Authority, the predecessor of the Commission. See 18 FR 176 (Jan. 19, 1953). For subsequent amendments, see 31 FR 5054 (Mar. 29, 1966), 41 FR 3191 (Jan. 21, 1976, eff. Feb. 20, 1976), and 46 FR 54500 (Nov. 3, 1981, eff. Dec. 3, 1981).

<sup>2</sup> Pub. L. 106-554, 114 Stat. 2763 (2000). Under the CFMA, such rules may be effected by the certification procedures set forth in section 5c(c) of the Act and 40.6 of the Commission's regulations.

<sup>3</sup> The CFMA was intended, in part, "to promote innovation for futures and derivatives." See § 2 of the CFMA. It was also intended "to reduce systemic risk," and "to transform the role of the [Commission] to oversight of the futures markets." *Id.*

<sup>4</sup> 7 U.S.C. 5 (2000).

<sup>5</sup> See section 7(b)(3) of the Act.

The Commission promulgated regulations implementing provisions of the CFMA relating to trading facilities in 2001, which established procedures relating to trading facilities, interpreted certain of the CFMA's provisions and provided guidance on compliance with various of its requirements.<sup>6</sup> Later, the Commission promulgated amendments to those regulations in response to issues that had arisen in administering the rules, noting that the Commission would consider "additional amendments to the rules implementing the CFMA based upon further administrative experience."<sup>7</sup> Consistent with that rationale, the Commission now proposes to amend: (i) Commission Regulation 1.38; and (ii) Commission guidance concerning Core Principle 9 as it relates to Commission Regulation 1.38, to include changes that the Commission believes necessary based upon its experience administering those provisions.<sup>8</sup>

## II. Discussion of the Proposed Rule Amendment and Guidance

### A. Proposed Amendments to Regulation 1.38

At the time that the Commission promulgated its first rules implementing the CFMA, it retained Regulation 1.38 as applicable to DCMs. The Commission now proposes to rearrange and amend Regulation 1.38 in light of further consideration of the implications of the CFMA and administrative experience. The proposed amendments simplify the text and update the requirements of Regulation 1.38, including language specifically expanding types of transactions that may lawfully be executed off of a DCM's centralized market in accordance with the CFMA.

For instance, the Act, as amended by the CFMA, specifically allows the exchange of futures for swaps,<sup>9</sup> and since the CFMA was enacted, several DCMs have adopted rules that allow the exchange of futures for swaps,<sup>10</sup> or for another derivatives position.<sup>11</sup> The

Commission is proposing, therefore, to update the language of Regulation 1.38 by substituting the phrase "the exchange of futures for a commodity or for a derivatives position" for the phrase "the exchange of futures for cash commodities or the exchange of futures in connection with cash commodity transactions."<sup>12</sup> Furthermore, as the CFMA implemented the rule certification procedures of Section 5c(c)(1) of the Act,<sup>13</sup> the proposed changes to Regulation 1.38 would add transactions carried out pursuant to certified rules to the transactions that are allowed to be executed away from the centralized market.<sup>14</sup>

### B. Amendments to Guidance on Core Principle 9

The Commission proposes to rearrange and amend its guidance for compliance with Core Principle 9 in light of consideration of the implications of the CFMA and further administrative experience. The proposed guidance separates guidance provided for DCM transactions on the centralized market from guidance provided for DCM transactions off the centralized market. The current proposal also provides more detailed information concerning acceptable practices regarding the execution of transactions off the centralized market. Specifically, given the Commission's growing experience with markets in which block trades are permitted, this release proposes amending the guidance

("NQLX") Rule 420 (Exchange for Physical Trades) and USFE Rule 418 (Volatility ("VOLA") Trading Facility—Exchange of Futures for Options)); (ii) rules allowing for the exchange of futures over-the-counter ("OTC") derivatives (Kansas City Board of Trade ("KCBT") Rule 1129 (Exchange For Risk ("EFR") Transactions) and CBOT Rule 444.06 (Exchange of Futures for, or in Connection with, OTC Agricultural Option Transactions)); and (iii) rules allowing the exchange of futures for any derivative, by-product or related product (NYMEX Rule 6.21 (Exchange of Futures for, or in Connection with, Product)).

<sup>12</sup> The Commission observes that although this language retains the phrase "futures for [a] commodity," it does not retain the phrase "in connection with [a] commodity." The Commission also notes that the phrase "exchange of futures for a commodity or for a derivatives position" does not include elements of these exchanges. Instead, essential elements of bona fide exchange of futures trades have been provided in the guidance to Core Principle 9 below. See *infra* section III.B.4. See also proposed Appendix B(9)(b)(2)(iii) to Part 38.

<sup>13</sup> Under section 5c(c)(1) of the Act as amended by the CFMA, DCMs are allowed to implement any new rule or rule amendment, except for material changes to enumerated agricultural products, by providing a written certification to the Commission that the new rule, or rule amendment complies with this Act and the Commission's regulations.

