



UNITED STATES

DETAILED ASSESSMENT OF IMPLEMENTATION

As of July 31, 2019

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

SELF-ASSESSMENT PREPARED BY THE STAFF OF THE U.S. COMMODITY FUTURES TRADING COMMISSION

This self-assessment has been prepared by the staff of the Commodity Futures Trading Commission (CFTC) solely for purposes of the IMF's 2020 Financial Sector Assessment Program (FSAP) mission in the United States and should not be considered outside the FSAP context. The responses contained herein are not rules, regulations, or statements of the CFTC. Further, the CFTC has neither approved nor disapproved these responses. Accordingly, any statements or responses contained herein are not binding and should not be deemed to constitute interpretive advice by the staff of the CFTC or be used or relied upon for legal purposes. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

CONTENTS

| | |
|---|-----------|
| INTRODUCTION | 3 |
| ADDITIONAL GUIDANCE | 4 |
| LIST OF ABBREVIATIONS | 7 |
| LINKS TO DOCUMENTS AND WEBSITES..... | 10 |
| CFTC ISSUES IDENTIFIED BY IMF IN 2015 U.S. FSAP..... | 13 |
| DETAILED QUESTIONNAIRE | 14 |

INTRODUCTION

| | |
|-----------------------|---|
| Jurisdiction: | United States |
| Authority: | U.S. Commodity Futures Trading Commission |
| Date prepared: | August 8, 2019 |

1. This self-assessment questionnaire has been prepared in reference to the Methodology to assess the implementation of the IOSCO Objectives and Principles of Securities Regulation approved by IOSCO.

2. **The questionnaire covers a subset of Principles deemed relevant for the scope of the 2020 United States FSAP exercise comprising Principles 1, 2, 3, 6, 7, 9, 24-28, 29-32 (with respect specifically to market intermediaries that are direct participants in trading venues, providers of direct electronic access to such venues and/or first tier direct electronic access clients, and operators of trading venues) and 33-37.**

3. Section II provides guidance that should be taken into account when preparing the responses to the questionnaire that is particularly important for the IMF to initiate the assessment of the efficiency of supervision. Please pay particular attention to the fact that the scope of the IOSCO assessment extends beyond the primary securities regulator, if other authorities are responsible for regulating, supervising and/or enforcing any elements covered by the Principles.

4. As described in the following section III, the authorities are requested to provide detailed answers for the identified subset of Principles.

5. In your answers to the questions, please describe the content of your regulatory framework in detail and include precise references to the relevant laws, regulations and guidelines. Please also provide us with links to/PDF copies of them.

ADDITIONAL GUIDANCE

A self-assessment constitutes a critical input in the FSAP work. It provides the authorities' own evaluation of the extent to which the jurisdiction is compliant with the IOSCO Objectives and Principles of Securities Regulation. A recurrent challenge for the IMF missions has been to receive sufficient information to determine whether the legal and regulatory framework described in the corresponding principle has been implemented in practice. The table below lists the most frequent cases where additional information has been requested in the past with respect to the above-identified subset of Principles, so that the authorities can take it into consideration when preparing the responses. The provision of this information should facilitate a more effective and efficient onsite mission work and meetings with the authorities.

| Number of the Principle and Question | Useful information to include under the response to the corresponding Principle/Question |
|---|---|
| 1, Question 2(a) | <ul style="list-style-type: none"> • Please ensure that your description identifies any possible division of responsibilities in the regulation and supervision of securities markets, activities and participants on the basis of the type of security, market participant (e.g. bank vs. securities dealer/broker) between the various statutory and self-regulatory authorities. Please note that the IOSCO assessment covers also banks' securities activities, and if more than one authority is responsible for the supervision of such activities, the discussion of Principles 1-5 should cover all those authorities. In such case, you are also expected to include information on the responsibilities and activities of all those authorities in all relevant Principles (particularly 29-32). |
| 1, Question 2(b) | <ul style="list-style-type: none"> • Do other types of financial institutions offer securities like products (such as CIS-like insurance products or deposit instruments that mimic CISs/return based on market performance, etc.)? • If so, how are these other products regulated with respect to disclosure, suitability for the client, etc.? • Is the regulation that is applied equivalent to that which applies to equivalent securities products? |
| 1, Question 2(d) | <ul style="list-style-type: none"> • Reference to any MoUs between the domestic authorities and the areas that they cover. If possible include copies. • Reference to any committees between the domestic authorities, with indication of frequency of meetings, and types of issues discussed in the past. |

| | |
|--------------------------|---|
| 3, Question 2 | <ul style="list-style-type: none"> Information on the budget development of the relevant regulatory authorities, including source(s) of funding (for the last three years and any budgets or estimates available for the upcoming years). |
| 3, Question 3 | <ul style="list-style-type: none"> Information on number of staff dedicated to securities markets regulation and supervision, if possible with a breakdown by main functions (licensing, supervision of intermediaries, market surveillance, enforcement), as well as by profession. Information on average years of experience of staff at different levels of the organization, staff turnover, and competitiveness of the salaries vis-à-vis private sector |
| 7, Question 1 | <ul style="list-style-type: none"> What information does the regulator have about securities activities in the jurisdiction, including about activities that are not subject to regulation? <ul style="list-style-type: none"> <input type="checkbox"/> Is this information complete, up to date and accurate? <input type="checkbox"/> What kind of analysis/review is done on this information? |
| 9, Question 2 | <ul style="list-style-type: none"> Details on the SRO's supervision of its members, including on- and off-site examinations and enforcement activities over the past 3-5 years. |
| 9, Question 3 | <ul style="list-style-type: none"> Detailed information on the regulator's oversight program of all entities that qualify as SROs as per Principle 9, including both off-site reporting and on-site inspections. With regards to the latter, include information on the cycle of inspections and their scope/coverage. |
| 24, Question 1 a) | <ul style="list-style-type: none"> Describe the regulation of CIS only sold to sophisticated investors (non-retail or wholesale funds) and how it differs from the regulation of retail funds. |
| 24, Question 1 b) | <ul style="list-style-type: none"> Cover in your response all entities involved in the operation of a CIS, including the fund management company, asset manager, fund administrator, custodian etc. |
| 24, Questions 8 and 9 | <ul style="list-style-type: none"> For the periodic inspection plan of CIS operators, custodians and CIS: number of inspections carried out, with a breakdown by type of firm, and by type of inspection (due to regular program, and due to complaint/cause). It is important that information be included on the <u>criteria</u> used to select firms and on the frequency and scope of inspections. Thematic inspections: number and themes. It is important that information be included on the way the themes are selected. Number of sanctions imposed on fund managers during the last three years, if possible with a break down by type of misconduct |
| 26, Questions 6, 7 and 9 | <ul style="list-style-type: none"> Information on the system, if any, to review the CIS offering documents, for example whether all offering documents are reviewed or just a sample, and if only a sample, what criteria are used to select the documents that will be reviewed. Similar information should be provided for the review of periodic |

| | |
|-----------------------|--|
| | <p>reports and other disclosure documents. If such review is carried out by the exchanges or a SRO, please provide the corresponding information based on what the exchanges or SRO do.</p> <ul style="list-style-type: none"> • Information on the number of offering documents filed with the regulator in the last three years. • Number of sanctions imposed on CIS operators and others involved in the preparation of CIS disclosure documents or advertisements, if possible with a break down by type of misconduct. |
| 28, Question 1 | <ul style="list-style-type: none"> • Does the jurisdiction have a definition of hedge fund? If so, please provide it. |
| 28, Question 8 | <ul style="list-style-type: none"> • Number of inspections carried out in hedge fund managers/ advisers and/ or hedge funds (if applicable), by type of inspection (due to regular program, and due to complaint/cause). It is important that information be included on the criteria used to select firms and on the frequency and scope of inspections. |
| 31, Question 25 | <ul style="list-style-type: none"> • For the periodic inspection plan of intermediaries: number of inspections carried out, with a break down by type of intermediary, and by type of inspection (due to regular program, and due to complaint/cause). It is important that information be included on the <u>criteria</u> used to select firms and on the frequency and scope of inspections. • Thematic inspections: number and themes. It is important that information be included on the way the themes are selected. • Number of sanctions imposed on market intermediaries during the last three years, if possible with a break down by type of misconduct. |
| 32, Question 3 d) | <ul style="list-style-type: none"> • Is there a compensation fund for investors or a settlement/default fund at a clearing house? <ul style="list-style-type: none"> • What losses are covered? • Who is covered? |
| 32, Question 4 | <ul style="list-style-type: none"> • If applicable, concrete examples of how the regulator has dealt with a failure of a market intermediary. |
| 34, Question 1 | <ul style="list-style-type: none"> • Information on the oversight of exchanges and trading platforms, including both off site reporting and on-site inspections. For the latter, please include information on the frequency and scope of inspections. |
| 36, Questions 2 and 3 | <ul style="list-style-type: none"> • Information on administrative/ civil sanctions imposed during the last three years on major misconducts, such as market manipulation and insider trading. • Information on criminal sanctions imposed for major offenses, such as insider trading and market manipulation. |

LIST OF ABBREVIATIONS

- Relevant to CFTC's Response

U.S. Federal Law

| | |
|-------------------------|---|
| APA | Administrative Procedure Act |
| BHCA | Bank Holding Company Act of 1956 |
| CEA | Commodity Exchange Act |
| CFMA | Commodity Futures Modernization Act of 2000 |
| CRA | Congressional Review of Agency Rulemaking Act |
| Dodd-Frank Act | Dodd-Frank Wall Street Reform and Consumer Protection Act |
| FOIA | Freedom of Information Act |
| PRA | Paperwork Reduction Act |
| Privacy Act | Privacy Act of 1974 |
| RegFlex Act | Regulatory Flexibility Act |
| Securities Act | Securities Act of 1933 |
| Securities Exchange Act | Securities Exchange Act of 1934 |
| Sunshine Act | Government in the Sunshine Act |

CFTC Divisions and Offices

| | |
|------|--|
| DCR | Division of Clearing and Risk |
| DMO | Division of Market Oversight |
| DOE | Division of Enforcement |
| DSIO | Division of Swap Dealer and Intermediary Oversight |
| OCE | Office of the Chief Economist |
| OIG | Office of the Inspector General |

U.S. Federal Departments and Agencies

| | |
|-----------------------|--|
| CFPB | Consumer Financial Protection Bureau |
| CFTC or Commission | Commodity Futures Trading Commission |
| DOJ | Department of Justice |
| FERC | Federal Energy Regulatory Commission |
| Federal Reserve Board | Board of Governors of the Federal Reserve System |
| FCA | Farm Credit Administration |
| FDIC | Federal Deposit Insurance Corporation |
| FHFA | Federal Housing Finance Agency |

UNITED STATES

U.S. COMMODITY FUTURES TRADING COMMISSION

| | |
|-----------------------|---|
| FSOC | Financial Stability Oversight Council |
| FTC | Federal Trade Commission |
| GAO | Government Accountability Office |
| NCUA | National Credit Union Administration |
| OCC | Office of the Comptroller of the Currency |
| OMB | Office of Management and Budget |
| Prudential Regulators | Federal Reserve Board, OCC, FDIC, FHFA, and FCA |
| SEC | Securities and Exchange Commission |
| Treasury Department | Department of the Treasury |

Other Abbreviations

| | |
|------------|--|
| AICPA | American Institute of Certified Public Accountants |
| AP | Associated Person |
| BIS | Bank for International Settlements |
| CCO | Chief Compliance Officer |
| CDS | Credit Default Swaps |
| CME | Chicago Mercantile Exchange |
| Congress | U.S. Congress |
| CPO | Commodity Pool Operator |
| CTA | Commodity Trading Advisor |
| DCM | Designated Contract Market |
| DCO | Derivatives Clearing Organization |
| DSRO | Designated Self-regulatory Organization |
| ECP | Eligible Contract Participant |
| FASB | Financial Accounting Standards Board |
| FCM | Futures Commission Merchant |
| FBOT | Foreign Board of Trade |
| FINRA | Financial Industry Regulatory Authority |
| FIO | Financial Insurance Office |
| IB | Introducing Broker |
| IOSCO | International Organization of Securities Commissions |
| IOSCO MMOU | IOSCO Multilateral Memorandum of Understanding |
| ISV | Independent Software Vendor |
| MSP | Major Swap Participant |
| MLWG | Money Laundering Working Group |
| MOU | Memorandum of Understanding |
| NFA | National Futures Association |
| OFR | Office of Financial Research |
| OTC | Over-the-counter |
| PCAOB | Public Company Accounting Oversight Board |
| President | President of the United States |
| RER | Rule Enforcement Review |

| | |
|--------|--|
| RFA | Registered Futures Association |
| RFED | Retail Foreign Exchange Dealer |
| ROC | Regulatory Oversight Committee |
| SD | Swap Dealer |
| SDR | Swap Data Repository |
| SEF | Swap Execution Facility |
| Senate | U.S. Senate |
| SIDCO | Systemically Important Derivatives Clearing Organization |
| SRO | Self-regulatory Organization |
| SSE | System Safeguards Examination |

LINKS TO DOCUMENTS AND WEBSITES

| NAME | LINK | PAGE ¹ |
|--|---|-------------------|
| Commodity Exchange Act and Regulations | https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm | 14 |
| CFTC website | www.cftc.gov | 29 |
| Memorandum of Understanding between the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission Regarding Coordination in Areas of Common Regulatory Interest and Information Sharing | https://www.cftc.gov/sites/default/files/2018-07/CFTC_MOU_InformationSharing062818.pdf | 32 |
| Memorandum of Understanding Between the Commodity Futures Trading Commission and the Federal Energy Regulatory Commission Regarding Information Sharing and Treatment of Proprietary Trading and Other Information | https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/cftcfercmou2014.pdf | 33 |
| Memorandum of Understanding Between the Federal Energy Regulatory Commission and the Commodity Futures Trading Commission | https://www.cftc.gov/PressRoom/PressReleases/pr6816-14 | 33 |
| Memorandum of Understanding Between the Board of Governors of the Federal Reserve System, the U.S. Commodity Futures Trading Commission, and the U.S. Securities and Exchange Commission Regarding Central Counterparties for Credit Default Swaps | https://www.treasury.gov/resource-center/fin-mkts/Documents/finalmou.pdf | 41 |

¹ The page listed is the first time the link or website is referenced.

| | | |
|--|---|-----|
| CFTC, Office of the Inspector General website | http://www.cftc.gov/About/OfficeoftheInspectorGeneral/index.htm | 46 |
| "Learn & Protect," CFTC consumer protection and education | https://www.cftc.gov/ConsumerProtection/index.htm | 58 |
| Copies of formal Arrangements with foreign regulators | https://www.cftc.gov/International/MemorandaofUnderstanding/index.htm . | 67 |
| Agricultural Advisory Committee meeting agenda | https://www.cftc.gov/About/CFTCCcommittees/AgriculturalAdvisory/aac_meetings.html | 69 |
| Technology Advisory Committee meeting agenda | https://www.cftc.gov/About/CFTCCcommittees/TechnologyAdvisory/tac_meetings.html | 69 |
| Market Risk Advisory Committee meeting agenda | https://www.cftc.gov/About/CFTCCcommittees/MarketRiskAdvisoryCommittee/mrac_meetings.html | 69 |
| Global Markets Advisory Committee meeting agenda | https://www.cftc.gov/About/CFTCCcommittees/GlobalMarketsAdvisory/gmac_meetings.html | 69 |
| Energy and Environmental Markets Advisory Committee | https://www.cftc.gov/About/CFTCCcommittees/EnergyEnvironmentalMarketsAdvisory/emac_meetings.html | 70 |
| CFTC Strategic Plan 2014-2018 | https://www.cftc.gov/About/CFTCReports/index.htm | 71 |
| CFTC Division of Market Oversight's 2019 Compliance Branch Examinations Priorities | https://www.cftc.gov/sites/default/files/2019-02/DMO2019ExaminationPriorities.pdf | 99 |
| National Futures Association, Articles of Incorporation | http://www.nfa.futures.org/nfamanual/NFAManual.aspx . | 103 |
| CFTC Division of Swap Dealer and Intermediary Oversight Intermediary Guidance (CPO guidance letters) | https://www.cftc.gov/IndustryOversight/Intermediaries/intermediaryguidance | 135 |
| Compliance Requirements for futures commission merchant applicants | http://www.nfa.futures.org/NFA-compliance/NFA-futures-commission-merchants/fcm-applicants.HTML | 142 |
| Swap dealers provisionally registered with the CFTC | http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer | 146 |
| NFA Board Update (video discussing NFA budget allocations) | www.nfa.futures.org/news/newsBoard.asp?ArticleID=5132 | 147 |
| NFA's Background Affiliation Status Information Center (BASIC) | https://www.nfa.futures.org/BasicNet/ | 149 |
| CFTC, <i>How to Become a Designated Contract Market</i> | https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmhowto.html | 202 |

| | | |
|---|---|-----|
| CFTC Staff Guidance on SEFs | http://www.cftc.gov/LawRegulation/DoddFrankAct/GuidanceQandA/index.htm | 202 |
| FORM SEF | http://www.cftc.gov/ucm/groups/public/@industryoversight/documents/file/formsef.pdf | 204 |
| Procedures for Listing Products | https://www.cftc.gov/IndustryOversight/ContractsProducts/ListingProcedures/index.htm | 216 |
| CFTC Weekly Swaps Report | http://www.cftc.gov/MarketReports/SwapsReports | 237 |
| CFTC Division of Enforcement's <i>Enforcement Manual</i> | https://www.cftc.gov/LawRegulation/Enforcement/EnforcementManual.pdf | 246 |
| CFTC Division of Enforcement, Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Companies | https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisorycompanies011917.pdf | 259 |
| CFTC Division of Enforcement, Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Individuals | https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisoryindividuals011917.pdf | 259 |
| CFTC Division of Enforcement, Enforcement Advisory: Self-Reporting and Full Cooperation | https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisoryselfreporting0917.pdf | 259 |
| CFTC Division of Enforcement, Enforcement Advisory: Self-Reporting and Cooperation for CEA Violations Involving Foreign Corrupt Practices | https://www.cftc.gov/sites/default/files/2019-03/enfadvisoryselfreporting030619.pdf | 260 |
| IOSCO MMOU | https://www.cftc.gov/International/MemorandaofUnderstanding/index.htm | 264 |
| Status of DCMs | https://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=TradingOrganizations&implicit=true&type=DCM&CustomColumnDisplay=TTTTTTTT | 286 |
| Status of SEFs | https://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=SwapExecutionFacilities | 286 |