<sup>14</sup> See proposed Regulation 1.38(b). Current Regulation 1.38 limits transactions that can be executed away from the centralized market to those transactions carried out pursuant to rules approved by the Commission.

to provide more detail regarding acceptable block trading rules. Additionally, the proposed guidance describes under what circumstances the exchange rules can permit arm's length block trades between affiliated parties.

### 1. General Guidance

Current Commission Regulation 1.38(b) provides that every person handling, executing, clearing, or carrying trades, transactions or positions that are not competitively executed, must identify and mark by appropriate symbol or designation all such transactions or contracts and all associated orders, records, and memoranda. As well as updating the language of Regulation 1.38(b), the proposed amendments add this requirement to the guidance under Core Principle 9, to provide consolidated guidance regarding recordkeeping practices pertaining to transactions off the centralized market.

The guidance for Core Principle 9 also addresses the testing and review of automated trading systems. Currently, the guidance states that acceptable testing of automated systems should be "objective," and calls for the provision of "objective" test results.<sup>15</sup> The proposed guidance would also call for the provision to the Commission of test results of any "non-objective" testing carried out by or for a DCM (*i.e.*, in-house reviews) regarding the system functioning capacity or security of any automated trading systems. Although the results of "non-objective" testing would be of more limited use, the Commission believes that test results of any "non-objective" testing carried out by or for the DCM should also be provided to the Commission.

### 2. Block Trade Rules

The Commission is proposing to provide guidance to DCMs with respect to their rules for block transactions. The guidance provides block trade standards that would be acceptable to the Commission. These acceptable block trade standards adopt elements of block trade rules previously approved by the Commission. For example, under proposed Appendix B(9)(b)(2)(ii)(B) to Part 38, block trade parties generally are required to be eligible contract participants ("ECPs"), although commodity trading advisors ("CTA") and investment advisors having over \$25 million in assets under management<sup>16</sup> are allowed to carry out

<sup>15</sup> Appendix B (a)(1)(iii) and (b)(1)(ii)(B), both to Part 38.

<sup>16</sup> Including foreign persons performing equivalent roles.

<sup>6</sup> See 66 FR 14262 (Mar. 9, 2001) and 66 FR 42256 (Aug. 10, 2001).

<sup>7</sup> See 67 FR 20702 (Apr. 26, 2002) and 67 FR 62873 (Oct. 9, 2002).

<sup>8</sup> Core Principle 9 (7 U.S.C. 5(d)(9) (Execution of transactions)) states that "The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions."

<sup>9</sup> See section 5(b)(3) of the Act (7 U.S.C. 7(b)(3)).

<sup>10</sup> See, e.g., (Chicago Board of Trade ("CBOT") Rule 444.04, INET Futures Exchange, LLC ("INET") Rule 606, Merchants Exchange ("ME") Rule 418(b), New York Board of Trade ("NYBOT") Rule 4.13, New York Mercantile Exchange, Inc. ("NYMEX") Rule 6.21A and U.S. Futures Exchange, LLC ("USFE") Rule 417.

<sup>11</sup> See, e.g., (i) rules allowing the exchange of futures for options NQLX LLC Futures Exchange

block trades for non-ECP customers. The Commission originally approved a comparable requirement in CX and Chicago Mercantile Exchange ("CME") block-trading rules.<sup>17</sup>

Under proposed Appendix B(9)(b)(2)(ii)(A) to Part 38, a DCM must determine a minimum size for block transactions. An acceptable minimum size would be no smaller than the customary size of large transactions in any relevant markets.<sup>18</sup> Aggregation of orders for different accounts in order to satisfy the minimum size requirement would be prohibited except in appropriate circumstances.<sup>19</sup> Under the proposal, the aggregation of orders would be acceptable only if done by certain registered persons having discretion to trade customer accounts.<sup>20</sup>

A majority of exchanges that permit block trading prohibit persons from effecting block trades on behalf of customers unless the person receives a customer's explicit instruction or prior consent to do so.<sup>21</sup> The proposed guidance incorporates this prohibition as an acceptable practice.

Under the proposed guidance, acceptable block trade rules would require parties to, and members

facilitating, a block trade to keep appropriate records.<sup>22</sup> Appropriate block trade records would comply with the requirements of Core Principle 10 and Core Principle 17. Records kept in accordance with the requirements of Statement No. 133 ("Accounting for Derivative Instruments and Hedging Activities"), issued by the Financial Accounting Standards Board ("FASB"), would be satisfactory.<sup>23</sup> Acceptable block trade rules would require that block orders be recorded by the member and time-stamped with both the time the order was received by the member and the time the order was executed. This guidance is based on CME and USFE block trading rules that have been approved by the Commission.<sup>24</sup> When requested during an investigation, parties to, and members facilitating, a block trade should provide records to document that the block trade is executed in accordance with contract market rules.