CFTC ISSUES IDENTIFIED BY IMF IN 2015 U.S. FSAP

The following chart reflects specific IOSCO Principles that the IMF identified as relevant to the CFTC in the 2015 FSAP and provides a brief summary of the issue for reference.

| IOSCO Objectives and Principles of Securities Regulation | | Summary of Issue Identified by IMF |
|--|---|---|
| 1 | The responsibilities of the Regulator should be clear and objectively stated. | SEC-CFTC coordination needs improvement; CPO-CTA conflicts of interest |
| 2 | The Regulator should be operationally independent and accountable in the exercise of its powers and functions. | Not self-funded or multiyear budgets |
| 3 | The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. | Insufficient funding |
| 6 | The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate. | Quality of swaps data; expand means of monitoring swap markets |
| 24 | The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme. | CPO internal controls and risk management |
| 25 | The regulatory system should provide for rules governing the legal form and structure of CIS and the segregation and protection of client assets. | Lack of statutory authority to require additional safeguards of pool assets |
| 27-29 | IOSCO Principles relating to CIS and hedge funds. | Recommendations related to pricing of interests in commodity pools, hedge fund risk management, and internal controls of CTAs |
| 35 | Regulation should promote transparency of trading. | CFTC block trade rules not final; no pre-trade transparency waivers |
| 37 | Regulation should aim to ensure the proper management of large exposures, default risk and market disruption. | Review whether authorities have a comprehensive view of the total exposures of market participants across markets |

DETAILED QUESTIONNAIRE

6. The following questions have been developed by IOSCO as a tool to assess the level of implementation of the IOSCO Objectives and Principles of Securities Regulation. To answer them, the authorities should have as a reference the preamble, scope and explanatory notes included in the IOSCO Methodology, in connection with each Principle. **The questionnaire below covers the subset of Principles deemed relevant for the scope of the 2020 United States FSAP exercise.**

| | |
|--|---|
| Principle 1 | The responsibilities of the Regulator should be clear and objectively stated. |
| Key Questions | |
| 1. | Are the regulator's responsibilities, powers and authority: |
| (a) | Clearly defined and objectively set out, preferably in law, and in the case of powers and authority, enforceable? |
| <p>Yes. The Commodity Futures Trading Commission (CFTC or Commission) is an independent five-member Federal agency established in 1974 pursuant to the Commodity Exchange Act (CEA). The responsibilities, powers, and authority of the CFTC are clearly defined and transparently set forth in the CEA and CFTC regulations promulgated thereunder.² In particular, the jurisdiction of the CFTC is established under Section 2(a) of the CEA while the powers of the CFTC are set forth in Section 8a of the CEA.</p> <p>It is the mission of the CFTC to protect market users and the public from fraud,</p> | |

² See 7 U.S.C. 1, *et seq.*, and 17 C.F.R. 1, *et seq.* The CEA and CFTC regulations can be found on the Commission's website.

manipulation, other abusive practices, and systemic risk related to derivatives, that are subject to the CEA and to foster open, transparent, competitive, and financially sound markets.

The Commission was directed by the U.S. Congress (Congress) to regulate the derivatives markets, which includes futures, options, and swaps contracts related to underlying commodities. These markets are critical to the efficient functioning of the global financial system and the economies it supports. The CEA vests the CFTC with exclusive jurisdiction over futures and commodity option transactions.³ Subject to certain exceptions, and to the CFTC's authority to exempt certain transactions or categories of transactions from most provisions of the CEA, all transactions in commodity futures contracts and all commodity option transactions are required to occur on or subject to the rules of designated contract markets (DCMs).

³ Section 2(a)(1)(A) of the CEA grants the CFTC exclusive jurisdiction with respect to "accounts, agreements (including any transaction which is of the character of . . . an 'option' . . .)" and "transactions involving swaps or contracts of sale of a commodity for future delivery (including significant price discovery contracts), traded or executed on a contract market designated pursuant to Section 5 or a swap execution facility pursuant to Section 5h or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to Section 19 of this title." Section 1a(9) of the CEA defines the term "commodity" to mean wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by the first section of Public Law 85-839 (7 U.S.C. 13-1)) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in. Swaps are defined in Section 1(a)(47) of the CEA and further defined by CFTC regulation 1.3. The CEA specifically excepts from the CFTC's exclusive jurisdiction security futures products and the setting of margin levels for stock index futures contracts.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)⁴ amended the CEA to establish a comprehensive statutory framework to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and comprehensive regulation of swap dealers (SDs) and major swap participants (MSPs); (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to all registered entities, intermediaries and others subject to the Commission's oversight.

Security Futures. Section 2(a)(1)(D) of the CEA, and related securities laws, allocate jurisdiction over certain derivative products between the CFTC and the Securities and Exchange Commission (SEC). The SEC has authority to regulate options on securities, on groups and indices of securities, on certificates of deposit

⁴ Public Law 111-203, 124 Stat. 1376 (2010).

and on foreign currencies when traded on a national securities exchange.⁵ The CFTC has exclusive jurisdiction over futures trading on government securities, foreign currency,⁶ on certain non-narrow-based groups or indices of securities,⁷ and over options on such futures.⁸ In addition, security futures products—futures on individual stocks and narrow-based securities indexes—are subject to the joint jurisdiction of the CFTC and SEC.⁹ Security futures products may be traded on any DCM that also is notice registered with the SEC as a national securities exchange.¹⁰ Security futures products may also be traded on any SEC-registered national securities exchange, national securities association, or alternative trading system

⁵ Section 4c(f) of the CEA provides that the CEA is inapplicable “to any transaction in an option on foreign currency traded on a national securities exchange.”

⁶ CEA Sections 2(c)(1) and 2(c)(2)(A).

⁷ CEA Section 2(a)(1)(C)(ii).

⁸ *Id.*

⁹ See Title II of the Commodity Futures Modernization Act (CFMA), Public Law 106-554 (Dec. 21, 2000).

¹⁰ See *Registration of National Securities Exchanges Pursuant to Section 6(g) of the Securities Exchange Act of 1934 and Proposed Rule Changes of Certain National Securities Exchanges and Limited Purpose National Securities Associations*, SEC Release No. 34-44692 (August 13, 2001), 66 FR 43721 (Aug. 20, 2001).

that is notice designated as a DCM by the CFTC.¹¹

Agricultural Swaps. The Dodd-Frank Act removed or revised the bilateral swaps exemptions added by the CFMA¹² by giving the Commission jurisdiction over swaps.¹³ The Dodd-Frank Act also included a general prohibition on any swap in an agricultural commodity unless permitted under the Commission's Section 4(c) exemptive authority. The Commission issued such a rule under its Section 4(c) exemptive authority in August 2011 permitting the transaction of swaps in an agricultural commodity (or, agricultural swaps) subject to the same rules and regulations applicable to any other swap. Part 35 of the Commission's regulations permits the transaction of swaps in an agricultural commodity to be treated like all other swaps transactions. CFTC regulation 35.1(a). Swaps in an agricultural commodity may be traded on a swap execution facility (SEF) or DCM.¹⁴

Trade Options/Commodity Options. The Dodd-Frank Act includes a definition of

¹¹ See Part 41 of the CFTC's regulations. See also *Customer Margin Rules Relating to Security Futures (Joint proposed rules)*, 84 FR 36434 (Jul. 26, 2019).

¹² Public Law 101-554 (Dec. 21, 2000).

¹³ CEA Section 2(d).

¹⁴ See CFTC regulation 35.1(b).

“swap” that encompasses “commodity options.”¹⁵ Pursuant to its rulemaking authority, the Commission determined commodity options are to be regulated as swaps.¹⁶ However, a commodity option involving a physical (as opposed to a financial) commodity may avoid being regulated as a swap if it is (1) a commodity option embedded in a forward contract;¹⁷ (2) a volumetric commodity option embedded in a forward contract; or (3) a trade option. To qualify as a trade option, a commodity option must involve a physical commodity (*i.e.*, an exempt or agricultural commodity) and meet three conditions: (1) the option is offered by either an “eligible contract participant” (ECP)¹⁸ or a commercial participant (*i.e.*, a producer, processor, commercial user of, or merchant handling, the underlying physical commodity); (2) the option is offered to a commercial participant; and (3) the option is intended to be physically settled so that, if exercised, the option would result in the sale of an exempt or agricultural commodity for immediate or deferred shipment or delivery. While trade options are exempt from most of the rules applicable to swaps, they remain subject to certain, minimal regulatory requirements set out in CFTC regulations.¹⁹

Excluded Financial Instruments. Section 2(c)(1) of the CEA specifically excludes from the CEA certain transactions in specified financial instruments including

¹⁵ See CEA Section 1a(47)(A)(i). Note that the swap definition excludes options on futures (which must be traded on a DCM pursuant to Part 33 of the Commission’s regulations) (see CEA Section 1a(47)(B)(i)), but it includes options on physical commodities (whether or not traded on a DCM) (see CEA Section 1a(47)(A)(i)). Other options excluded from the statutory definition of swap are options on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof, that is subject to the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Securities Exchange Act) (see CEA Section 1a(47)(B)(iii)) and foreign currency options entered into on a national securities exchange registered pursuant to Section 6(a) of the Securities Exchange Act (see CEA Section 1a(47)(B)(iv)). Note also that the Commission’s regulations define a commodity option transaction or commodity option as “any transaction or agreement in interstate commerce which is or is held out to be of the character of, or is commonly known to the trade as, an ‘option,’ ‘privilege,’ ‘indemnity,’ ‘bid,’ ‘offer,’ ‘call,’ ‘put,’ ‘advance guaranty’ or ‘decline guaranty.’” CFTC regulation 1.3.

¹⁶ *Commodity Options*, 77 FR 25320 (Apr. 27, 2012).

¹⁷ The CEA generally excludes forward contracts from CFTC jurisdiction (other than in cases of fraud or manipulation). A forward contract is “any sale of any cash commodity for deferred shipment or delivery.” See CEA Section 1a(19).

¹⁸ ECP is defined in Section 1a(18) of the CEA to include, among others, financial institutions, insurance companies, registered investment companies, highly-capitalized commodity pools, employee benefit plans, certain governmental entities, certain broker-dealers, futures commission merchants (FCMs), floor brokers/traders, and high net worth individuals.

¹⁹ See CFTC regulations 32.3(b)-(d).

foreign currency, government securities, security rights, security warrants, resales of installment loan contracts, repurchase transactions in excluded commodities,²⁰ mortgages and mortgage commitments, unless conducted on an organized exchange. The Commodity Futures Trading Commission Act of 1974 originally exempted from the CFTC's jurisdiction, among other things, contracts based on foreign currency and Treasury securities so long as the transactions did not involve the sale of a futures contract (or option thereon) or commodity options executed or traded on a futures exchange. The CFTC Reauthorization Act of 2008²¹ clarified that the CFTC retains jurisdiction to regulate transactions in futures contracts (and options thereon) and commodity options based on excluded financial instruments to the extent that such transactions occur on a DCM.

Foreign Currency Transactions. The CFTC has anti-fraud jurisdiction over any agreement, contract, or transaction in foreign currency that is offered by a FCM or a retail foreign exchange dealer (RFED) on a leveraged or margined basis to persons who are not ECPs, as if the foreign currency contracts were "futures contracts."²² The CFTC also has jurisdiction over foreign currency futures or options on foreign currencies (unless traded on a national securities exchange) entered into by persons who are not ECPs, where the counterparty to the transaction is an FCM or RFED. The CFTC does not have jurisdiction over retail forex transactions that are entered into by a financial institution (except an FCM or RFED), a registered broker-dealer, an insurance company, a financial holding company, or an investment bank holding company.

Furthermore, pursuant to a written determination issued by the Secretary of the Treasury, foreign exchange forwards and foreign exchange swaps are not regulated as swaps under the CEA, with certain exceptions.²³ In addition, the CFTC does not have jurisdiction over bona fide foreign exchange spot transactions. A foreign

²⁰ Excluded commodities are not themselves excluded from the CEA. Instead, these commodities are "excluded" in the sense that they are eligible to be the underlying commodities for certain off-exchange contracts that are excluded from the CEA.

²¹ Public Law 110-246 (June 18, 2008).

²² See CEA Section 2(c)(2)(B).

²³ Section 1a(47)(E) of the CEA, as amended by the Dodd-Frank Act, vested the Secretary of the Treasury with the authority to determine whether foreign exchange swaps and foreign exchange forwards should be regulated as swaps under the CEA, provided that the Secretary makes a written determination satisfying certain criteria specified in Section 1b of the CEA. The Secretary of the Treasury issued such a written determination on November 16, 2012. See *Determination of Foreign Exchange Forwards Under the Commodity Exchange Act*, 77 FR 69694 (Nov. 20, 2012). Notwithstanding the written determination, foreign exchange swaps and foreign exchange forwards are still subject to the swap data repository (SDR) reporting requirements set forth in Section 4r of the CEA, and any party to a foreign exchange swap or foreign exchange forward that is an SD or MSP must comply with the business conduct standards requirements contained in Section 4s(h) of the CEA. See Sections 1a(47)(E)(iii)-(iv) of the CEA.

exchange transaction will be considered a bona fide spot transaction if it settles via an actual delivery of the relevant currencies within two business days. In certain circumstances, however, a foreign exchange transaction with a longer settlement period concluding with the actual delivery of the relevant currencies may be considered a bona fide spot transaction depending on the customary timeline of the relevant market.

Retail Forex Transactions. The Commission adopted a comprehensive regulatory scheme to implement the provisions of the Dodd-Frank Act and the CFTC Reauthorization Act of 2008 with respect to off-exchange transactions in foreign currency with members of the retail public.²⁴

Hybrid Instruments. A “hybrid instrument” is defined in Section 1a(29) of the CEA to mean a security having one or more payments indexed to the value, level or rate of, or providing for the delivery of one or more commodities. The CFTC is not authorized to regulate hybrid instruments that are predominantly securities.²⁵ This provision enacted as part of the CFMA effectively expanded the exemption provided by CFTC regulations in Part 34, which applies to the regulation of hybrid instruments.²⁶ A hybrid instrument is deemed to be predominantly a security and thus excluded from regulation under the CEA if: the issuer receives full payment of the purchase price of the instrument substantially contemporaneously with delivery of the instrument; the purchaser is not required to make any payment to the issuer in addition to the purchase price during the life of the instrument; the issuer is not subject, under the terms of the instrument, to mark-to-market margining requirements; and the hybrid instrument is not marketed as a futures contract.

Swaps. The Dodd-Frank Act gave the CFTC regulatory authority over swaps and the SEC regulatory authority over security-based swaps. A swap is defined in Section 1a(47) of the CEA. A security-based swap is defined in Section 3(a)(68) of the Securities Exchange Act.²⁷ The terms were further defined through a joint rulemaking by the SEC and CFTC in August 2012.²⁸

²⁴ See Part 5 of the CFTC’s regulations.

²⁵ See CEA Section 2(f).

²⁶ CFTC regulation 34.2(a), adopted prior to the CFMA, defines “hybrid instrument” to mean an equity or debt security or depository instrument with one or more commodity-dependent components that have payment features similar to commodity futures or commodity options contracts or combinations thereof.

²⁷ 15 U.S.C. 78c(a)(68).

²⁸ *Further Definition of “Swap,” “Security-Based Swap,” “Security-Based Swap Agreement,” “Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 FR 48208 (Aug. 13, 2012).

Designated Contract Markets. DCMs are boards of trade that operate under the regulatory oversight of the CFTC, pursuant to Section 5 of the CEA.²⁹ DCMs are traditional futures exchanges that permit access to their facilities by all types of traders, including retail customers. DCMs may list for trading futures or options contracts based on any underlying commodity, index, or instrument. With the passage of the Dodd-Frank Act, swaps may be traded and executed on a DCM.

To obtain and maintain its designation, a DCM must also comply with 23 core principles established in Section 5(d) of the CEA and implemented in Part 38 of the CFTC's regulations. Specifically, DCMs must comply on an initial and continuing basis with the following core principles: (1) designation as a contract market; (2) compliance with rules; (3) contracts not readily subject to manipulation; (4) prevention of market disruption; (5) position limits or accountability; (6) emergency authority; (7) availability of general information; (8) daily publication of trading information; (9) execution of transactions; (10) trade information; (11) financial integrity of transactions; (12) protection of markets and market participants; (13) disciplinary procedures; (14) dispute resolution; (15) governance fitness standards; (16) conflicts of interest; (17) composition of governing boards of contract markets; (18) recordkeeping; (19) antitrust considerations; (20) system safeguards; (21) financial resources; (22) diversity of board of directors; and (23) availability of certain records to the SEC.