Proposed Appendix B(9)(b)(2)(ii)(F) to Part 38 requires reporting of the block trade to the DCM within a reasonable period of time once the transaction is executed. Reporting periods previously approved by the Commission, when executed under comparable circumstances, would be considered reasonable time periods for reporting a block transaction to the DCM.<sup>25</sup>

The proposed guidance also identifies publication of block trade details by DCMs immediately upon receipt of block trade reports as an acceptable practice.<sup>26</sup> This proposed acceptable

practice would also require the DCM to identify block trades on its trade register.<sup>27</sup>

Under the proposed guidance, acceptable block trade rules would require that the block trades be at a price that is fair and reasonable.<sup>28</sup> Consideration of whether a block transaction price is fair and reasonable could take into account: (i) The size of the block; and (ii) the price and size of other trades in any relevant markets at the applicable time, or the circumstances of the market or the parties to the block trade.<sup>29</sup> Relevant markets could include, without limitation, the DCM itself, the underlying cash markets and/or other related futures markets.

If a DCM rule requiring a fair and reasonable price included the "circumstances" of the parties or of the market within its parameters, a block trade participant could execute a block transaction at a price that was away from the market provided that the participant retained documentation to demonstrate that the price was indeed fair and reasonable under the participant's legitimate trading objectives or the market's particular circumstances. Analysis of whether a block trade price outside the bid/ask spread or prices of contemporaneous transactions in the futures market is fair and reasonable, however, should consider how the block trade price reflects commercial realities. A price that is away from any market may raise suspicion concerning the legitimacy of the trade.

As a result, inclusion of the "circumstances" of the parties or of the market within the parameters of the fair and reasonable price guidance provides flexibility to market participants while allowing the DCM to later review the price of the block trade, as the exchange would have the ability to obtain trade participant documentation if necessary.

### 3. Block Trades Between Affiliated Parties

Under the proposed guidance, acceptable block trade rules would

and USFE block trading rules. This is also an element of compliance with Designation Criterion 3 (Fair and Equitable Trading) and Core Principle 8 (Daily Publication of Trading Information).

<sup>17</sup> Proposed Appendix B(9)(b)(2)(ii)(H) to Part 38.

<sup>18</sup> Proposed Appendix B(9)(b)(2)(ii)(I) to Part 38.

<sup>19</sup> A similar "fair and reasonable" price parameter is found in Commission memoranda on block trading, in versions of Part 38 regulations adopted prior to the passage of the CFMA (*see* 65 FR 77962, *see also* 65 FR 82272 (withdrawing regulations due to enactment of the CFMA)) as well as current CBOT, CFE, CME, and NYBOT block trading rules, Rules 331.05(b), 415(c), 526.D., 4.31(a)(iii), respectively.

<sup>17</sup> *See* CX Rule 305-A and CME Rule 523. CX's and CME's original block trade rules both called for the CTA or investment advisor to have \$50 million in assets under management. Subsequently, CME submitted a rule change that lowered the amount of assets required to be under management to \$25 million for CTAs and investment advisors. This requirement is currently found in CME, CBOE Futures Exchange ("CFE"), CBOT, NYBOT, OneChicago Futures Exchange ("OCX") and USFE block trading rules (Rules: 523(I), 415(a)(ii), 331.05(c), 4.31, 417(ii) and 415(b); all respectively). Although BTEX trading operations have been suspended, its block trading rules also included this requirement. This requirement is not included in NQLX and INET block trading rules (Rules 419(a) and 704(a), respectively), as those rules limit block trades to members and wholesale customers.

<sup>18</sup> *See* proposed Appendix B(9)(b)(2)(ii)(A) to Part 38.

<sup>19</sup> *See* proposed Appendix B(9)(b)(2)(ii)(C) to Part 38.

<sup>20</sup> Appropriate registered persons include a CTA registered pursuant to section 4m of the Act, or a principal thereof, including any investment advisor who satisfies the criteria of § 4.7(a)(2)(v) of this chapter, or a foreign person performing a similar role or function and subject as such to foreign regulation, where such CTA, investment advisor or foreign person has more than \$25,000,000 in total assets under management. This requirement is currently found in CME, CBOT, CFE, NYBOT, OCX and USFE block trading rules (Rules: 523(I), 331.05(c), 415(a)(ii), 4.31(a)(i), 417(ii) and 415(f); all respectively)). BTEX and CX block trading rules also included this requirement. INET Rule 704(c) and NQLX Rule 419(c)(2) each include a similar rule that allows aggregation only for advisers with discretion over multiple discretionary accounts of appropriate customers ("wholesale customers" or "block trader" respectively).

<sup>21</sup> *See* CME Rule 526(C), CFE Rule 415(a)(i), CBOT Rule 331.05(a), NYBOT Rule 4.31(a)(ii)(A), OCX Rule 417(a)(i), and USFE Rule 415(c). BTEX's block trading rules also tracked this requirement.

<sup>22</sup> Proposed Appendix B(9)(b)(2)(ii)(E) to Part 38.

<sup>23</sup> FASB Statement No. 133 provides guidance on the use of accounting for corporate hedge activity involving derivative transactions. The statement includes guidance on documenting the hedging relationship.

<sup>24</sup> Rules 536.A and 415(c), respectively. BTEX block trading rules also tracked this requirement.

<sup>25</sup> Currently, NYBOT block trading rule requires reporting of block trades within two minutes. *See* Rule 4.31(a)(v). CBOT, CME (generally), and INET rules require reporting of a block trade within five minutes, although CME allows 15 minutes for reporting block trades in Eurodollars. *See* Rules 331.05(d), 526.F., and 704(e)(iv), respectively. NQLX rules require reporting of a block trade to the DCM within eight minutes. *See* Rule 419(g)(2). The OCX rule, in comparison, requires that parties report the block trade "without delay" and also prohibits carrying out offsetting trades until after the block trade has been reported to and disseminated by the exchange. *See* Rules 417(e) and (f). Finally, the USFE rule requires that the block trade buyer enter the details of the block trade into the USFE trading system immediately upon agreement to enter into the trade, to which the seller must respond within 15 minutes confirming the block transaction on the electronic trading system. *See* Rule 415(h). By the seller's confirmation of the block transaction on the trading system, USFE is immediately, and automatically, notified of the block trade.

<sup>26</sup> Proposed Appendix B(9)(b)(2)(ii)(G) to Part 38. *See also*, CME, CFE, CBOT, INET, NYBOT, OCX

require that block trades be arm's length transactions.<sup>30</sup> For exchanges that desire to allow block trading between affiliated parties, however, the proposed Appendix B(9)(b)(2)(ii)(f) to Part 38, would also provide guidance on acceptable rules for affiliate block trades, which when carried out consistent with the guidance would be presumed to be arm's length transactions. Specifically, the proposed guidance provides that block transactions between parties that have an arm's length organizational structure will be presumed to be at arm's length. Under the guidance, an "arm's length organizational structure" is one in which the counterparties (whether affiliated or not), each have a separate account controller, with its own responsibility to review and evaluate the terms and conditions and the potential risks and benefits of prospective transactions. Alternatively, block transactions between affiliated parties will be presumed to be at arm's length if they are executed during trading hours and are carried out at an arm's length price, as provided by the guidance.<sup>31</sup>

In addition to the requirements previously discussed, acceptable DCM rules for affiliate block trades would require: (i) Execution during the contract's trading hours; (ii) transaction prices that fall within the bid/ask spread on electronic trading systems or prices of contemporaneous related trading floor transactions, although if the contract does not have a bid/ask spread or any floor transactions at the time of the block transaction, then the contemporaneous bid/ask spread or price of transactions on related futures or cash markets could be used; and (iii) identification of the trade on the order ticket and to the DCM as a trade that was between affiliated parties.

The proposed price parameters for affiliate block trades (a prevailing bid-ask spread or price of contemporaneous related floor transactions) would be a narrower subset of the fair and reasonable price parameter proposed for block trades between parties that are not affiliated.<sup>32</sup> Block transactions between affiliated parties raise concerns that such block trades may be susceptible to abuse. Under the Commission's proposal, only block trade prices between affiliated parties that fall within a price parameter using concrete prices (contemporaneous bid-ask spread

or prices in contemporaneous market(s)) would be assumed to be at arm's length. Such a pricing parameter provides an objective method for determining whether the price of an affiliated party block trade was fairly negotiated and absent any pricing abuse, and, consequently, warranting a presumption that the block trade was carried out at arm's length.

The Commission expects that the proposed guidance will benefit DCMs that are interested in allowing affiliate block transactions, as well as participants that desire to take advantage of such rules as the guidance provides participants with alternative means to comply with the requirement that block transactions be carried out at arm's length.<sup>33</sup> Affiliate block trades that are not carried out according to this guidance could be subject to greater scrutiny. Such scrutiny would not be based on a presumption of illegitimacy, but on lack of information about the trade. Firms that execute affiliate block transactions outside of the guidance, therefore, should preserve records (in addition to those they are required to keep in any event) in order to answer any questions regarding the trade.

#### 4. Exchange of Futures for a Commodity or for a Derivatives Position

The essential elements of bona fide exchange of futures trades have been provided in the guidance to Core Principle 9 below.<sup>34</sup> The elements proposed are found in current contract market EFP, EFS, EFR and EFO rules and are based on the essential elements for bona fide EFPs detailed in the 1987 EFP Report prepared by the Commission's then Division of Trading and Markets.<sup>35</sup> The elements include separate but integrally related transactions, an actual transfer of ownership of the commodity or derivatives position, and both legs transacted between the same two parties. The Commission notes that the determination whether an actual transfer of ownership has occurred will depend upon the facts and circumstances of each transaction. In each instance where an exchange of futures for a commodity or for a

derivatives position is linked to another offsetting transaction, the particular facts and circumstances may warrant a determination that there was not an actual ownership transfer of each leg of the commodity or derivatives position.