DCMs may implement new rules or rule amendments or list new products by filing with the CFTC a certification that the rule or rule amendment complies with the CEA and CFTC regulations and policies and/or by requesting approval from the CFTC.

Swap Execution Facilities. SEFs are trading systems or platforms that operate under the regulatory oversight of the CFTC, pursuant to Section 5h of the CEA.³⁰ SEFs are platforms in which multiple participants have the ability to execute or trade swaps by accepting bids or offers made by multiple participants in the facility or system, through any means of interstate commerce. Only swaps may be traded and executed on a SEF regulated by the CFTC. No person may operate a facility for the trading or processing of swaps unless the facility is registered as a SEF or DCM.³¹

To register and maintain registration as a SEF, a SEF must comply with 15 core

²⁹ Part 38 of the CFTC's regulations details the procedures and requirements for operating a DCM.

³⁰ Part 37 of the CFTC's regulations details the procedures and requirements for operating a SEF.

³¹ A facility that is registered with the SEC as a security-based SEF must also register with the Commission if it intends to operate a facility to trade swaps. CEA Section 5h(a)(2).

principles established in Section 5h of the CEA and implemented in Part 37 of the CFTC's regulations. Specifically, a SEF must comply on an initial and continuing basis with the following core principles: (1) compliance with core principles; (2) compliance with rules; (3) swaps not readily subject to manipulation; (4) monitoring of trading and trade processing; (5) ability to obtain information; (6) position limits or accountability; (7) financial integrity of transactions; (8) emergency authority; (9) timely publication of trading information; (10) recordkeeping and reporting; (11) antitrust considerations; (12) conflicts of interest; (13) financial resources; (14) system safeguards; and (15) designation of chief compliance officer (CCO).

SEFs may implement new rules or rule amendments or list new products by filing with the CFTC a certification that the rule or rule amendment complies with the CEA and CFTC regulations and policies and/or by requesting approval from the CFTC.

Derivatives Clearing Organizations. Derivatives clearing organizations (DCOs) operate under the regulatory oversight of the CFTC, pursuant to Section 5b of the CEA.³² A DCO is a clearinghouse, clearing association, clearing corporation, or similar entity, facility, system, or organization that with respect to an agreement, contract, or transaction enables each party to an agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the DCO for the credit of the parties; arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the DCO; or otherwise provides clearing services or arrangements that mutualize or transfer among participants in the DCO the credit risk arising from such agreements, contracts, or transactions executed by the participants.

To register and maintain registration as a DCO, a DCO must comply with 18 core principles established in Section 5b of the CEA and implemented in Part 39 of the CFTC's regulations. Specifically, a DCO must comply on an initial and continuing basis with the following core principles: (1) compliance with core principles; (2) financial resources; (3) participant and product eligibility; (4) risk management; (5) settlement procedures; (6) treatment of funds; (7) default rules and procedures; (8) rule enforcement; (9) system safeguards; (10) reporting; (11) recordkeeping; (12) public information; (13) information sharing; (14) antitrust considerations; (15) governance fitness standards; (16) conflicts of interest; (17) composition of governing boards; and (18) legal risk.

DCOs generally may implement new rules or rule amendments by filing with the

³² Part 39 of the CFTC's regulations details the procedures and requirements for operating a DCO.

CFTC a certification that the rule or rule amendment complies with the CEA and CFTC regulations and policies and/or by requesting approval from the CFTC. A DCO that has been designated by Financial Stability Oversight Council (FSOC) as systemically important (SIDCO), however, must provide notice to the Commission no less than 60 days in advance of any proposed changes to its rules, procedures or operations that could materially affect the nature or level of risks presented by the SIDCO.

Swap Data Repositories. SDRs are entities that provide a central facility for swap data reporting and recordkeeping. All swaps, whether cleared or uncleared, are required to be reported to a registered SDR. Section 21 of the CEA governs the registration and regulation of SDRs and establishes registration requirements and core duties and responsibilities for SDRs.³³ SDRs are required to register with the CFTC and comply with rules promulgated by the CFTC, including real-time public reporting of swap transaction and pricing data.

Commodity Pools. The solicitation of funds for investment in a commodity pool³⁴ constitutes the offer of a “security” that Section 4m of the CEA states necessitates compliance with certain provisions of the Securities Act and the Securities Exchange Act. Separately, the CFTC maintains jurisdiction over the operation of commodity pools and has issued regulations mandating, among other things, certain required disclosures in connection with the offer of a pool.³⁵ As a practical matter, public offers for commodity pools are generally made by one prospectus that complies with both the securities laws and the CFTC’s commodity pool regulations. Although the majority of all commodity pools are private placements, and therefore subject primarily to CFTC substantive regulation,³⁶ issuers of exchange-traded products (ETPs) have launched commodity-based ETPs for trading on national securities exchanges. As a result, these products are subject to “dual” regulation by both the CFTC and SEC consisting of commodity pool operator (CPO) registration and regulation, disclosure requirements under both the CEA and Federal securities laws, and securities exchange regulation.

CFTC regulation 4.5 excludes from the definition of CPO, and therefore application of the CEA and CFTC regulations related to pools and their related advisors, certain

³³ Part 49 of the CFTC’s regulations implement Section 21 of the CEA.

³⁴ Although the CEA does not define the term “commodity pool,” CFTC regulation 4.10(d)(1) defines “pool” to mean any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading commodity interests.

³⁵ See CFTC regulations 4.21, 4.24, 4.25, and 4.26.

³⁶ The SEC, however, does retain anti-fraud and anti-manipulation authority over the securities of such commodity pool offerings.

collective investment vehicles that are otherwise regulated entities, such as certain registered investment companies, insurance company separate accounts, banks and trust companies, and certain defined benefit (pension) plans. CFTC regulation 4.13 also provides exemptions from CPO registration for CPOs that meet specified criteria, including small or family pools, and pools that engage in minimal futures trading. The CFTC, pursuant to CFTC regulation 4.12, can also exempt entities from the application of Part 4 of the CFTC's regulations in appropriate cases.

Intermediaries. The CFTC regulates the following categories of intermediaries:

- "Futures Commission Merchant" is defined as any person who solicits or accepts orders to buy or sell futures, options, swaps, or leverage contracts, security futures products, or any transaction described in Section 2(c)(2)(C)(i) or Section 2(c)(2)(D)(i) of the CEA, or acts as a counterparty in any transaction described in those sections, and who, in connection with the order, accepts any money or other property (or extends credit) to margin, guarantee, or secure the contracts resulting from these activities. See CFTC regulation 1.3.
- "Swap dealer" is defined as any person who holds itself out as a dealer in swaps, makes a market in swaps, regularly enters into swaps with counterparties as an ordinary course of business for its own account, or engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps, subject to certain exemptions for entities that engage in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of customers. The term was further defined through a joint rulemaking between the SEC and CFTC published in May 2012.³⁷ See CFTC regulation 1.3.
- "Major swap participant" is defined as any person who is not an SD and maintains a substantial position in swaps for any of the major swap categories (excluding both positions held for hedging or mitigating commercial risk and certain positions maintained by employee benefit plans), or whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets, or is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency, subject to certain exclusions. The term was also further defined through joint rulemaking between the SEC and CFTC. There currently are no registered major swap participants. See CFTC regulation

³⁷ Further Definitions of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596 (May 23, 2012).

1.3.

- “Introducing Broker” is any person who solicits or accepts orders to buy or sell futures, options, swaps, or leverage transaction contracts, security futures products, or any transaction described in Section 2(c)(2)(C)(i) or 2(c)(2)(D)(i) of the CEA, but who does not accept any money or property (or extend credit) to margin, guarantee, or secure the contracts. See CFTC regulation 1.3.
- “Floor trader” is a person who trades contracts on DCMs and/or SEFs for his or her own account. See CFTC regulation 1.3.
- “Floor broker” is a person who trades contracts on DCMs and/or SEFs for the account of others. See CFTC regulation 1.3.
- “Foreign futures and options broker” is any non-U.S. person that is a member of a non-U.S. exchange or self-regulatory organization (SRO) and subject to regulation in such foreign jurisdiction. Also included are foreign affiliates of U.S. firms that are licensed and subject to regulation in such non-U.S. jurisdiction. See CFTC regulation 30.1(e).
- “Leverage Transaction Merchant” is a person engaged in the solicitation, execution or acceptance of leverage contracts. There currently are no registered leverage transaction merchants. See CFTC regulation 1.3.
- “Commodity Trading Advisor” is defined as any person who, for compensation or profit, is engaged in the business of providing commodity interest advisory services to others. See CFTC regulation 1.3.
- “Commodity Pool Operator” is defined as any person who solicits funds from others for the purpose of pooling the funds for use in investing in commodity interests. As noted above, pools also may be regulated by the SEC if publicly offered or under the Investment Company Act of 1940, under certain circumstances. See CFTC regulation 1.3.
- “Retail Foreign Exchange Dealer” is defined as any person who is, or offers to be, the counterparty to an off-exchange retail forex transaction, but does not include persons that are regulated by another financial regulator, such as banks or securities broker dealers. FCMs may also be the counterparty to such off-exchange retail forex transactions but, unlike FCMs, RFEDs may not engage in exchange-traded commodities transactions. See CFTC regulation 5.1(h).

Associated Persons. The CEA and CFTC regulations impose requirements related to licensing, conduct of business, mandatory firm capital, and custodianship of

customer assets. In addition, the CEA requires the officers of the above registrants and persons who solicit funds or supervise such persons within such registrants to register as associated persons (APs).

Accounting Standards. In addition to the standards established by the American Institute of Certified Public Accountants (AICPA), the Public Company Accounting Oversight Board (PCAOB), and the Financial Accounting Standards Board, CFTC regulations establish requirements pertaining to independent public accountants who audit CFTC registrants. For example, under CFTC regulation 1.16, the CFTC will recognize only a licensed certified public accountant or licensed public accountant who is in good standing under the laws of the place of his or her residence or principal place of business and such accountants' report must be prepared consistent with the requirements of CFTC regulation 1.16(c)(1). The CFTC also has worked with AICPA to provide guidance on the application of accounting standards to CFTC registrants.

Foreign Brokers. Part 30 of the CFTC regulations govern the offer and sale of foreign futures and options contracts to customers located in the United States. As set forth in CFTC regulation 30.4, any domestic or foreign person engaged in activities like those of an FCM, introducing broker (IB), CPO or commodity trading advisor (CTA) must register in the appropriate capacity or seek an exemption from registration under CFTC regulations 30.5 or 30.10.

CFTC regulation 30.5 provides an exemption from registration for any person located outside of the United States who is required to be registered with the CFTC under Part 30 other than a person required to be registered as an FCM. A foreign futures or options broker in such case is required to consent to the jurisdiction of the U.S. courts and the CFTC with respect to dealings with U.S. customers, and engage in all transactions subject to regulation under Part 30 through a registered FCM or foreign broker who has received confirmation of exemption from registration as an FCM under CFTC regulation 30.10.

CFTC regulation 30.10 permits a person affected by any of the requirements contained in Part 30 of the Commission's regulations to petition the Commission for an exemption from such requirements. If the CFTC determines that compliance with the foreign jurisdiction's regulatory program would offer "comparable" protection to persons located in the United States and there is an information sharing arrangement between the Commission and the firm's home country regulator, the CFTC will consider issuance of an order to the foreign regulator or SRO granting general relief, subject to certain conditions.

Margin Authority. Section 4s(e) of the CEA requires that the CFTC adopt rules establishing margin requirements for uncleared swaps of SDs and MSPs for which

there is no prudential regulator. The term prudential regulator is defined in Section 1a(39) of the CEA to include the Federal Reserve Board; the Office of the Comptroller of the Currency (OCC); the Federal Deposit Insurance Corporation (FDIC); the Farm Credit Administration; and the Federal Housing Finance Agency (FHFA). The SDs subject to the CFTC’s margin regulations are primarily nonbank subsidiaries of bank holding companies and certain non-U.S. SDs. Part 23, Subpart E of the CFTC regulations, adopted in 2016, sets out the margin requirements for SDs and MSPs on uncleared swaps.

Section 5b(c)(2)(D) of the CEA requires that DCOs have adequate margin requirements as a condition of their registration with the CFTC. Margin requirements for cleared swaps and futures contracts are set by DCOs in accordance with this provision and applicable Commission rules.

Section 2(a)(1)(C)(v) of the CEA requires any DCM that trades stock index futures contracts (or options thereon) to file with the Federal Reserve Board any rule establishing or changing the levels of margin (initial and maintenance) for that contract and authorizes the Federal Reserve Board to set the margin levels. Under the authority of that section, the Federal Reserve Board delegated such margin authority to the CFTC in 1993, subject to certain conditions.

Dual Registration. Securities broker-dealers registered with the SEC may also dually register in the above-referenced CFTC categories. In this regard, many of the largest FCMs are also registered with the SEC as securities broker-dealers. The Commission’s regulatory structure recognizes that such entities are subject to dual registration and attempts to harmonize regulations where possible. For example, the Commission and the SEC have implemented a uniform capital and financial reporting regime for dual-registrant FCMs/broker-dealers, which allows such entities to meet the requirements of both agencies by following a single set of coordinated regulations. In addition, banks that intermediate derivatives transactions for customers typically establish subsidiaries to conduct such business due to the requirements of banking regulators, as well as the liquidity requirements of CFTC capital rules. FCM subsidiaries of bank holding companies are subject to supervision by Prudential Regulators, including examination and certain other requirements.

(b) If the regulator can interpret its authority, are the criteria for interpretation clear and transparent?

Yes. The criteria for interpreting the CFTC’s authority are clear and transparent. The CFTC largely interprets the CEA based on the plain meaning of the statute and available legislative history as related to relevant markets and market participants. CFTC rulemaking is employed to administer and implement various provisions of

| |
|--|
| <p>the CEA as provided for in Section 8a(5) of the CEA.³⁸ The rulemaking process is governed by Section 553 of the Administrative Procedure Act (APA) and other various statutes that prescribe the manner in which the CFTC may adopt rules and regulations. This process is fully transparent with CFTC rule proposals and adoptions, concept releases, and interpretations published in the <i>Federal Register</i>. CFTC staff may also provide guidance to market participants and practitioners on a variety of legal and regulatory matters. Although not legally binding on the CFTC, these staff interpretations provide guidance on a host of CEA and related issues.</p> |
| <p>(c) Is the interpretative process transparent enough to preclude situations in which an abuse of discretion can occur?</p> |
| <p>Yes. The CFTC can interpret how to apply the authority granted to it by the CEA. The CEA also grants the CFTC broad exemptive authority under Section 4(c) as well as broad rulemaking authority under Section 8a(5).³⁹ As discussed in response to Question (b), above, Section 553 of the APA requires agencies to incorporate a concise general statement of the basis and purpose for adopted rules. Generally, all CFTC orders, exemption letters, and advisories contain written explanations of the basis for such actions. These CFTC actions are publicly disclosed in the <i>Federal Register</i> and/or the CFTC's website, www.cftc.gov. Parties affected by any such CFTC actions may also seek judicial review by the Federal courts.</p> |
| <p>2. When more than one regulator is responsible for securities regulation:</p> |
| <p>(a) Where responsibility is divided among regulators, is legislation designed to avoid regulatory differences or gaps?</p> |
| <p>Yes. For example, Sections 712(b) and 712(c) of the Dodd-Frank Act delimit the CFTC's jurisdiction and the SEC's jurisdiction with respect to swaps and security-based swaps, respectively, and provide that either agency may object if the other promulgates a rule, regulation, or order that conflicts with the statutory delimitation. In addition, Section 718 of the Dodd-Frank Act provides a coordinated review process in connection with novel derivatives products that both the CFTC and SEC may use in determining the regulatory status of these instruments.</p> <p>The Dodd-Frank Act also requires that the CFTC, SEC, and Prudential Regulators coordinate with each other with respect to certain rulemakings. Section 712(a)(1) of the Dodd-Frank Act provides that, before the Commission commences any</p> |

³⁸ The Commission may also interpret its authority through adjudicatory proceedings under Parts 10 and 12 of the Commission's regulations.

³⁹ See *id.*

rulemaking or issues an order regarding swaps pursuant to Subtitle A of Title VII of the Dodd-Frank Act (which relates to regulation of the over-the-counter (OTC) swaps markets), the Commission shall “consult and coordinate to the extent possible with the [SEC] and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible.”⁴⁰ Section 712(a)(2) of the Dodd-Frank Act has a parallel provision with respect to rulemakings commenced by the SEC, requiring it to consult with the CFTC and the U.S. prudential regulators.⁴¹

Section 712(d) of the Dodd-Frank Act requires that the CFTC and the SEC, in consultation with the Federal Reserve Board, further define the terms “swap,” “security-based swap,” “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant,” “eligible contract participant,” and “security-based swap agreement” (which the agencies completed in 2012).⁴²

In addition, Section 752(a) of the Dodd-Frank Act provides in part that “[i]n order to promote effective and consistent global regulation of swaps and security-based swaps, the [CFTC], the [SEC], and the prudential regulators . . . as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps”⁴³ The CFTC has undertaken comparability analyses for various jurisdictions in the context of regulating SDs, DCOs, and SEFs. *See, e.g.*, Comparability Determinations for Japan, the European Union, and Australia regarding margin requirements for uncleared swaps for swap Dealers and major swap participants (81 FR 63376, 82 FR 48394, and 84 FR 12908, respectively); Comparability Determination for the European Union: Dually-Registered Derivatives Clearing Organizations and Central Counterparties (81 FR 15260); and Order of Exemption, In the Matter of the Exemption of Approved Exchanges and Locally-Incorporated Recognized Market Operators Authorized within Singapore from the Requirement to Register with the Commodity Futures Trading Commission as Swap Execution Facilities (2019).