## IV. Related Matters

### A. Regulatory Flexibility Act

The Regulatory Flexibility Act<sup>36</sup> requires federal agencies, in proposing rules, to consider the impact of those rules on small businesses. The rule amendments adopted herein will affect DCMs, FCMs, CTAs and large traders. 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.<sup>37</sup> The Commission has previously determined that DCMs,<sup>38</sup> registered FCMs,<sup>39</sup> and large traders<sup>40</sup> are not small entities for the purpose of the RFA. With respect to CTAs, the Commission has determined to evaluate within the context of a particular rule proposal whether CTAs would be considered "small entities" for purposes of the Regulatory Flexibility Act and, if so, to analyze the economic impact on the affected entities of any such rule at that time.<sup>41</sup> The Commission believes that the instant proposed rules will not place any new burdens on entities that would be affected hereunder, and the Commission does not expect the proposed amendments to cause persons to change their current methods of doing business in most cases. This is because requirements under the instant proposal, if adopted, would be similar to most existing DCM requirements.

Accordingly, the Commission does not expect the rules, as proposed herein, to have a significant economic impact on a substantial number of small entities. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed amendments will not have a significant economic impact on a substantial number of small entities. The Commission invites the public to comment on this finding and on its proposed determination that the trading facilities covered by these rules would not be small entities for purposes of the Regulatory Flexibility Act.

<sup>33</sup> See proposed Appendix B(9)(b)(2)(ii)(f) to Part 38.

<sup>34</sup> See proposed Appendix B(9)(b)(2)(iii) to Part 38.

<sup>35</sup> See generally, Division of Trading and Markets, Report on Exchanges of Futures for Physicals (1987). See also, CBOT Rules 444.01, 444.01B, 444.04 and 444.06; CBOE Rule 414; CME Rule 538; INET Rules 705 and 706; KCBT Rules 1128.00, 1128.02, 1129.00, and 1129.02; ME Rule 418; MGE Rule 719; NQLX Rule 420; NYBOT Rules 4.12 and 4.13, NYMEX Rules 6.21, 6.21A and 6.21E, and OCX Rule 416.

<sup>36</sup> 5 U.S.C. 601 *et seq.*

<sup>37</sup> 47 FR 18618–21 (Apr. 30, 1982).

<sup>38</sup> *Id.* at 18618–19.

<sup>39</sup> *Id.* at 18619–20.

<sup>40</sup> *Id.* at 18620.

<sup>41</sup> 47 FR at 18618, 18620.

<sup>30</sup> Proposed Appendix B(9)(b)(2)(ii)(f) to Part 38.

<sup>31</sup> See proposed Appendix B(9)(b)(2)(ii)(f) to Part 38.

<sup>32</sup> See proposed Appendices B(9)(b)(2)(ii)(f)(2) and B(9)(b)(2)(ii)(f) to Part 38.

### B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. The proposed rule amendments do not require a new collection of information on the part of any entities subject to these rules. Accordingly, for purposes of the Paperwork Reduction Act of 1995, the Commission certifies that these rule amendments do not impose any new reporting or recordkeeping requirements.

### C. Cost-Benefit Analysis

Section 15 of the Act, as amended by section 119 of the CFMA, requires the Commission to consider the costs and benefits of its action before issuing a new regulation. The Commission understands that, by its terms, Section 15 does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the proposed regulation outweigh its costs. Nor does it require that each proposed regulation be analyzed in isolation when that regulation is a component of a larger package of regulations or of rule revisions. Rather, section 15 simply requires the Commission to "consider the costs and benefits" of its action.

Section 15(a) further specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern: protection of market participants and the public; efficiency, competitiveness, and financial integrity of futures markets; price discovery; sound risk management practices; and other public interest considerations. Accordingly, the Commission could, in its discretion, give greater weight to any one of the five enumerated areas of concern and could, in its discretion, determine that, notwithstanding its costs, a particular regulation was necessary or appropriate to protect the public interest, to effectuate any of the provisions, or to accomplish any of the purposes of the Act.

The proposed amendments constitute a package of amendments to Regulation 1.38 and to guidance that the Commission originally promulgated to implement the CFMA. The amendments are proposed in light of past experience with the implementation of the CFMA, and are intended to facilitate increased flexibility and consistency. Some sections of the proposed amendments merely clarify or make explicit past Commission decisions concerning transactions off the centralized market.

As most provisions incorporate rules previously approved by the Commission, the proposed amendments would not, in most cases, impose new costs on DCMs or market participants. Most current DCM rules already meet the acceptable practices proposed, furthermore, these amendments incorporate standards that the Commission has previously determined protect market participants and the public,<sup>42</sup> the financial integrity or price discovery function of the markets, and sound risk management practices. Moreover, the additional clarification of acceptable practices provides a benefit to markets and market participants. In addition, the amendments are expected to benefit efficiency and competition by providing more detailed guidance as to acceptable means of meeting the applicable designation criteria and core principles, allowing a greater degree of legal certainty to the markets and market participants.

After considering the five factors enumerated in the Act, the Commission has determined to propose the rules and rule amendments set forth below. The Commission invites public comment on its application of the cost-benefit provision. Commenters also are invited to submit any data that they may have quantifying the costs and benefits of the proposed rules with their comment letters.

### List of Subjects in 17 CFR Parts 1 and 38

Block transactions, Commodity futures, Contract markets, Transactions off the centralized market, Reporting and recordkeeping requirements.

In consideration of the foregoing, the Commission hereby proposes to amend 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.

2. Section 1.38 is proposed to be revised to read as follows:

#### § 1.38 Execution of transactions.

(a) *Transactions on the centralized market.* All purchases and sales of any commodity for future delivery, and of any commodity option, on or subject to the rules of a contract market, shall be executed openly and competitively by

open outcry, or posting of bids and offers, or by other equally open and competitive methods, in a place provided by the contract market, during the regular hours prescribed by the contract market for trading in such commodity or commodity option.

(b) *Trades off the centralized market; requirements.* Notwithstanding paragraph (a) of this section, transactions may be executed away from a centralized market, including by transfer trades, office trades, block trades, or trades involving the exchange of futures for a commodity or for a derivatives position, if transacted in accordance with written rules of a contract market that provide for execution away from the centralized market and that have been certified to or approved by the Commission. Every person handling, executing, clearing, or carrying the trades, transactions or positions described in this paragraph shall comply with the rules of the appropriate contract market and derivatives clearing organization, including to identify and mark by appropriate symbol or designation all such transactions or contracts and all orders, records, and memoranda pertaining thereto.

### PART 38—DESIGNATED CONTRACT MARKETS

3. The authority section for Part 38 continues to read as follows:

**Authority:** 7 U.S.C. 2, 5, 6, 6c, 7 and 12a, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106-554, 114 Stat. 2763 (2000).

4. In Appendix B to Part 38 Core Principle 9 is proposed to be revised to read as follows:

#### Appendix B to Part 38—Guidance on, and Acceptable Practices in, Compliance With Core Principles

\* \* \* \* \*

Core Principle 9 of section 5(d) of the Act: EXECUTION OF TRANSACTIONS—The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions.

(a) Application guidance—(1) Transactions on the centralized market. (i) All purchases and sales of any commodity for future delivery, and of any commodity option, on or subject to the rules of a contract market shall be executed openly and competitively by open outcry, or posting of bids and offers, or by other equally open and competitive methods, in a place provided by the contract market, during the regular hours prescribed by the contract market for trading in such commodity or commodity option.

(ii) A competitive and open market and mechanism for executing transactions includes a board of trade's methodology for entering orders and executing transactions.

<sup>42</sup> See, e.g. proposed Appendix B(9)(b)(2)(ii)(B) to Part 38. See also, *supra* notes 14-15 and accompanying text.

(iii) Appropriate objective testing and review of a contract market's automated systems should occur initially and periodically to ensure proper system functioning, adequate capacity and security. A designated contract market's analysis of its automated system shall address compliance with appropriate principles for the oversight of automated systems, ensuring proper system functionality, adequate capacity and security.

(2) *Transactions off the centralized market.*

(i) Transactions may be executed off the centralized market if transacted in accordance with written rules of a contract market that have been certified to or approved by the Commission and that specifically provide for execution of such transactions away from the centralized market.

(ii) Every person handling, executing, clearing, or carrying the trades, transactions or positions that are not executed on the centralized market, including transfer trades, office trades, block trades, or trades involving the exchange of futures for a commodity or for a derivatives position, shall comply with the rules of the applicable designated contract market and derivatives clearing organization.

(iii) A designated contract market that determines to allow trades off the centralized market shall ensure that such trading does not operate in a manner that compromises the integrity of prices or price discovery on the centralized market.

(b) Acceptable practices—(1) Matters relating to trade execution facilities. (i) *General provisions.* [Reserved]

(ii) *Electronic trading systems.* (A) The guidelines issued by the International Organization of Securities Commissions (IOSCO) in 1990 (which have been referred to as the "Principles for Screen-Based Trading Systems"), and adopted by the Commission on November 21, 1990 (55 FR 48670), as supplemented in October 2000, are appropriate guidelines for a designated contract market to apply to electronic trading systems.

(B) Any objective testing and review of the system should be performed by a qualified independent professional. A professional that is a certified member of the Information Systems Audit and Control Association experienced in the industry is an example of an acceptable party to carry out testing and review of an electronic trading system.

(C) Information gathered by analysis, oversight, or any program of testing and review of any automated systems regarding system functioning, capacity and security must be made available to the Commission upon request.

(iii) *Pit trading.* [Reserved]

(2) Transactions off the centralized market—(i) *General provisions.* (A) Types of allowable trades off the centralized market. Acceptable transactions off the centralized market include: transfer trades, office trades, block trades, or trades involving the exchange of futures for a commodity or for a derivatives position, if transacted in accordance with written rules of a contract market appropriately providing for execution away from the centralized market, that have

been certified to or approved by the Commission.