Section 619 of the Dodd-Frank Act, commonly known as the “Volcker rule,” adds a new Section 13 to the Bank Holding Company Act of 1956 (BHCA) which, in subsection (b)(2)(B)(ii), requires the Commission, SEC, Federal Reserve, FDIC, and

⁴⁰ See 15 U.S.C. 8302(a)(1).

⁴¹ See 15 U.S.C. 8302(a)(2).

⁴² See 15 U.S.C. 8302(d).

⁴³ See 15 U.S.C. 8325.

OCC to “consult and coordinate with each other, as appropriate, for the purposes of assuring, to the extent possible, that such regulations [issued under this section] are comparable and provide for consistent application and implementation of the applicable provisions of this section to avoid providing advantages or imposing disadvantages to the companies affected by this subsection and to protect the safety and soundness of banking entities and nonbank financial companies supervised by the [Federal Reserve].”⁴⁴ Under this authority, the Commission, along with the SEC and the Federal banking agencies, issued final rules to implement the Volcker rule.⁴⁵

(b) Is substantially the same type of conduct and product generally subject to consistent regulatory requirements?

Yes. See response to Principle 1, Question 2(a). In particular, Section 712(a)(7)(A) of the Dodd-Frank Act provides that “[i]n adopting rules and orders under this subsection [*i.e.*, those relating to swaps and security-based swaps] the [Commission] and the [SEC] shall treat functionally or economically similar products or entities ... in a similar manner.”⁴⁶ Section 712(a)(7)(B), however, provides “[n]othing in this subtitle requires the [CFTC] or the [SEC] to adopt joint rules or orders that treat functionally or economically similar products or entities ... in an identical manner.”⁴⁷

SEC. The SEC and CFTC have worked to recommend changes to their respective statutes and regulations that would eliminate differences with respect to similar types of financial instruments so that the agencies’ regulations are harmonized when appropriate. Examples include: (1) *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Advisors on Form PF*, 76 FR 71128 (Nov. 16, 2011); (2) *Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool*

⁴⁴ See 12 U.S.C. 1851(b)(2)(B)(ii).

⁴⁵ *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds*, 79 FR 5808 (Jan. 31, 2014). The CFTC, SEC and the Federal banking agencies recently amended the Volcker rule implementing regulations to conform to statutory amendments made pursuant to the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). The EGRRCPA amendments and the recent rule changes exclude from the Volcker rule prohibitions and restrictions certain banking assets with total consolidated assets equal to \$10 billion or less. The amendments also make minor changes to rules on naming of investment funds affiliated with banks. *Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 84 FR 38115 (Aug. 6, 2019).

⁴⁶ 15 U.S.C. 8302(7)(A).

⁴⁷ 15 U.S.C. 8302(7)(B).

Operators, 78 FR 52308 (Aug. 22, 2013); (3) *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant,"* 77 FR 30596 (May 23, 2012); (4) *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,* 77 FR 48208 (Aug. 13, 2012); and (5) *Identity Theft Red Flag Rules*, 78 FR 23638 (Apr. 19, 2013). Recently, the CFTC and the SEC also entered into a Memorandum of Understanding (MOU) that ensures continued coordination and information sharing between the two agencies.⁴⁸ The MOU updates and enhances a 2008 MOU to make it more relevant in the current market environment and promote efficiency in rule making, regulatory oversight, and enforcement. Greater harmonization of swap and security-based swap rules enhances SEC and CFTC oversight efforts, reduces unnecessary complexity, and lessens costs for both regulators and market participants. The new MOU specifically addresses the regulatory regime for swaps and security-based swaps.

In addition, at the direction of the CFTC and SEC Chairmen, in 2018 the CFTC and the SEC began a harmonization project that included close coordination and harmonizing requirements such as recordkeeping requirements, business conduct rules, statutory disqualification rules, and coordinating on issues such as security futures margin, data reporting, and swap execution facilities. The CFTC and SEC are currently engaged in additional efforts to coordinate and harmonize regulatory oversight. CFTC staff is engaged with its SEC counterparts in identifying areas ripe for further alignment that may enhance CFTC and SEC oversight efforts while reducing unnecessary complexities and lessening costs for both regulators and shared market participants. As noted above, the two regulators recently issued a joint rulemaking proposing to align margin requirements for security futures with similar financial products.⁴⁹

FERC. The Federal Energy Regulatory Commission (FERC) and CFTC have two

⁴⁸ *Memorandum of Understanding between the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission Regarding Coordination in Areas of Common Regulatory Interest and Information Sharing* (July 11, 2018).

⁴⁹ *See Customer Margin Rules Relating to Security Futures*, available at <https://www.cftc.gov/PressRoom/PressReleases/7967-19>.

MOUs to address circumstances of overlapping jurisdiction and to share information in connection with market surveillance and investigations into potential market manipulation, fraud, or abuse.⁵⁰ The CFTC and FERC have overlapping jurisdiction over energy commodities, but the CFTC has exclusive jurisdiction over swaps and futures transactions involving such commodities.

Prudential Regulators. As described above under the Margin Authority section in Question 1(a), the CFTC, in adopting its margin rule for uncleared swaps,⁵¹ worked closely with the Prudential Regulators in adopting similar margin requirements, which are based on an agreed upon international framework.⁵²

FSOC. As a member of the FSOC, CFTC and banking and non-banking financial regulators coordinate in, among other things, identifying and addressing risks to financial stability. As part of this charter, CFTC has participated in several FSOC workgroups to facilitate coordination among regulators in areas of joint concern. In collaboration with the CFTC and other FSOC members, the FSOC recently issued for public comment proposed interpretive guidance regarding nonbank financial company designations.⁵³ The proposed guidance would implement an activities-based approach to identifying and addressing potential risks to financial stability. It would also enhance the transparency of the FSOC’s process for designating nonbank financial companies. The CFTC has also coordinated with the FSOC and other FSOC members on issues related to, among other things, cybersecurity, reforms related to reference rates, data quality, collection and sharing, financial innovation, and regulatory efficiency and effectiveness.

| | |
|-----|--|
| (c) | Are responsible authorities required to cooperate and communicate in areas of shared responsibility? |
|-----|--|

| | |
|--|----------------|
| | See (d) below. |
|--|----------------|

| | |
|-----|--|
| (d) | Are there arrangements for cooperation and communication between responsible regulators through appropriate channels and are cooperation and communication occurring between responsible regulators without significant limitations? |
|-----|--|

⁵⁰ *Memorandum of Understanding Between the Commodity Futures Trading Commission and the Federal Energy Regulatory Commission Regarding Information Sharing and Treatment of Proprietary Trading and Other Information* (Jan. 2, 2014); *Memorandum of Understanding Between the Federal Energy Regulatory Commission and the Commodity Futures Trading Commission* (Jan. 2, 2014).

⁵¹ *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 FR 636 (Jan. 6, 2016) (Margin Rule) (adopting margin requirements for nonbank swap dealers and nonbank major swap participants).

⁵² BCBS/IOSCO, *Margin requirements for non-centrally cleared derivatives* (Sept. 2013).

⁵³ *Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies*, 84 FR 9028 (Mar. 13, 2019).

Yes. The Chairperson of the CFTC is a member of the FSOC. FSOC is chaired by the Secretary of the Treasury, and also includes the Chairperson of the Federal Reserve Board, the OCC, the Director of the Consumer Financial Protection Bureau (CFPB), the Chairperson of the SEC, the Chairperson of the FDIC, the Director of the FHFA, the Chairperson of the National Credit Union Administration (NCUA), and an independent member with insurance expertise who is appointed by the President of the United States (President) and confirmed by the U.S. Senate (Senate) for a six-year term.

In addition, five nonvoting members serve in an advisory capacity: the Director of the Office of Financial Research (OFR) in the Treasury Department, the Director of the Federal Insurance Office (FIO) in the Treasury Department, a state insurance commissioner designated by the state insurance commissioners, a state banking supervisor designated by the state banking supervisors, and a state securities commissioner (or officer performing like functions) designated by the state securities commissioners.

FSOC provides comprehensive monitoring of the stability of the U.S. financial system. FSOC is charged with identifying risks to the financial stability of the U.S. financial system, promoting market discipline, and responding to emerging risks to the stability of the U.S. financial system. The FSOC Principals Group meets no less than four times per year to discuss and analyze market developments and financial regulatory issues. The FSOC also has biweekly meetings of the Deputies Group, and periodic meetings of the Regulatory and Resolution Committee and the Systemic Risk Committee.

FSOC also issues an annual report detailing its members' recommendations in shared areas of concern such as cybersecurity, management of systemic risk, emerging threats, and more.

Section 813 of Title VIII of the Dodd-Frank Act⁵⁴ requires the CFTC and the SEC to coordinate with the Federal Reserve Board to jointly develop risk management supervision programs for designated clearing entities, including SIDCOs. Consistent with that provision, the CFTC, SEC, and Federal Reserve Board issued a report in July 2011 that included recommendations with respect to systemically important clearing entities in order to achieve the statutory goals of improving consistency in the SEC's and CFTC's oversight programs, promoting robust risk

⁵⁴ 12 U.S.C. 5472.

management and risk management oversight, and enhancing the ability of regulators to monitor the potential effects of such risk management on the stability of the U.S. financial system.⁵⁵ Section 807(d) requires the CFTC and SEC to consult annually with the Federal Reserve Board regarding the scope and methodology of all SIDCO examinations, and the Federal Reserve Board may participate in the SIDCO examinations. Since 2012, the CFTC has consulted with the Board of Governors of the Federal Reserve System (Federal Reserve Board) regarding examinations of the two SIDCOs for which the CFTC is the primary regulator and they have participated in the examinations, as well as certain rule filings made by those SIDCOs.

Staff also works through various established intergovernmental partnerships to share information and to consult on issues of importance both to the CFTC and to other regulators. Meetings are typically held among the CFTC, SEC, Treasury Department, Federal Reserve Board, Federal Reserve regional banks, Department of Energy, Department of Agriculture, Federal Trade Commission (FTC), and FERC. Meetings to discuss implementation of the Volcker rule are held among the CFTC, SEC, Federal Reserve, FDIC, and OCC. Other meetings are event driven.

The working relationships with federal law enforcement entities are also fundamental to an effective law enforcement effort. The CFTC coordinates its enforcement efforts with agencies such as the Department of Justice (DOJ), the Federal Bureau of Investigation, FTC, SEC, the Postal Inspection Service, and FERC. Enforcement efforts are coordinated with state authorities as well, including state commissions responsible for the regulation of corporations, securities, insurance, and banking.

The CFTC also is represented on several interagency task forces designed to keep participants abreast of new developments in financial crimes and to coordinate the government's response. In this area, the CFTC participates in the Money Laundering Working Group (MLWG), a forum for discussing money laundering issues among relevant U.S. governmental agencies, chaired by the Treasury Department and DOJ and attended by Prudential Regulators, SEC, CFTC, and state and Federal law enforcement agencies. Through the MLWG, the CFTC also lends advice to the Treasury Department's Financial Crimes Enforcement Network (FinCEN) regarding the work undertaken by the Financial Action Task Force (FATF), an international organization created to formulate recommendations for combating money laundering.

⁵⁵ Board of Governors of the Federal Reserve System, Securities and Exchange Commission, and Commodity Futures Trading Commission, *Risk Management Supervision of Designated Clearing Entities* (July 2011).

Section 12(g) of the CEA requires the CFTC to cooperate with the Office of the Trade Representative, Treasury Department, Department of Commerce, and Department of State to remove any trade barriers that may be imposed by a foreign nation on the international use of electronic trading systems.

Cooperation with other government agencies is also mandated by the CEA as discussed in response to Principle 2, Question 2.

In order to facilitate the sharing of information between federal agencies, the CFTC is a signatory to the following MOUs:⁵⁶

- *Memorandum of Understanding Regarding the Treatment of Non-public Information Shared among the Federal Agency Members of the Inter-Agency Working Group for Market Surveillance (IAWG)* (June 28, 2016) establishes procedures and protocols for the access, use, and confidentiality of information supplied in connection with information sharing related to market surveillance of the U.S. Treasury securities and related derivatives markets. The signatories to the MOU are the CFTC, the Treasury Department, the Federal Reserve Board on behalf of the Federal Reserve System, and the SEC.
- *Memorandum of Understanding Regarding the Treatment of Non-Public Information Shared Among Parties Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act* (July 22, 2011). The ten member agencies of the FSOC entered into an MOU to establish procedures and protocols for the access, use, and confidentiality of information supplied in connection with or related to the functions and activities of the FSOC as well as the OFR pursuant to the Dodd-Frank Act.
- *Memorandum of Understanding Regarding Treatment of Non-Public Information Shared among the Federal Agency Members of the Financial and Banking Information Infrastructure Committee (FBIIC) (FBIIC I MOU)* (April 25, 2016). This MOU establishes procedures and protocols solely among federal financial agency members of FBIIC for the access, use, and confidentiality of information supplied in connection with information sharing related to major cyber or other incidents affecting the financial sector, financial institutions, and financial market utilities. An expanded second FBIIC MOU (*FBIIC II MOU*) was executed that was similar to the *FBIIC I MOU*, but it included non-governmental agencies as signatories. See

⁵⁶ Some MOUs entered into by the CFTC are publicly available and some are not. Those that are publicly available can be found on the table at the front of this document, as well as on the CFTC's website.

Memorandum of Understanding (MOU) Relating to the Confidentiality and Use of Non-public Information Shared among the FBIIC (FBIIC II MOU) (September 30, 2016). The *FBIIC II MOU* is very similar to the *FBIIC I MOU*, but it significantly limits or prohibits sharing with the non-governmental agency parties to the MOU.

- *Memorandum of Understanding Between the Commodity Futures Trading Commission and the Federal Energy Regulatory Commission Regarding Information Sharing and Treatment of Proprietary Trading and Other Information* (January 2, 2014). The FERC and CFTC signed an MOU to address, among other things, sharing of information in connection with market surveillance and investigations into potential market manipulation, fraud, or abuse.
- *Memorandum of Understanding Between the Federal Energy Regulatory Commission and the Commodity Futures Trading Commission* (January 2, 2014). The CFTC and FERC have overlapping jurisdiction over energy commodities, but the CFTC has exclusive jurisdiction over swaps and futures transactions. The MOU sets out a process under which the agencies will notify each other of activities that may involve overlapping jurisdiction and coordinate to address the agencies' regulatory concerns.
- *Memorandum of Understanding between the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission Regarding Coordination in Areas of Common Regulatory Interest and Information Sharing* (July 11, 2018). As noted earlier, the CFTC and the SEC recently entered into a MOU that ensures continued coordination and information sharing between the two agencies. The MOU updates and enhances a 2008 MOU to make it more relevant in the current market environment and promote efficiency in rulemaking, regulatory oversight, and enforcement. Greater harmonization of swap and security-based swap rules enhances SEC and CFTC oversight efforts, reduces unnecessary complexity, and lessens costs for both regulators and market participants.

| | |
|--|---|
| Principle 2 | The Regulator should be operationally independent and accountable in the exercise of its powers and functions. |
| Key Questions | |
| <i>Independence</i> | |
| 1. | Does the regulator have the ability to operate on a day-to-day basis without: |
| (a) | External political interference? |
| <p>Yes. The CEA established the CFTC as an independent regulatory commission of the U.S. government (<i>i.e.</i>, the CFTC does not operate as a division of any Executive Branch department or other agency). Also, as noted below in response to Question 5, the CEA mandates that no more than three CFTC Commissioners may be members of the same political party. The CFTC is accountable to, and subject to the oversight of, Congress.</p> | |
| (b) | Interference from commercial or other sectoral interests? |
| <p>Yes. As set forth below in response to Question 7, interested parties may comment on various CFTC rulemaking proposals, proposed guidance, and proposed orders. In this manner, persons that may be affected by Commission action may provide input and voice any concerns. It is the Commission's practice to place <i>ex parte</i> communications in informal rulemakings into the public record. Specifically, oral comments made privately to members of the Commission or staff are summarized and placed in the public comment file if the information relates to the merits of the rule proposal and is to be considered in formulating a final rule. Similarly, written communications addressed to the merits of the rule proposal are placed in the comment file.</p> | |
| 2. | Where particular matters of regulatory policy require consultation with, or even approval by, a government minister or other authority: |
| (a) | Is the consultation process established by law? |
| <p>Yes. See response to Principle 1, Question 2(a), with respect to consultation required by the Dodd-Frank Act between the Commission, SEC, and Federal Reserve Board regarding coordination in the implementation of Title VII of the Dodd-Frank Act, and between the Commission, SEC, and certain Prudential Regulators regarding coordination in the implementation of the Volcker rule.</p> <p>Section 712 of the Dodd-Frank Act requires the CFTC to consult and coordinate, to the extent possible, with the SEC and the Prudential Regulators "[b]efore commencing any rulemaking or issuing an order regarding swaps, swap dealers, major swap participants, swap data repositories, derivative clearing organizations</p> | |

with regard to swaps, persons associated with a swap dealer or major swap participant, eligible contract participants, or swap execution facilities.”

In addition, under Section 805 of Title VIII of the Dodd-Frank Act,⁵⁷ the CFTC may prescribe regulations, in consultation with the FSOC and the Federal Reserve Board, containing risk management standards, taking into consideration relevant international standards and existing prudential requirements, for SIDCOs, governing the operations related to payment, clearing, and settlement activities of such designated DCOs. The CFTC is also a signatory to an MOU relating to the confidentiality and use of non-public information obtained from or shared among the parties in connection with or related to the functions and activities of the FSOC or the OFR pursuant to the Dodd-Frank Act.⁵⁸ In addition and in accordance with Title VIII of the Dodd-Frank Act, the CFTC consults with the Federal Reserve Board on the examination of SIDCOs, as well as with respect to any proposed changes to a SIDCO’s rules, procedures, or operations that could materially affect the nature or level of risks presented by the SIDCO.⁵⁹

Section 2(a)(9)(B)(ii) of the CEA requires the CFTC to deliver a copy of any application by a board of trade for designation or registration as a DCM to trade futures based on any security issued or guaranteed by the United States or any agency thereof to the Treasury Department and the Federal Reserve Board.

Section 2(a)(9)(B)(ii) of the CEA prohibits the CFTC from designating or registering a board of trade as a DCM in U.S. government issued or guaranteed securities until forty-five days after the CFTC provides a copy of the application to the Treasury Department and the Federal Reserve Board or until the CFTC receives comments from those agencies, whichever period is shorter. This section requires the CFTC to take into account any comments received from those agencies, not only in designation decisions but also in refusing, suspending, or revoking the designation of a contract market trading futures contracts based on U.S. government issued or guaranteed securities.

Security futures products may be traded either on a national securities exchange,

⁵⁷ 12 U.S.C. 5464(a)(2)(A).

⁵⁸ Signatories to this MOU include the FSOC, Treasury Department, Federal Reserve Board, OCC, CFPB, SEC, FDIC, FHFA, NCUA, OFR, FIO, the independent member appointed by the President having insurance expertise on the FSOC, the designated State insurance commissioner, the designated State banking supervisor, and the designated State securities commissioner.

⁵⁹ For example, pursuant to Section 806(e) of Title VIII of the Dodd-Frank Act, 12 U.S.C. 5465(e)(1)(A), and CFTC regulation 40.10, a SIDCO must provide notice 60-day advance notice to the CFTC and Federal Reserve Board of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the SIDCO. In addition, under Section 806(e)(4), before taking any action on, or completing its review of, a material rule change proposed by a SIDCO, the CFTC must consult with the Federal Reserve.

national securities association, or DCM; however, in each case, the entity must become registered with both the CFTC and SEC. This additional registration for a national securities exchange or national securities association is accomplished through an immediately effective notice filing pursuant to CFTC regulation 41.31.⁶⁰ Comparatively, a DCM would submit its notice registration with the SEC pursuant to Section 6(g) of the Securities Exchange Act. Thus, an entity that lists security futures for trading must be registered with the SEC as a national securities exchange or national securities association *and* be designated by the CFTC as a DCM. In addition, exchanges trading security futures are required to file with the SEC and the CFTC proposed rule changes relating to higher margin levels, fraud or manipulation, recordkeeping, reporting, listing standards, decimal pricing, sales practices for security futures products, or rules effectuating such SRO's obligation to enforce the securities laws. A DCM that is "notice-registered" with the SEC would submit most proposed rule changes to the SEC pursuant to Section 19(b)(7) of the Securities Exchange Act while at the same time filing with the CFTC under CFTC regulation 41.24 (rule amendments), and/or CFTC regulation 41.23 (listing of new security futures products). Alternatively, a national securities exchange or national securities association that is "notice-registered" with the CFTC would submit proposed rule changes with the SEC pursuant to Section 19(b)(1) of the Securities Exchange Act and concurrently provide a notice filing with the CFTC under CFTC regulation 41.32.

A clearing agency that is associated with a DCM for security futures and that would be required to register as a clearing agency under Section 17A(b)(1) of the Securities Exchange Act only because it performs clearing functions for security futures products is exempt from registration as a clearing agency under the Securities Exchange Act. However, DCOs regulated by the CFTC through their association with DCMs for security futures products (other than cash-settled contracts) that are national securities exchanges for trading of security futures products must have arrangements in place with a registered clearing agency to effect payment and delivery of the securities underlying the security futures product. Further, any clearing agency for security futures products must develop linkages with all other clearing agencies for security futures products to permit the product to be purchased on one market and offset on another.

Section 2(a)(1)(D)(iv) of the CEA authorizes the Commission to conduct periodic or special examinations of FCMs, IBs, floor brokers, and floor traders engaging in security futures transactions. However, Section 2(a)(1)(D)(iv) of the CEA requires that the CFTC provide the SEC with notice of such examinations for the purpose of assessing the feasibility and desirability of coordinating efforts.

As discussed in the response to Principle 1, Question 2(d), in July 2018, the SEC

⁶⁰ A national securities exchange, national securities association, or alternative trading system subject to Regulation ATS under the Securities Exchange Act that only lists and trades security futures products may be designated as a contract market in security futures pursuant to Section 5f of the CEA by filing a notice with the CFTC.

and CFTC entered into a new MOU which updated and enhanced a 2008 MOU between the SEC and CFTC to make it more relevant in the current market environment and promote efficiency in rulemaking, regulatory oversight, and enforcement. The MOU provides for continued coordination and information sharing between the two agencies and specifically addresses coordination and information sharing related to the regulatory regime for swaps and security-based swaps. The new MOU is a statement of intent to consult, cooperate, and exchange information and data in connection with areas of common regulatory interest. The MOU supersedes the 2008 MOU.

In connection with the beginning of central clearing for credit default swaps (CDS), the Federal Reserve Board, CFTC, and SEC entered into an MOU on November 14, 2008. The MOU established a framework for consultation and information sharing on issues related to CDS clearinghouses and reflected the agencies' intent to cooperate, coordinate, and share information.

The FERC and CFTC signed two MOUs required by the Dodd-Frank Act to address circumstances of overlapping jurisdiction and to share information in connection with market surveillance and investigations into potential market manipulation, fraud, or abuse. The CFTC and FERC have overlapping jurisdiction over energy commodities, but the CFTC has exclusive jurisdiction over swaps and futures transactions in such commodities. See response to Principle 1, Question 2(d).

In 2007, Congress also directed the FTC to adopt an anti-manipulation rule for the physical, wholesale, crude oil, gasoline, and other petroleum distillates markets as part of the Energy Independence and Security Act of 2007.⁶¹ In addition to its exclusive jurisdiction over futures trading on regulated exchanges, the CFTC also has anti-manipulation authority over cash markets as set forth in Section 9(a)(2) of the CEA. As a result, the CFTC and FTC each have concurrent jurisdiction over the underlying cash markets while the CFTC retains its exclusive jurisdiction over futures trading set forth in Section 2(a)(1)(A) of the CEA. The agencies coordinate efforts to efficiently deter and prosecute illegal activity in cash markets consistent with each agency's statutory mandate.

CFTC staff works with staff of other U.S. agencies on an as-needed basis and regularly provides formal and informal feedback on various financial regulation and

⁶¹ The FTC finalized its anti-manipulation rule in 2009. See *Prohibitions on Market Manipulation*, 74 FR 40686 (Aug. 2, 2009) (adding new Part 317 to FTC regulations). Similar to the anti-fraud rule found under Section 10(b) of the Securities Exchange Act (Rule 10b-5), the FTC proposal prohibits fraudulent and deceptive practices which may include "intentional acts that obstruct or impair wholesale petroleum markets." Proof that fraudulent or deceptive conduct actually had an effect on the market is not required under the FTC rule.

| | |
|-----|--|
| | <p>financial stability initiatives of the Treasury Department and fellow financial regulators.</p> <p>Federal agencies also must comply with certain general rulemaking requirements such as the Regulatory Flexibility Act⁶² (RegFlex Act) (which requires agencies to take into account the impact of proposed rules on small businesses), the Paperwork Reduction Act (PRA)⁶³ (which requires agencies to review rules to evaluate the information collection burden such rules would impose on the public), and the Congressional Review Act (CRA)⁶⁴ (which requires agencies to submit rules to Congress and the General Accounting Office (GAO) with a report that includes a consideration of costs and benefits).</p> |
| (b) | <p>Do the circumstances, in which consultation is required, exclude decision making on day-to-day technical matters?</p> |
| | <p>Yes. Consultation with other appropriate Federal agencies and bodies, as described in responses to Principle 1, Questions 2(a) - (d), is narrowly-tailored to specific issues of concurrent or shared jurisdiction.</p> |
| (c) | <p>Are the circumstances in which such consultation or approval is required or permitted clear and the process sufficiently transparent, or the failure to observe procedures and the regulatory decision or outcome subject to sufficient review, to safeguard its integrity?</p> |
| | <p>Yes. See responses to Principle 1, Questions 2(a) – (d) and Principle 2, Questions 2(a) and 6(a). For example, Section 712(c) of the Dodd-Frank Act provides that the Commission or the SEC may object to, and obtain judicial review of, a rule, regulation, or order that does not conform to the statutory delimitation of jurisdiction between the Commission and the SEC with respect to swaps and security-based swaps. Regarding the PRA and RegFlex Act (RegFlex ACT), Federal agencies submit certain filings to the Office of Management and Budget (OMB) (regarding the PRA) and to the General Services Administration (regarding the RegFlex Act) that essentially document compliance with the requirements of those statutes. Before an agency rule can take effect, the CRA requires Federal agencies to submit to each House of Congress and to the Comptroller General of the United States⁶⁵ (Comptroller General) a report containing a copy of the rulemaking, a concise statement relating to the rule and whether it is a major rule, and the proposed effective date. A “non-major” rule becomes effective as proposed by an agency if Congress and the GAO receive the required report. A “major” rule will</p> |

⁶² 5 U.S.C. 601 *et seq.*

⁶³ 44 U.S.C. 3501 *et seq.*

⁶⁴ 5 U.S.C. 804(2).

⁶⁵ The Comptroller General is the head of the GAO.

generally become effective 60 days after Congressional receipt of an agency's report.

As noted above, the regulatory decisions and outcomes of the CFTC are subject to judicial review in the Federal courts.

3. Does the regulator have a stable and continuous source of funding sufficient to meet its regulatory and operational needs?

The CFTC is an independent U.S. regulatory agency. Section 2(a)(10)(A) of the CEA requires that whenever the CFTC submits any budget request to the President of the United States or OMB (the agency within the office of the President that analyses and makes recommendations to the President on budget matters), the CFTC must concurrently transmit copies of the request to the House and Senate Appropriations Committees, the House Committee on Agriculture, and the Senate Committee on Agriculture, Nutrition and Forestry. The vehicle to authorize the CFTC's budget funds is through the adoption by the Congress of a specific bill authorizing and funding the CFTC's operations (as part of the President's budget). The CFTC ceased operations not excepted by the Anti-Deficiency Act, 31 U.S.C. 1342, due to a lapse of appropriations from December 22, 2018, through January 25, 2019.⁶⁶

Determinations regarding the sufficiency of the CFTC's requested resources are made by Congress during its consideration of the CFTC's formal budget request. Information regarding specific needs of the CFTC is communicated by the formal budget document and related written submissions, direct testimony by the Chairman and/or CFTC Commissioners to Congress, and by CFTC and Congressional staff communications and meetings.

For FY2019, the CFTC received a budgetary increase to \$268 million, up from \$249 million in FY2018. This level of funding supports 696 full time equivalents (FTEs). The President's FY2020 budget recommends \$315 million for the CFTC for FY2020, an increase of \$47 million. The \$315 million request is two separate requests: the operational budget of \$284 million, and a one-time request of \$31 million to support the relocation of the regional offices, each with expiring leases. The \$284 million funding level supports 707 FTEs. The President's FY2020 budget would enable the CFTC to expand economic analysis, increase examiners, strengthen cybersecurity, fully fund LabCFTC, and enhance IT capability to improve

⁶⁶ The lapse in appropriations meant that much of the CFTC's work was required by law to cease. The CFTC continued to perform essential market-critical functions throughout the shutdown. The agency was well prepared, utilizing its Lapse in Appropriations action plan adopted in 2017. A small team of agency staff continued to monitor derivatives markets and ensured that essential enforcement activities were carried out. Personnel performing these excepted functions remained in communication throughout with key market participants and self-regulatory organizations.

| | |
|---|--|
| market oversight. | |
| 4. | Are the regulator, the head and members of the governing body of the regulator, as well as its staff, accorded adequate legal protection for the <i>bona fide</i> discharge of their governmental, regulatory and administrative functions and powers? |
| <p>Yes. The Federal Employees Liability Reform and Tort Compensation Act of 1988⁶⁷ provides Federal employees with immunity from individual liability for torts committed in the scope of their employment. In order to insulate CFTC staff from individual liability for possible violation of constitutional or statutory duties that are not shielded by the Federal Liability Reform and Tort Compensation Act of 1988, the CFTC has adopted indemnification rules.⁶⁸</p> | |
| 5. | Are the head and governing board of the regulator subject to mechanisms intended to protect independence, such as: procedures for appointment; terms of office; and criteria for removal? |
| <p>Yes. Section 2(a)(2)(A) of the CEA provides that each of the five Commissioners of the CFTC are to be appointed by the President, by and with the advice and consent of the Senate. Each CFTC Commissioner holds office for a term of five years. The terms of the Commissioners are staggered due to the CEA's initial requirement that the first Commissioners' terms were to expire one, two, three, four, and five years from the date the CFTC began operations on April 21, 1975. Not more than three Commissioners may be members of the same political party.</p> <p>The President appoints, with the advice and consent of the Senate, a member of the CFTC as Chairman, who serves as Chairman at the pleasure of the President. The President may appoint at any time, with the advice and consent of the Senate, a different Chairman, and the CFTC Commissioner previously appointed as Chairman may complete his or her term as a CFTC Commissioner.</p> | |
| <i>Accountability</i> | |
| 6. | With reference to the system of accountability for the regulator's use of its powers and resources: |
| (a) | Is the regulator accountable to the legislature or another government body on an ongoing basis? |
| <p>Yes. The CFTC is accountable for its conduct to Congress. The House Committee on Agriculture and its Subcommittee on Risk Management and Specialty Crops,</p> | |

⁶⁷ 28 U.S.C. 2671.

⁶⁸ CFTC regulation Part 142.

and the Senate Agriculture, Nutrition and Forestry Committee and its Subcommittee on Research, Nutrition and General Legislation have the principal responsibility for oversight of the CFTC. In general, these Committees handle, in the first instance, the reauthorization, budget, and funding decisions for the CFTC, as well as legislation affecting the CEA.

Section 8(i) of the CEA requires the Comptroller General to conduct reviews and audits of the CFTC and make reports related to such reviews and audits. Section 8(i) of the CEA directs the CFTC to make available to the Comptroller General (any information regarding the powers, duties, organization, transactions, operations, and activities of the CFTC, as well as access to any books and records (subject to confidentiality requirements), as the Comptroller General may require.

(b) Is the regulator required to be transparent in its way of operating and use of resources and to make public its actions that affect users of the market and regulated entities, excluding confidential or commercially sensitive information?

Yes. Section 8(a) of the CEA requires the CFTC to make certain public disclosures regarding its operating performance and finances. The Reports Consolidation Act of 2000 authorizes Federal agencies, with the Office of Management and Budget (OMB) concurrence, to consolidate various reports in order to provide performance, financial, and related information in a more meaningful and useful format. The Commission has chosen an alternative to the consolidated Performance and Accountability Report and instead produces an Agency Financial Report and Annual Performance Report, pursuant to OMB Circular A-136, *Financial Reporting Requirements*. Section 18(b) of the CEA requires that the annual report contain plans and findings regarding implementation of Section 18(a) of the CEA, which mandates certain research and information programs.

(c) Is the regulator's receipt and use of funds subject to review or audit?

Yes. Externally, the CFTC's budget and available resources are subject to oversight by the Congress through the exercise of its authorization and funding procedures. Additionally, the Comptroller General periodically conducts audits of the CFTC.

Internally, the CFTC Office of the Executive Director and the Office of Financial Management oversee the use of resources provided to the CFTC by Congress and report directly to the Office of the Chairman. In particular, the Office of Financial Management manages the CFTC's financial and budget programs by coordinating development of the CFTC's strategic plan, annual performance plan and annual performance report; formulates and executes the CFTC's budget; provides contracting and purchasing of services; ensures proper use of, and accounting for, agency resources; and manages the CFTC's travel services.