(B) *Reporting.* Acceptable contract market rules would require reporting of transactions off the centralized market to the contract market within a reasonable period of time.

(C) *Publication.* Acceptable contract market rules would require the contract market to publicize details about transactions off the centralized market immediately upon the receipt of the transaction report.

(D) *Trade register.* Acceptable contract market rules would require the contract market to identify transactions off the centralized market on its trade register.

(E) *Recordkeeping.* Acceptable contract market rules would require parties to, and members facilitating, transactions off the centralized market to keep appropriate records. Appropriate records for transactions off the centralized market would comply with Core Principle 10 and Core Principle 17.

(F) *Identification of trades.* Section 1.38(b) of this chapter establishes the guidance regarding the identification of all trades off the centralized market. It requires contract market rules to require every person handling, executing, clearing, or carrying trades, transactions or positions that are executed off the centralized market, including transfer trades, office trades, block trades or trades involving the exchange of futures for a commodity or for a derivatives position, to identify and mark by appropriate symbol or designation all such transactions or contracts and all orders, records, and memoranda pertaining thereto.

(ii) *Block transactions.* (A) Include an acceptable minimum block size. An acceptable minimum block size would be no smaller than the customary size of large transactions in any relevant markets. A "large" transaction is one that may affect the quality of the transaction price due to the significant impact of such a large order on the centralized market. An acceptable minimum block size, for example, would be a transaction size that is greater than 90 percent of the trades in a relevant market. The relevant market should be the subject futures or options market, any related derivatives market, and/or the underlying cash market, as appropriate. If a contract market chooses to allow block participants to meet the minimum block size requirement by aggregating the component legs of a spread or combination position executed as a block trade, the acceptable size for each leg should be the size of a large transaction in the relevant market (that is, a size that is greater than 90 percent of the trades in the relevant market). For markets where transaction data in the relevant market(s) are unavailable, inadequate to conduct an analysis, or for markets where there is no underlying cash market, an acceptable minimum block size should be set initially at 100 contracts and adjusted thereafter as transaction data in the relevant market(s) become available.

(B) *Restrict access to appropriate parties.* Acceptable block trade parties would be eligible contract participants. However, contract market rules could also allow a commodity trading advisor registered pursuant to section 4m of the Act, or a principal thereof, including any investment

advisor who satisfied the criteria of § 4.7(a)(2)(v) of this chapter, or a foreign person performing a similar role or function and subject as such to foreign regulation, to transact block trades for customers who are not eligible contract participants, if such commodity trading advisor, investment advisor or foreign person has total assets under management that exceed \$25,000,000.

(C) *Aggregation of orders.* Acceptable contract market rules would prohibit aggregation of orders for different accounts in order to satisfy the minimum size requirement except in appropriate circumstances. Aggregation of orders for different accounts in order to satisfy the minimum size requirement would be acceptable if done by a commodity trading advisor registered pursuant to section 4m of the Act, or a principal thereof, including any investment advisor who satisfies the criteria of § 4.7(a)(2)(v) of this chapter, or a foreign person performing a similar role or function and subject as such to foreign regulation, where such commodity trading advisor, investment advisor or foreign person has more than \$25,000,000 in total assets under management.

(D) *Acting for a customer.* Acceptable contract market rules would prohibit a person from effecting a block trade on behalf of a customer, unless the person has received an instruction or prior consent to do so from the customer;

(E) *Recordkeeping.* Acceptable contract market rules would require parties to, and members facilitating, a block trade to keep appropriate records. Appropriate block trade records would comply with Core Principle 10 and Core Principle 17. Records kept in accordance with the requirements of FASB Statement No. 133 ("Accounting for Derivative Instruments and Hedging Activities") would be acceptable records. Block trade orders must be recorded by the member and time-stamped with both the time the order was placed and the time the order was executed, and must indicate when block trades are between affiliated parties. When requested during an investigation, parties to, and members facilitating, a block trade shall provide records to document that the block trade is executed in conformance with contract market rules.

(F) *Reporting.* Acceptable contract market rules would require reporting of the block trade to the contract market within a reasonable period of time. Reporting periods previously approved by the Commission would be considered reasonable time periods for reporting a block transaction to the contract market once the transaction is executed.

(G) *Publication.* Acceptable contract market rules would require the contract market to publicize details about the block trade immediately upon its being reported to the contract market.

(H) *Identification of trades.* Acceptable contract market rules would require the contract market to identify block trades as such on its trade register, and to identify when block trades are between affiliated parties.

(I) *Pricing.* Acceptable contract market rules would require that the block trades be

at a price that is fair and reasonable. Consideration of whether a block transaction price is fair and reasonable could take into account: (i) The size of the block; and (ii) the price and size of other trades in any relevant markets at the applicable time, and the circumstances of the market or the parties to the block trade. Relevant markets could include, without limitation, the contract market itself, the underlying cash markets and/or other related futures markets. If a contract market rule requiring a fair and reasonable price includes the "circumstances" of the parties or of the market within its parameters, a block trade participant could execute a block transaction at a price that was away from the market provided that the participant retains documentation to demonstrate that the price was indeed fair and reasonable under the participant's or market's particular circumstances.