In addition, the operations of the CFTC are subject to ongoing review by an independent Office of the Inspector General (OIG) with offices in the CFTC headquarters. OIG was established in April 1989 and conducts and supervises

| | |
|----|--|
| | <p>audits and investigations of programs and operations of the CFTC and reviews existing and proposed legislation and regulations. OIG recommends policies to promote economy, efficiency, and effectiveness in CFTC programs and operations, and to prevent and detect fraud and abuse. OIG keeps the Chairman of the CFTC and Congress informed about any problems, deficiencies, and progress of corrective action in programs and operations. For more information about the OIG, please visit the OIG information page available on the CFTC website.</p> |
| 7. | <p>Are there means for natural or legal persons adversely affected by a regulator’s decisions or exercise of administrative authority ultimately to seek review in a court, specifically:</p> |
| | <p>(a) Does the regulator have to provide written reasons for its material decisions?</p> |
| | <p>Yes. CFTC rulemaking must comply with the procedural requirements of the APA, which are intended to provide public notice and opportunity for public comment in the rulemaking. As discussed in the response to Principle 1, Question 1(b), the APA specifically requires Federal administrative agencies such as the CFTC to publish a notice of proposed rulemaking in the <i>Federal Register</i> and to provide interested persons an opportunity to participate in the rulemaking through submission of written data, views, or arguments with or without an opportunity for oral presentations. The APA requires agencies to incorporate a concise general statement of their basis and purpose in the rules adopted.</p> |
| | <p>(b) Does the decision-making process for such decisions include sufficient procedural protections to be meaningful?</p> |
| | <p>Yes. See response to Principle 2, Question 7(a).</p> <p>Part 147 of the CFTC’s regulations implements the open meetings requirement of the Government in the Sunshine Act (Sunshine Act), 5 U.S.C. 552b, which mandates the conditions under which CFTC Commissioners must conduct open meetings. As stated in CFTC regulation 147.1(b), “among the primary purposes of these rules is the CFTC’s desire to inform the public to the fullest extent possible of its activities as an aid to its properly carrying out its responsibility for administering and enforcing the CEA.”</p> <p>The CFTC has also adopted regulations that provide objective due process procedures to ensure that various aspects of its programs are conducted with fairness and impartiality.</p> <p>The APA imposes mandatory procedures (notice and public comment) on the CFTC to ensure procedural fairness in the proposal and adoption of rules. The APA also establishes procedures in the adjudicatory context.</p> <p>In addition, the CFTC has adopted rules of procedure addressing various aspects of the CFTC’s program. For example:</p> |

- CFTC regulations in Part 9 includes procedural regulations relating to the review of exchange disciplinary, access denial, or other adverse actions;
- CFTC regulations in Part 10 contains rules of practice that are generally applicable to adjudicatory proceedings before the CFTC under the CEA (such as denial, suspension, revocation, conditioning, restricting, or modifying registration, the issuance of cease and desist orders, the denial of trading privileges, the assessment of civil penalties, the issuance of restitution orders) and any other proceeding where the CFTC declares them to be applicable;
- CFTC regulations in Part 11 govern rules relating to investigatory proceedings conducted by the CFTC or its staff;
- CFTC regulations in Part 12 relate to reparation proceedings (*i.e.*, claims against registrants for violations of the CEA and CFTC regulations resolved by Administrative Law Judges or hearing officers) pursuant to Section 14 of the CEA;
- CFTC regulations in Part 14 relate to the suspension or disbarment of persons from appearance and practice before the CFTC as an attorney or accountant;
- CFTC regulations in Part 147 specify the regulations applicable to the conduct of CFTC business, with a presumption of open CFTC meetings; and
- CFTC regulations in Part 171 govern procedures applicable to the review of National Futures Association or (NFA) decisions.

As previously noted (*see* response to Principle 2, Question 2(a) and 7(a)), Federal agencies such as the CFTC also must comply with certain general rulemaking requirements (*e.g.*, the RegFlex Act that requires agencies to take into account the impact of proposed rules on small businesses, and the PRA that requires agencies to review rules to evaluate the information collection burden such rules would impose on the public) and its decisions are subject to review by Federal courts.

(c) Are affected persons permitted to make representations prior to such a decision being taken by a regulator in appropriate cases?

Yes. As noted above in response to Questions 7(a) and (b), the CFTC is subject to the APA. The APA establishes procedures that most Federal agencies, including the

CFTC, must follow when they take agency action.⁶⁹ The APA also provides the standards of judicial review of final agency action.⁷⁰

The CFTC typically promulgates rules through “informal” rulemakings under the APA. Informal rulemaking requires that the public be given notice of a proposed rule and the opportunity for public comment.⁷¹ The APA generally requires Federal administrative agencies such as the CFTC to publish a notice of proposed and final rulemaking in the *Federal Register* and to provide interested persons an opportunity to participate in the rulemaking through submission of written data, views, or arguments with or without an opportunity for oral presentations. The Commission’s procedural rules require that whenever the CFTC proposes to issue, amend, or repeal any rule or regulation of general application, that notice of the action be published in the *Federal Register*. See CFTC regulation 13.3. The CFTC sometimes holds open forums to permit oral communication of views by the public on proposed rules of particular significance.

CFTC regulation 140.98 provides, among other things, that each written response by the Commission or its staff to: (i) a letter requesting interpretative legal advice; (ii) a statement that, on the basis of the facts stated in such letter, the staff would not recommend that the Commission take any enforcement action; or (iii) certain exemption letters, will be made available to the public for inspection and copying, except: (i) for a period of up to 120 days, a letter and response thereto granted confidential treatment under CFTC regulation 140.98 and (ii) any data or information that would separately disclose market position, business transactions, trade secrets, or names of customers in violation of Section 8(a)(1) of the CEA.

As noted, the APA requires an agency to give its rationale and policy purpose in proposing or adopting a rule. In addition, the CFTC generally articulates the rationale for all interpretations, exemptions, orders, or policy changes.

The CFTC has from time to time created various advisory committees as a mechanism for public consultation with interested members of the commodities industry and users of the derivatives markets.⁷² Such advisory committees include: (i) an Agricultural Advisory Committee with individuals representing agricultural producers, direct and indirect users/consumers of agricultural products, providers of agricultural credit, other major market participants (including derivatives intermediaries, buy-side representatives, and exchanges), regulators or representatives from other relevant government agencies, academia, and/or public interest groups; (ii) a Technology Advisory Committee with individuals representing industry, exchanges, regulatory organizations, academia, think tanks, and/or public

⁶⁹ The APA is codified at 5 U.S.C. 551 *et seq.*

⁷⁰ 5 U.S.C. 702.

⁷¹ 5 U.S.C. 553.

⁷² These advisory committees are established pursuant to the Federal Advisory Committee Act of 1972 (FACA).

interest groups; (iii) a Market Risk Advisory Committee with members representing end users, exchanges, swap execution facilities, swap data repositories, clearinghouses, asset managers, intermediaries, market makers, service providers, academia, public interest groups, and regulators; and (iv) a Global Markets Advisory Committee with members representing exchanges, clearinghouses, non-exchange SROs, brokers and other market intermediaries, derivatives dealers, providers of other services, market end users (financial and commercial), and public interest groups.

The CFTC also consults with industry on matters of concern to exchanges, trading firms, end users, energy producers, and regulators regarding energy and environmental markets and their regulation by the Commission through the statutorily created Energy and Environmental Markets Advisory Committee.⁷³

The CFTC also periodically holds informal roundtables and formal public hearings on issues.

In addition, the CEA and CFTC regulations also provide various procedural rules in connection with, among other things, investigations and enforcement proceedings, review of exchange disciplinary proceedings, and the reparations program. The CFTC is subject to the Freedom of Information Act (FOIA), which requires Federal agencies to make public information that is not subject to one or more limited restrictions on disclosure.

(d) Are all such decisions taken by the regulator subject to a sufficient, independent review process, ultimately including judicial review?

Yes. Aggrieved parties may challenge agency actions under the APA in U.S. Federal District Court.⁷⁴

8. Where accountability is through the government or some other external agency, is confidential and commercially sensitive information subject to appropriate safeguards to prevent inappropriate use or disclosure?

Yes.

Safeguards against Inappropriate Use of Information. Section 2(a)(8) of the CEA prohibits any CFTC Commissioner or employee of the CFTC from accepting employment or compensation from any person, exchange, or clearinghouse subject to regulation by the CFTC and from participating, directly or indirectly, in any contract market operations or transactions of a character subject to CFTC

⁷³ See CEA Section 2(a)(15). The EEMAC is not subject to the FACA.

⁷⁴ See 5 U.S.C. 702.

regulation.

Section 9(c) of the CEA makes it a felony punishable by a fine of not more than \$500,000 or imprisonment for up to 5 years, or both, for a CFTC employee or CFTC Commissioner to trade commodity futures and options or to participate directly or indirectly in any investment transaction in an actual commodity if non-public information is used in the transaction or if prohibited by CFTC regulations. CFTC regulation 140.735-2 provides, subject to very limited exceptions, that no member or employee of the CFTC may participate directly or indirectly in any transaction involving commodity futures and commodity options, among other things. Section 9(d) of the CEA similarly makes it a punishable felony for a CFTC employee or CFTC Commissioner to pass on or otherwise benefit from information such employee or Commissioner receives in the course of employment which may affect or tend to affect the price of commodities.

Regarding insider trading, Section 4c(a)(3) of the CEA prohibits insider trading as follows:

(3) CONTRACT OF SALE.—It shall be unlawful for any employee or agent of any department or agency of the Federal Government who, by virtue of the employment or position of the employee or agent, acquires information that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, and which information has not been disseminated by the department or agency of the Federal Government holding or creating the information in a manner which makes it generally available to the trading public, or disclosed in a criminal, civil, or administrative hearing, or in a congressional, administrative, or [GAO] report, hearing, audit, or investigation, to use the information in his personal capacity and for personal gain to enter into, or offer to enter into (A) a contract of sale of a commodity for future delivery (or option on such a contract); (B) an option (other than an option executed or traded on a national securities exchange registered pursuant to Section 6(a) of the [Securities Exchange Act]; or (C) a swap.

Safeguards Against Inappropriate Disclosure of Information. Section 8(a)(1) of the CEA provides that, except as otherwise specified in the CEA, the CFTC may not publish data and information that would separately disclose market position, business transactions, trade secrets or names of customers (*i.e.*, Section 8 Material), and the CFTC may withhold from public disclosure any data or information concerning or obtained in connection with any pending investigation of any person. Section 8(a)(1) of the CEA also furnishes protection from compelled disclosure for confidential information received from foreign futures authorities. The effect of this provision is to protect the disclosure of confidential information provided to the CFTC under an MOU in response to a request under FOIA or third-party subpoena.

CFTC regulation 140.735-5 prohibits a Commission employee or former employee from divulging, or causing or allowing to be divulged, confidential or non-public

commercial, economic, or official information to any unauthorized person or to release such information in advance of authorization for its release.

CFTC regulation 145.5 provides that the CFTC may decline to publish or make available to the public any "non-public" records, as defined in CFTC regulation 145.5(a)-(i). Generally, this type of information concerns trade secrets, national defense, or foreign policy concerns, personal privacy, various financial statement forms, and pending investigations. In addition, CFTC regulation 145.9 outlines the procedures by which a person submitting information to the CFTC may request confidential treatment of that information.

Part 146 of the CFTC's regulations implement the Privacy Act, which provides protections for information concerning an individual. Among the primary purposes of these rules are to enable individuals to determine whether information about them is contained in government files and, if so, to obtain access to that information; to establish procedures whereby individuals may have inaccurate and incomplete information corrected; and to restrict access by unauthorized persons to that information.

Sanctions. Section 9(e)(1) of the CEA makes it a felony for any person who is an employee, member of the governing board, or member of any committee of a board of trade, contract market or registered futures association, in violation of a regulation issued by the CFTC, willfully and knowingly to trade for such person's own account, or for or on behalf of any other account in futures contracts or options thereon, on the basis of, or willingly and knowingly to disclose for any purpose inconsistent with the performance of such person's official duties, any material non-public information obtained through special access related to the performance of duties. Violations are punishable by a fine of up to \$500,000 in the case of an individual plus the amount of any gains realized from such trading or disclosures, and/or prison of up to five years.

Section 9(a)(5) of the CEA makes it a felony, punishable by a fine of up to \$1,000,000 in the case of an individual and/or prison of up to ten years, for any person willfully to violate any other provision of the CEA, or any rule or regulation thereunder.

Permissible Disclosures. The CEA specifies the circumstances for the permissible disclosure of information. CEA Section 8(a) also contains a provision that explicitly sets forth certain permissible disclosures of Section 8 Material. This provision includes reference to confidential information received from a foreign futures authority. This explicit list is necessary because, under the CEA, Section 8 Material may not be disclosed by the CFTC "except as otherwise specifically authorized in this Act." See *also* Section 8(e) of the CEA for exceptions to the prohibition against disclosure of Section 8 Material.

CEA Section 8(b) provides that the Commission may disclose confidential information in connection with a congressional proceeding, in an administrative or

judicial proceeding brought under the CEA or CFTC Regulations, in any receivership proceeding involving a receiver appointed in a judicial proceeding brought under the CEA or CFTC Regulations, or in any bankruptcy proceeding in which the CFTC has intervened or in which the CFTC has the right to appear and be heard under Title 11 of the United States Code. As a matter of practice, the Division of Enforcement (DOE) seeks to place safeguards and restrictions on the use and disclosure of confidential information in litigation as appropriate and where possible through the use of protective orders. DOE also makes use of non-disclosure agreements (*e.g.*, for consulting experts) and confidentiality provisions in access letters, memoranda of understanding, or other arrangements (*e.g.*, for sharing with other agencies, including foreign futures authorities) in investigations.

| | |
|---|---|
| Principle 3 | The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. |
| Key Questions | |
| 1. | Are the powers and authorities of the regulator sufficient, taking into account the nature of a jurisdiction's markets and a full assessment of these Principles to meet the responsibilities of the regulator(s) to which they are assigned? |
| <p>Yes. The mission of the CFTC is to protect market users and the public from fraud, manipulation, other abusive practices, and systemic risk, related to derivatives that are subject to the CEA and to foster open, transparent, competitive, and financially sound markets.⁷⁵</p> <ul style="list-style-type: none"> • The CFTC has the power to conduct direct surveillance of those markets and financial institutions that fall within its regulatory jurisdiction.⁷⁶ Significantly, the Dodd-Frank Act gave the Commission regulatory authorities over SDs, MSPs, DCMs, DCOs, SEFs, and SDRs. The CFTC also can obtain certain information on unregulated affiliates of FCMs or affiliates of FCMs subject to regulation by other authorities such as the SEC, the Prudential Regulators, and relevant foreign authorities.⁷⁷ In addition, the CFTC has the power to obtain information regarding regulated markets, institutions, financial products, customers, and parties to transactions.⁷⁸ Further, the CFTC has the power to review books and records of persons holding reportable positions in futures and swaps, including all cash and spot transactions in and inventories of, and purchase and sale commitments of the commodities underlying reportable positions.⁷⁹ • Section 8a(6) of the CEA authorizes the CFTC to communicate to the proper committee or officer of any DCM, registered futures association (RFA), or SRO as defined in Section 3(a)(26) of the Securities Exchange Act, notwithstanding Section 8 of the CEA, the full facts concerning any transaction or market operation, including the names of parties thereto, which in the judgment of the CFTC disrupts or tends to disrupt any market or is otherwise harmful or against the best interests of producers, consumers, or investors, which is necessary to effectuate the purposes of the CEA. Section 8a(6) of the CEA further provides that any information so provided must not be disclosed except in a self- | |

⁷⁵ See Section 3(b) of the CEA.

⁷⁶ See CEA Sections 4(a), 4(b), 4d, 4e, 4m, 4s, 5b, 5h, 8a(5) and 21.

⁷⁷ See CEA Sections 4f(c), 8(a)(1) and 8(a)(2).

⁷⁸ See CEA Sections 4g and 4n.

⁷⁹ See CEA Sections 4i and 4t.

regulatory proceeding or action.⁸⁰

- The CFTC has the power to conduct investigations⁸¹ and sanction violations of the CEA. Administrative sanctions may include orders suspending, denying, revoking, or restricting registration and exchange trading privileges and imposing civil monetary penalties and orders of restitution (CEA Section 6(c)) as well as cease and desist orders (CEA Section 6(d)). The CFTC may also obtain temporary restraining orders and preliminary and permanent injunctions in Federal court for CEA violations, as well as impose civil monetary penalties (CEA Section 6c). Other relief may include appointment of a receiver, freeze assets, restitution, and disgorgement of unlawfully acquired benefits.
- The CEA also provides that the CFTC may obtain certain temporary relief on an *ex parte* basis (that is, without notice to the other party) including restraining orders preserving books and records, freezing assets, and appointing a receiver.⁸² When those enjoined violate court orders, the CFTC may seek to have the offenders held in contempt.
- The CFTC has the power to direct “registered entities”⁸³ to alter or supplement their rules and to take such action as it deems to be necessary to maintain or restore orderly trading.⁸⁴ Section 5e of the CEA authorizes the CFTC to suspend or revoke the designation of a contract market, SEF or DCO based on a failure or refusal to comply with any of the provisions of the CEA, CFTC regulations, or CFTC orders.
- Section 12(a) of the CEA provides that the CFTC “may cooperate with any Department or agency of the government, any state, territory, district, or possession, or department, agency, or political subdivision thereof, any foreign futures authority, any department or agency of a foreign government or political subdivision thereof, or any person.”
- The Commission has broad enforcement anti-manipulation authority. For example, Section 6(c)(1) of the CEA prohibits the use of any “manipulative or deceptive device or contrivance” in connection with any swap or contract of sale of any commodity in interstate commerce for future delivery on or subject

⁸⁰ See also CFTC regulation 140.72 (delegating such authority to certain staff).

⁸¹ See CEA Section 8(a)(1).

⁸² See CEA Section 6c.

⁸³ The term “registered entity” is defined in Section 1a(40) of the CEA to mean (i) a board of trade designated as a contract market under Section 5; (ii) a DCO registered under Section 5b; (iii) a board of trade designated as a contract market under Section 5f; (iv) a SEF registered under Section 5h; (v) an SDR registered under Section 21; and (vi) with respect to a contract that the Commission determines is a significant price discovery contract, any electronic trading facility on which the contract is executed or traded.

⁸⁴ See CEA Sections 8a(7) and (9).

to the rules of any registered entity and includes a special provision for manipulation by false or misleading or inaccurate reporting.⁸⁵ These provisions prohibit "the reckless use of fraud-based manipulative schemes."

- The Dodd-Frank Act also expanded the CFTC's authority to bring new types of enforcement actions alleging false statements to the CFTC. Section 6(c)(2) of the CEA makes it unlawful to make any false or misleading statement of a material fact to the Commission. Section 6(c)(3) of the CEA prohibits any person from directly or indirectly manipulating or attempting to manipulate the price of any product regulated by the Commission.
- The CEA prohibits certain trading practices that Congress determined were disruptive of fair and equitable trading. Section 4c(a) of the CEA makes it unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that:
 - violates bids or offers;
 - demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
 - is of the character of, or is commonly known to the trade as, "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution).
- The Dodd-Frank Act also established structural mechanisms to ensure that gaps are addressed as soon as new products are developed. The Dodd-Frank Act removed previous exemptions from regulation related to: (1) transactions in excluded commodities between ECPs and not executed or traded on a trading facility; (2) principal-to-principal transactions in excluded commodities between certain ECPs and executed or traded on an electronic trading facility; (3) transactions subject to individual negotiation between ECPs in commodities other than agricultural commodities and not executed or traded on a trading facility; (4) transactions in exempt commodities between ECPs and not entered into on a trading facility; (5) principal-to principal transactions in exempt commodities between eligible commercial entities and executed or traded on an electronic trading facility; and (6) transactions in commodities, among other things, having a nearly inexhaustible deliverable supply or no cash market, between ECPs and traded on an exempt board of trade.
- Additionally, the Dodd-Frank Act amended the CEA to include detailed core principles for DCOs to enhance the CEA regulatory regime for central counterparties. It also authorized the CFTC to prescribe regulations, in consultation with FSOC and the Federal Reserve Board, containing risk management standards for SIDCOs, taking into consideration relevant

⁸⁵ See CFTC regulation 180.1(a).

| | |
|---|---|
| <p>international standards and existing prudential requirements.</p> <ul style="list-style-type: none"> • In order to provide greater transparency to the swap market and permit regulators to properly assess the market and its participants, the Dodd-Frank Act established SDRs for the purpose of collecting and maintaining data and information related to swap transactions.⁸⁶ SDRs are required to register⁸⁷ with the CFTC and make such data and information directly and electronically available to the CFTC and other regulators.⁸⁸ In addition, the Dodd-Frank Act also required in Section 727 that swap transaction data be publicly available and disseminated to the marketplace. The CFTC adopted Part 43 to its regulations to implement these Congressional requirements.⁸⁹ • Foreign boards of trade (FBOTs) that wish to permit identified members and other participants located in the United States. with direct access to their electronic trading and order matching system must apply for and receive an order of registration pursuant to the procedures set forth in Part 48 of the Commission’s regulations. | |
| 2. | With regard to funding: |
| (a) | Is the regulator’s funding adequate to permit it to fulfil its responsibilities, taking into account the size, complexity and types of functions subject to its regulation, supervision or oversight? |
| <p>See response to Principle 2, Question 3, above.</p> | |
| (b) | Can the regulator affect the operational allocation of resources once funded? |
| <p>Yes. An allocation request is submitted by the CFTC to Congress. The request contains a specific breakdown of resource allocation within the CFTC. The final allocation may be revised as part of discussions between the Congress and the CFTC. The final allocation is established when the Congress adopts the bill funding the CFTC’s operations.</p> | |
| 3. | Does the level of resources recognize the difficulty of attracting and retaining experienced and skilled staff? |
| <p>The CFTC is able to attract and retain experienced and skilled staff within the constraints of the budget approved by Congress. Section 12 of the CEA authorizes the CFTC to employ personnel and obtain necessary technical resources; Section</p> | |

⁸⁶ See CEA Section 21.

⁸⁷ *Swap Data Repositories: Registration Standards, Duties and Core Principles*, 76 FR 54538, 54544 (Sept. 1, 2011).

⁸⁸ *Swap Data Recordkeeping and Reporting Requirements*, 77 FR 2136 (Jan. 13, 2012).

⁸⁹ *Real-Time Public Reporting of Swap Transaction Data*, 77 FR 1182 (Jan. 9, 2012).

12(b)(1) of the CEA also authorizes the CFTC to employ such investigators, special experts, Administrative Law Judges, clerks, and other employees as it may from time to time find necessary for the proper performance of its duties and as may be from time to time be appropriated by Congress; Section 12(b)(2) of the CEA authorizes the CFTC to employ experts and consultants; and Section 12(b)(3) of the CEA authorizes the CFTC to make and enter into contracts with respect to all matters which in the judgment of the CFTC are necessary and appropriate to effectuate the purposes of the CEA.

Section 2(a)(4) of the CEA requires the Commission to have a General Counsel and to appoint such other attorneys as may be necessary to assist the General Counsel and perform legal duties and functions as the Commission may direct.

Section 2(a)(7) of the CEA permits the CFTC to provide additional compensation and benefits to employees "if the same type of compensation or benefits are provided by any agency referred to in section 1206(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. 1833b(a), or could be provided by such an agency under applicable provisions of law (including rules and regulations)." In effect, Section 2(a)(7) of the CEA enables the CFTC to maintain comparative compensation and benefits in relation to other Federal financial regulators for the purpose of retaining and attracting employees.

4. Does the regulator ensure that its staff receives adequate ongoing training?

Yes. Throughout the year, the Human Resources Branch provides a series of educational/training seminars keyed to the primary mission of the CFTC through its Talent Management and Leadership Development Section. The Section employs a full-time Learning Officer to ensure that the training needs of all employees are met. These training seminars are focused on the financial and legal aspects of the derivatives markets. In 2018, the Commission implemented a Learning Management System (CFTC Learning Center) that provides access to online, webinar, and live face-to-face accredited, financial markets, financial industry, financial management, and business skills enhancement training for all CFTC employees. The Learning Management System also provides accredited online professional development training in auditing, accounting, taxes, government, and regulatory ethics for financial auditors and financial management review employees. Technical and computer skills are also provided to employees as needed. Off-site educational seminars provided by third parties (such as continuing legal education, leadership, and office skills) are also made available. Additionally, the Commission has an executive coaching program and a training program for supervisors.

5. Does the regulator have policies and governance practices to perform its functions and exercise its powers effectively?

Yes. See responses to Principle 1, Question 1, and Principle 3, Question 1.

| |
|---|
| 6. Does the regulator play an active role in promoting education in the interest of protecting investors? |
|---|

Yes. The Commission has an Office of External Affairs that supports the Commission by creating and distributing financial education messages to help consumers avoid fraud and deception in the commodities markets.

The Commission has a section on its website devoted to consumer protection, "Learn & Protect." The link is prominently located on the banner of the CFTC home page.

The consumer protection section of the website educates consumers about U.S. derivatives markets; notifies the public about the types of fraud in the marketplace; offers guidance on how to file complaints or send in tips regarding suspicious activities; and provides updates on disciplinary actions.

| | |
|---|--|
| Principle 6 | The Regulator should have or contribute to a process to identify, monitor, mitigate and manage systemic risk, appropriate to its mandate. |
| Key Questions | |
| 1. | |
| (a) | Does the regulator have clear responsibilities in: |
| (i) | identifying, monitoring, mitigating and appropriately managing systemic risks related to securities markets; and |
| <p>Yes, the CFTC has clear responsibility for regulating certain critical infrastructure and market participants with regard to systemic risk as it exists in derivatives markets. The avoidance of systemic risk is one of the stated purposes enumerated in Section 3(b) of the CEA.⁹⁰</p> <p>With respect to DCOs, the CEA provides core principles for risk management and system safeguards.⁹¹ CFTC regulations define clearing activities with a more complex risk profile, establish system safeguards, and establish stress and system safeguards testing.⁹² CFTC regulation 39.2 defines a systemically important DCO (SIDCO) as “a financial market utility that is a derivatives clearing organization registered under Section 5b of the Act, which is currently designated by the [FSOC] to be systemically important and for which the Commission acts as the Supervisory Agency pursuant to 12 U.S.C. 5462(8).”⁹³ DCOs provide clearing services for derivatives markets. All futures and options on futures are required to be cleared through a DCO. For swaps, the Commission determined that certain interest rate and credit default swaps are required to be cleared.⁹⁴ In determining that certain swaps are required to be cleared, the Commission took into account the “effect on the mitigation of systemic risk” as required by Section 2(h)(2)(D)(ii)(III) of the CEA.</p> <p>With regard to market participants, under Section 4s(e)(3)(A) of the CEA, the CFTC is required to establish minimum capital and margin requirements for all CFTC-registered SDs and MSPs for which there is no prudential regulator in order to “help ensure the safety and soundness” of the SD or MSP. The CFTC Margin Rule which is codified in Part 23 of the Commission’s regulations, establishes margin requirements for uncleared swaps that are designed to be appropriate for the risk associated with uncleared swaps.⁹⁵</p> | |

⁹⁰ Under the findings and purpose section of CEA Section 3(b), one of the purposes of the CEA is “to ensure the financial integrity of all transactions subject to this Act and the avoidance of systemic risk.”

⁹¹ CEA Sections 5b(c)(2)(D) and 5b(c)(2)(I), respectively.

⁹² CFTC regulations 39.2, 39.13, 39.18, 39.34, and 39.36.

⁹³ CFTC regulations 39.30-39.42, subpart C, establishes the regulation of SIDCOs (and DCOs that elect to be subject to the same provisions).

⁹⁴ See Part 50 of the Commission’s regulations as adopted in 2012 and 2016.

⁹⁵ See CFTC regulations 23.150–23.161.

| |
|---|
| |
| <p>(ii) contributing to processes in relation to other financial markets.</p> |
| <p>Yes. Section 619 of the Dodd-Frank Act, commonly known as the “Volcker rule,” added Section 13 to the Bank Holding Company Act of 1956 which, in subsection (b)(2)(B)(ii), requires the Commission, SEC, Federal Reserve Board, FDIC and OCC to “consult and coordinate with each other, as appropriate, for the purposes of assuring, to the extent possible, that such regulations [issued under this section] are comparable and provide for consistent application and implementation of the applicable provisions of this section to avoid providing advantages or imposing disadvantages to the companies affected by this subsection and to protect the safety and soundness of banking entities and nonbank financial companies supervised by the [Federal Reserve].” Under this authority, the Commission, along with the SEC, Federal Reserve Board, FDIC, and OCC issue rules to implement the Volcker rule. <i>See also</i> response to Principle 1, Question 2(a).</p> |
| <p>(b) Is there a clear definition of systemic risk within the jurisdiction?</p> |
| <p>“Systemic Risk” is not a statutorily defined term or defined in the CFTC’s regulations. However, in the context of the markets that the CFTC regulates, it is generally accepted that systemic risk includes the risk that a default by one or more market participants will have repercussions on other market participants due to the inter-connected nature of derivatives markets and the financial market more generally. With respect to DCOs, Title VIII of the Dodd-Frank Act established a new supervisory framework for systemically important financial market utilities. Financial market utilities manage or operate multilateral systems for the purpose of transferring, clearing, or settling financial transactions. The FSOC has the authority to designate a financial market utility as systemically important if the failure of or a disruption to the financial market utility’s operations could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. The FSOC determined in 2012 that two DCOs registered with the CFTC were systemically important. The CFTC’s regulations define a SIDCO under CFTC regulation 39.2 to mean “a financial market utility that is a derivatives clearing organization registered under Section 5b of the Act, which is currently designated by the [FSOC] to be systemically important and for which the Commission acts as the Supervisory Agency pursuant to 12 U.S.C. 5462(8).”</p> |
| <p>2. Does the regulator have, or contribute to a regulatory process (which may be focused on the securities market or be cross-sectoral) through formalized arrangements to identify, monitor, mitigate and appropriately manage systemic risk, according to the complexity of the regulator’s market consistent with its mandate and authority?</p> |
| <p>Yes. The Commission has market surveillance and financial risk procedures to identify risks.</p> |

Market Surveillance

Market risks present in the derivatives markets under CFTC jurisdiction are generally assessed by the CFTC's market surveillance program, which was formerly within its Division of Market Oversight (DMO), but has been re-aligned within the DOE. Market surveillance is intended to preserve the economic functions of U.S. derivatives markets under the CFTC's jurisdiction by monitoring trading activity:

- to detect and prevent manipulation or abusive practices;
- to keep the CFTC informed of significant market developments;
- to enforce CFTC and exchange speculative position limits; and
- to ensure compliance with CFTC reporting requirements.

The market surveillance program's primary mission is to identify situations that could pose a threat of manipulation and to initiate appropriate preventive actions in physical commodities related to corners and squeezes. Further, surveillance is conducted forensically to uncover manipulation or other abusive practices in markets within the CFTC's jurisdiction for which information is not readily available or detection is not possible in real-time. Each day, the CFTC's market surveillance staff monitors the activities of large traders, examines price spikes, tracks scheduled news releases of market-sensitive data, and conducts analysis of daily and final settlements in selected major commodities and options contracts. Staff also tracks key price relationships, and relevant supply and demand factors in a review for potential market problems. With the addition of swaps, staff monitors credit events for impacts on credit default indices and initiates an evaluative process to determine if the CDS settlement, after a credit event, was potentially manipulated. Interest rates swaps, foreign exchange, currency swaps and the other commodity asset class swaps are regularly examined for potential abuses and submission compliance with Commission regulations.

Also as part of the re-alignment of DMO's Market Surveillance Unit within DOE, a new branch was created within DMO, called the Market Intelligence Branch (MIB). MIB focuses on analyzing and communicating current and emerging derivatives market dynamics, developments, and trends to assist the Commission and public in making informed decisions.

Financial Risk

DCOs under the CFTC's jurisdiction must comply with 18 core principles in order to be registered and to maintain registration. These core principles address the following topics, among others:

- Financial Resources
- Risk Management

- Settlement Procedures
- Treatment of Funds
- Default Rules and Procedures
- Rule Enforcement
- System Safeguards
- Reporting
- Recordkeeping

The Division of Clearing and Risk's (DCR's) Risk Surveillance Group (RSG) monitors the risk posed to and by DCOs, clearing members, and market participants, including market risk, liquidity risk, credit risk, and concentration risk. Relevant margin and financial resources are included within this monitoring program. CFTC staff regularly conducts back-testing to review margin coverage at the product level and follows up with the relevant clearinghouse regarding exceptional results. Independent stress testing of portfolios is conducted regularly. The independent stress tests may lead to individual trader reviews and/or FCM risk reviews. Traders and FCMs that have a higher risk profile are then reviewed during the Commission's on-site review of a clearinghouse's risk management procedures. In addition, the RSG also coordinates with other domestic and foreign regulators on matters of common jurisdictional interest.

DCR's Examinations Branch examines DCOs that are registered with the Commission for compliance with the DCO core principles as well as all relevant CFTC regulations. These core principles encompass all aspects of clearing, and an examination frequently involves a sophisticated analysis of a broad range of topics including, but not limited to, the adequacy of a DCO's financial, operational, and managerial resources; the DCO's ability to manage all risks associated with clearing and settlement, including whether the DCO uses appropriate tools and procedures to monitor such risks; whether the DCO's risk analysis and oversight program is able to accurately identify and minimize sources of operational risk; and a DCO's ability to resist, and to minimize, any potential damage from cyber security threats. The Examinations Branch examines DCOs as frequently as practicable. The Examinations Branch examines each SIDCO at least once annually to determine: (1) the nature of the operations of, and the risks borne by, the SIDCO; (2) the financial and operational risks presented by the SIDCO to financial institutions, critical markets, or the broader financial system; (3) the resources and capabilities of the SIDCO to monitor and control such risks; (4) the safety and soundness of the SIDCO; and (5) the SIDCO's compliance with Title VIII, Section 807 of the Dodd-Frank Act. The Examinations Branch also frequently coordinates with other domestic and foreign regulators during an examination. Finally, the Examinations Branch also performs the following tasks: (i) reviews all monthly and quarterly submissions from DCOs to evaluate compliance with the CFTC's financial resource requirements; (ii) reviews the certified financial statements of each DCO; (iii)

reviews the notice filings from all DCOs; (iv) assists with DCO applications by reviewing information supporting the DCO applicant's compliance with certain core principles; (v) develops tools to help in the evaluation of compliance with core principles; and (vi) assists in the review of SIDCO material rule change filings.

Economic Research and Analysis.

The Office of the Chief Economist (OCE) conducts rigorous economic and econometric analysis of derivatives markets; fosters market transparency by disseminating its research to market participants and the general public; and partners with other CFTC divisions and offices to integrate economic reasoning and data analysis into Commission policy and cost-benefit considerations.

OCE economists write and publish research that educates the CFTC and the general public about derivatives markets and, in many cases, provides concrete policy guidance to the Commission and other regulatory bodies. OCE authors often aim to publish their work in peer-reviewed academic journals, both to ensure that their work is of the highest quality and to engage a particularly knowledgeable and influential part of the general public. In pursuing this part of its mission, OCE often partners with economic and finance faculty at various academic institutions.