(j) *Arm's length transactions.* Acceptable contract market rules would require that block trades be arm's length transactions. The following block trades will be presumed to be carried out at "arm's length" (1) Block trades transacted between separate counterparties (whether affiliated or not), where each counterparty has a separate account controller with its own responsibility to review and evaluate the terms and conditions and the potential risks and benefits of prospective transactions would be presumed to be carried out at "arm's length;" and (2) Block trades between affiliated parties if transacted under contract market rules that require, along with the requirements of paragraphs (b)(2)(i)(A)–(H) of this appendix: (i) execution during the contract's trading hours; and (ii) transaction prices that fall within the bid/ask spread on electronic trading systems or prices of contemporaneous related trading floor transactions, however, if the contract does not have a bid/ask spread or any floor transactions at the time of the block transaction, then the contemporaneous bid/ask spread or price of transactions on related futures or cash markets could be used.

(iii) *Exchange of futures for a commodity or for a derivatives position.* Acceptable contract market rules for exchange of futures for a commodity or for a derivatives position would require that such trades include the following elements:

(A) Separate but integrally related transactions, involving (1) the same or a related commodity; (2) price correlation of legs; and (3) quantitative equivalence;

(B) A buyer of futures who is the seller of the corresponding commodity or derivatives position and a seller of futures who is the buyer of the corresponding commodity or derivatives position; and

(C) An actual transfer of ownership, involving (1) separate parties; (2) possession, right of possession, or right to future possession of each leg prior to the trade; (3) an ability to perform; and (4) a transfer of title.

(iv) *Office trades.* [Reserved]

(v) *Transfer trades.* [Reserved]

\* \* \* \* \*

Issued in Washington, DC, on June 24, 2004, by the Commission.

**Jean A. Webb,**

*Secretary of the Commission.*

[FR Doc. 04–14815 Filed 6–30–04; 8:45 am]

**BILLING CODE 6357–01–P**

## DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

### 24 CFR Part 81

[Docket No. FR–4790–N–02]

**RIN 2501–AC92**

### HUD's Proposed Housing Goals for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) for the Years 2005–2008 and Amendments to HUD's Regulation of Fannie Mae and Freddie Mac Extension of Public Comment Period

**AGENCY:** Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

**ACTION:** Proposed rule; extension of comment period.

**SUMMARY:** This notice announces an extension of the public comment period on HUD's proposed rule regarding new housing goals for Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs), published on May 3, 2004. The May 3, 2004, proposed rule provided for a 60-day public comment period, which would close the public comment period on July 2, 2004. This notice advises that the public comment period has been extended to July 16, 2004.

**DATES:** Comments must be submitted on or before July 16, 2004.

**ADDRESSES:** Interested persons are invited to submit written comments regarding this proposed rule to the Regulations Division, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410. All communications should refer to the above docket number and title. Facsimile (FAX) comments and e-mail comments are *not* acceptable. A copy of each communication submitted will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address.

**FOR FURTHER INFORMATION CONTACT:** Sandra Fostek, Director, Office of Government Sponsored Enterprises, Office of Housing, Room 3150, telephone 202–708–2224. For questions on data or methodology, contact John L. Gardner, Director, Financial Institutions

Regulation Division, Office of Policy Development and Research, Room 8212, telephone (202) 708–1464. For legal questions, contact Kenneth A. Markison, Assistant General Counsel for Government Sponsored Enterprises/RESPA or Paul S. Ceja, Deputy Assistant General Counsel for Government Sponsored Enterprises/RESPA, Office of the General Counsel, Room 9262, telephone 202–708–3137. The address for all of these persons is Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410. Persons with hearing and speech impairments may access the phone numbers via TTY by calling the Federal Information Relay Service at (800) 877–8399.

**SUPPLEMENTARY INFORMATION:** On May 3, 2004 (69 FR 24228), HUD published its proposed rule that would establish new housing goals levels for the GSEs for years 2005 through 2008. The new housing goal levels are proposed in accordance with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA) and govern the purchase by Fannie Mae and Freddie Mac of mortgages financing low- and moderate-income housing, special affordable housing, and housing in central cities, and rural areas and other underserved areas. In the May 3, 2004, rule, HUD also proposed to revise the existing regulations to provide enhanced requirements to ensure GSE data integrity.

The May 3, 2004, proposed rule provided for a 60-day public comment period. In addition to the 60-day public comment period, HUD had also posted the rule on its website on April 7, 2004, in advance of publication in the **Federal Register**. In response to recent requests for additional time to submit public comments, and since the original public comment deadline coincides with the July 4th holiday weekend, HUD is announcing through this notice that it is extending the public comment period on the May 3, 2004, proposed rule for an additional two-week period. The new public comment deadline is July 16, 2004.

Dated: June 28, 2004.

**Sean G. Cassidy,**

*General Deputy Assistant Secretary for Housing.*

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