Broadly speaking, OCE research papers can be divided into three categories:

- (1) *Who Does What in Derivatives Markets*: For example, a 2018 study of West Texas Intermediate (WTI) Crude Oil derivatives showed that commercial end users are short, mostly in swaps; financial end users are long, mostly in futures; and dealers intermediate across these markets and market participants.⁹⁶
- (2) *The Impact of Regulation on Derivatives Markets*: For example, a 2018 working paper demonstrated that the Basel III leverage ratio drove market share in equity options from U.S. banks to European banks and to non-banking institutions.⁹⁷
- (3) *Trading Dynamics and Market Liquidity*: For example, a 2019 paper analyzed traders in WTI Crude Oil futures and pointed out that those who

⁹⁶ Mixon, S., Onur, E., and Riggs, L. (2018), "Integrating Swaps and Futures: A New Direction for Commodity Research," *Journal of Commodity Markets* 10, pp. 3-21.

⁹⁷ Haynes, R., McPhail, L., and Zhu, H. (2018), "Assessing the Impact of the Basel III Leverage Ratio on the Competitive Landscape of U.S. Derivatives Markets: Evidence from Options," working paper, CFTC, June 15, 2018.

successfully anticipate price trends are not necessarily high-frequency traders.⁹⁸

OCE economists produce *ad hoc* and periodic reports on derivatives markets. The CFTC's collection of regulatory data from the public enables the agency to create reports that the public itself cannot create.

An important example of periodic reports are the Entity-Netted Notionals (ENNs) reports, which give the size of swaps markets and sectors in terms of market risk equivalents. The methodology was introduced in Haynes *et al.* (2018)⁹⁹ and Baker *et al.* (2019).¹⁰⁰ ENNs are a better measure of market risk transfer in swap markets than notional amounts. Notional amounts add together swaps positions with very different amounts of risk (*e.g.*, 3-month and 30-year interest rate swaps) and add together long and short positions between the same two counterparties, which, from a risk perspective, are really offsetting. By contrast, ENNs convert notional amounts to risk equivalents of a benchmark (*e.g.*, a 5-year interest rate swap) and then net long and short positions between each pair of counterparties. Currently, the CFTC regularly computes ENNs for interest rate swaps, credit default swaps on corporates and sovereigns, and foreign exchange swaps. Two examples of less regular reports are Haynes and Roberts (2019),¹⁰¹ which documents the extent of automated trading in futures markets, and Baker, McPhail, and Tuckman (2018),¹⁰² which presents a liquidity hierarchy in the U.S. Treasury bond and futures markets.

OCE plays a significant role in working with the rulemaking divisions to apply economic and data expertise throughout the process of commission policymaking, including providing critical analysis of the costs and benefits associated with such policy decisions. Most examples of this activity are embedded in Commission rules, CFTC staff letters, and other documents. Other examples, however, take the form of separate papers, like Haynes, Lau, and Tuckman (2018)¹⁰³ on the phase in of initial margin requirements and Riggs *et al.* (2017)¹⁰⁴ on the characteristics of trading at swap execution facilities.

⁹⁸ Fishe, R. P., Haynes, R., and Onur, E. (2019), "Anticipatory Traders and Trading Speed," *Journal of Financial and Quantitative Analysis* 54(2), April 2019, pp. 729-758.

⁹⁹ Haynes, R., Roberts, J., Sharma, R., and Tuckman, B. (2018), "Introducing ENNs: A Measure of the Size of Interest Rate Swap Markets," CFTC, January 2018.

¹⁰⁰ Baker, L., Haynes, R., Lau, M., Roberts, J., Sharma, R., and Tuckman, B. (2019), "ENNs for Corporate and Sovereign CDS and FX Swaps," CFTC, February 2019.

¹⁰¹ Haynes, R., and Roberts, J. (2019), "Automated Trading in Futures Markets—Update #2," CFTC, March 26, 2019.

¹⁰² Baker, L., McPhail, L., and Tuckman, B. (2018), "The Liquidity Hierarchy in the U.S. Treasury Market: Summary Statistics from CBOT Futures and TRACE Bond Data," CFTC, December 3, 2018.

¹⁰³ Haynes, R., Lau, M., and Tuckman, B. (2018), "Initial Margin Phase 5," October 2018.

¹⁰⁴ Riggs, L., Onur, E., Reiffen, D., and Zhu, H. (2017), "Mechanism Selection and Trade Formation on Swap Execution Facilities: Evidence from Index CDS," CFTC, September 29, 2018.

The FSOC

As discussed above in response to Principle 1, Question 2(d), the CFTC is also a member of the FSOC. Under Section 113 of the Dodd-Frank Act, the FSOC is authorized to determine that a nonbank financial company's material financial distress—or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities—could pose a threat to U.S. financial stability.

The Dodd-Frank Act also authorizes the FSOC to designate a financial market utility (FMU) as "systemically important" if the FSOC determines that the failure of or a disruption to the functioning of the FMU could create or increase the risk of significant liquidity or credit problems among financial institutions or markets and thereby threaten the stability of the U.S. financial system. Pursuant to Title VIII of the Dodd-Frank Act, designated FMUs are subject to heightened prudential and supervisory requirements that promote robust risk management and safety and soundness, including conducting their operations in compliance with applicable risk-management standards; providing advance notice and review of changes to their rules, procedures and operations that could materially affect the nature or level of their risks; and being subject to relevant examination and enforcement provisions.

3.

- (a) Is there an effective information sharing framework in place with other regulators and supervisors within the jurisdiction covering systemic risks, which is supported by formal cooperation or institutional arrangements?

Yes. The CFTC frequently coordinates with other domestic and foreign regulators on matters of common jurisdictional interest, as well as on DCO examinations. In addition, as a voting member, Supervisory Agency, and subject matter expert, the CFTC frequently works with the FSOC on a number of matters, including systemic risk surveillance. Specific FSOC authorities include:

- Facilitate Regulatory Coordination: The FSOC has a statutory duty to facilitate information sharing and coordination among the member agencies regarding domestic financial services policy development and rulemaking, examinations, reporting requirements, and enforcement actions with respect to designated FMUs and designated nonbank financial companies.
- Facilitate Information Sharing and Collection: In instances where the data available proves insufficient, the FSOC has the authority to direct the OFR to collect information from certain individual financial companies to assess risks to the financial system, including the extent to which a financial activity or financial market in which the financial company participates, or

| | |
|------------|--|
| | <p>the financial company itself, poses a threat to the financial stability of the United States.</p> <ul style="list-style-type: none"> • <u>Designate Nonbank Financial Companies for Consolidated Supervision</u>: The Dodd-Frank Act gives the FSOC the authority to require consolidated supervision of nonbank financial companies, regardless of their corporate form. • <u>Designate Systemic Financial Market Utilities and Systemic Payment, Clearing, or Settlement Activities</u>: The Dodd-Frank Act authorizes the FSOC to designate FMUs and payment, clearing, or settlement activities as systemically important, requiring them to meet risk management standards prescribed by the relevant Supervisory Agency and heightened oversight by the Federal Reserve Board, SEC or CFTC. • <u>Recommend Stricter Standards</u>: The FSOC has the authority to recommend stricter standards for the largest, most interconnected firms, including nonbanks, designated by the FSOC for Federal Reserve supervision. Moreover, where the FSOC determines that certain practices or activities pose a threat to financial stability, the FSOC may make recommendations to the primary financial regulatory agencies for new or heightened standards. • <u>Recommend Congress close specific gaps in regulation</u>. |
| <p>(b)</p> | <p>Does the regulator communicate information and data about identified systemic risk(s) with regulators in other jurisdictions under established procedures or arrangements and/or supported by bilateral and/or multilateral memoranda of understanding (MoUs)?</p> |
| | <p>Yes. The CFTC may share information with any foreign futures authority or with any department, central bank, ministry or agency of any foreign government or any political subdivision thereof acting within the scope of its jurisdiction, provided that the requirements in Section 8(e) of the CEA are satisfied. The CFTC shares <i>non-public</i> information pursuant to an MOU or a less formal arrangement (Arrangement) that includes undertakings related to, among other things, confidentiality and use of the information. In addition, Section 809(e)(2) of the Dodd-Frank Act states that the FSOC, Federal Reserve Board, appropriate financial regulators and supervisory agencies may provide, subject to appropriate terms, conditions and assurances of confidentiality, confidential supervisory and other information to, among others, foreign financial supervisors, foreign central banks and foreign finance ministries.</p> <p>The CFTC has a long-standing practice of entering into Arrangements with foreign regulators and is a signatory to a wide range of Arrangements. For example, the CFTC has entered into broad-scope supervisory Arrangements with regulators in</p> |

Canada, Hong Kong, Japan, and Singapore that include, among others, DCOs. In addition, the CFTC has signed clearing-related Arrangements with regulators in Australia, France, Germany, Mexico, South Korea, the United Kingdom, and the European Union. Copies of formal Arrangements with foreign regulators generally are available on the CFTC's website.

CFTC staff regularly communicates with its counterparts in other jurisdictions regarding information related to systemic risk, oversight of clearinghouses, and other matters.

4. Does the regulator have appropriately skilled human and adequate technical resources to support effective risk arrangements?

Yes. See response to Principle 2, Question 3, above.

| | |
|--------------------|--|
| Principle 7 | The Regulator should have or contribute to a process to review the perimeter of regulation regularly. |
|--------------------|--|

| |
|----------------------|
| Key Questions |
|----------------------|

- | |
|---|
| <p>1. Does the regulator have or participate in a process, to identify and assess whether its regulatory requirements and framework adequately addresses risks posed by products, markets, market participants and activities to investor protection, fair, efficient and transparent markets and the reduction of systemic risk?</p> |
|---|

Yes. The FSOC is a forum for the exchange of issues and concerns among the U.S. financial regulatory agencies that participate in the FSOC. As noted in response to Principle 1, Question 2(d), FSOC members include the heads of, among others, the Treasury Department, Federal Reserve Board, CFTC, OCC, CFPB, SEC, and FDIC. The agencies are all separate US government agencies. Review occurs through staff discussions within the FSOC, through event-based discussions with other regulatory agencies, and through the day-to-day exercise of supervisory responsibilities.

In addition to participation with FSOC, CFTC staff also is in regular contact with officials at the SEC, Federal Reserve Board, FDIC, OCC, and Treasury Department, which provides opportunity to discuss any emerging regulatory concerns.

In addition, in adopting its margin requirements for uncleared swaps, CFTC staff worked closely with staff of the Prudential Regulators in developing similar requirements, which were all based on the Bank for International Settlements-International Organization of Securities Commissions (BIS-IOSCO) international framework. More recently, CFTC staff coordinated with SEC staff with regard to the SEC's rule addressing capital, margin, and segregation for security-based swap dealers, as well as with regard to the phased implementation of margin for uncleared swaps rules.

The CFTC is a member of the FBIIC, a partnership across government agencies to enhance the U.S. financial sector's capabilities to mitigate vulnerabilities and maintain a strong cybersecurity posture.

The CFTC also launched its LabCFTC program in 2017. LabCFTC is an initiative aimed at facilitating market-enhancing fintech innovation, informing policy, and ensuring that the agency has the regulatory and technological tools and understanding to keep pace with changing markets. It is the agency's point of contact for engaging with fintech innovation and promoting fair competition by making the CFTC more accessible to fintech innovators. LabCFTC is an information source for Commissioners and staff on market-enhancing innovation, and works to identify emerging opportunities, challenges, and risks that may influence policy development.

As discussed in more detail in response to Principle 6, Question 2, OCE conducts rigorous economic and econometric analysis of derivatives markets; fosters market

transparency by disseminating its research to market participants and the general public; and partners with other CFTC divisions and offices to integrate economic reasoning and data analysis into Commission policy and cost-benefit considerations. OCE economists write and publish research that educates the CFTC and the general public about derivatives markets and, in many cases, provides concrete policy guidance to the Commission and other regulatory bodies. OCE authors often aim to publish their work in peer-reviewed academic journals, both to ensure that their work is of the highest quality and to engage a particularly knowledgeable and influential part of the general public. In pursuing this part of its mission, OCE often partners with economic and finance faculty at various academic institutions.

The CFTC's advisory committees, discussed in response to Principle 2, Question 7(c), provide input and make recommendations to the Commission on a variety of regulatory and market issues that affect the integrity and competitiveness of U.S. markets. The committees facilitate communication between the Commission and U.S. futures and swaps markets, trading firms, market participants, and end users. The committees currently include:

- Agricultural Advisory Committee
- Technology Advisory Committee
- Market Risk Advisory Committee
- Global Markets Advisory Committee
- Energy and Environmental Markets Advisory Committee

The agendas of recent advisory committee meetings illustrate the “perimeter of regulation” type inquiries that are taking place. Examples include:¹⁰⁵

- Agricultural Advisory Committee: cash market innovations, the role of matching algorithms, future of FCMs, risk management crop insurance, and block trading.
- Technology Advisory Committee: virtual currencies, digital and digitized assets, cyber security, distributed ledger technology, and market infrastructure.
- Market Risk Advisory Committee: interest rate benchmark reform, oversight of third-party service providers and vendor risk management, domestic and international policy initiatives regarding market risk from climate change, self-certification for new products and regulatory approach for novel products, Brexit's effect on markets, cybersecurity, and risk surveillance.
- Global Markets Advisory Committee: financial system issues in other

¹⁰⁵ The agendas for the committees are available on the CFTC's website and the links on the table at the front of this document.

countries, regulatory-driven market fragmentation, trading on exchanges or electronic platforms and clearing through counterparties, initial margin for non-centrally cleared derivative contracts, and OTC derivatives reporting to trade repositories.

- Energy and Environmental Markets Advisory Committee: Derivatives markets' responses to physical markets' developments, energy futures markets, and the globalization of oil and gas trading, the shift toward clean and renewable energy sources, and the availability of clearing and other services in the energy derivatives markets.

2. Does the regulator have formalized arrangement and/or a process to review, when there is evidence of changing circumstances, its past regulatory policy decisions on products, markets, entities, market participants or activities, especially decisions to exempt, and take measures as appropriate?

Yes. Review of past regulatory policy decisions occurs through a variety of mechanisms:

(a) Project KISS (which stands for "Keep It Simple, Stupid") is an initiative launched by the Commission in 2017 to seek public input on simplifying and modernizing the Commission's rules. It follows Executive Order 13777 on regulatory reform issued by the President the same year.¹⁰⁶ The President's executive order directed federal agencies to designate a Regulatory Reform Officer and establish a Regulatory Reform Task Force. While the CFTC is not directly covered by the President's order, the agency designated a Regulatory Reform Officer and established a task force. Following a period of public comment and its own review, the Commission has issued a number of revised rules under Project Kiss.

(b) Executive Order 13563, "Improving Regulation and Regulatory Review" (issued Jan. 18, 2011), calls on agencies to undertake an annual retrospective review of agency regulations. The Executive Order emphasizes several guiding principles, including that: agencies consider the costs and benefits of their regulations and choose the least burdensome path; the regulatory process must be transparent and include public participation; and agencies must attempt to coordinate, simplify and harmonize regulations to reduce costs and promote certainty for businesses and the public. Section 6 of the Executive Order focuses on the importance of maintaining a consistent culture of retrospective review and analysis by agencies of their regulatory programs. To that end, Section 6 includes a "look-back" provision for agencies to develop a preliminary plan under which the agency will periodically review its existing significant regulations to determine whether any should be modified, streamlined, expanded, or repealed in order to make the agency's regulatory program more effective and less burdensome.

As part of the implementation of the Dodd-Frank Act, the Commission reviewed many of its existing regulations. In determining the extent to which these existing

¹⁰⁶ Executive Order 13777, 82 FR 12285 (2017).

regulations needed to be modified to conform to the Dodd-Frank Act's new requirements, the Commission has subjected many of its existing rules to scrutiny in accordance with the Executive Order. A number of the rules promulgated and implemented by the Commission after the passage of the Dodd-Frank Act have been, or may be, amended or revised. *See, e.g., Swap Execution Facilities and Trade Execution Requirement*, 83 FR 61946 (Nov. 30, 2018); *Derivatives Clearing Organization General Provisions and Core Principles*, 84 FR 22226 (May 16, 2019).

(c) Regulatory Flexibility Act (RegFlex Act). The CFTC formed an interdivisional working group in 2017 to enhance the Commission's implementation of the RegFlex Act.

(d) Congressional Review Act (CRA). In light of the CRA guidance issued by OMB on April 11, 2019 (OMB Guidance), the CFTC is evaluating the OMB Guidance's meaning and effect on current agency practice and will continue to engage OMB to better understand the potential implications of the guidance for the Commission's final rulemakings.

(e) Periodic reauthorization legislative proceedings in which the CFTC makes various legislative recommendations to amend the CEA.

(f) Internal review through the CFTC's Strategic Plan, which sets out the CFTC's regulatory priorities. Although the plan covers five-year periods, the Commission continuously reviews the continuing relevancy of the plan through discussions with the operating divisions. These discussions generally culminate in formal structured discussions.

The approved Strategic Plan forms the basis for each fiscal year's operating plan and associated activities. At the end of each fiscal year or the conclusion of individual activities, CFTC staff evaluates performance and resource utilization against performance measures that have been identified in the Strategic Plan and in the CFTC's budget submissions to Congress. These evaluations tell the Commission how effective it has been and whether adjustments are needed in future program activities or resource allocations. The Strategic Plan is available on the CFTC website.

(g) Through initiatives raised by individual Commissioners at advisory committee and formal Commission meetings.

3. Does the regulator participate in a process (with other financial system supervisors and regulators if appropriate) which reviews unregulated products, markets, market participants and activities, including the potential for regulatory arbitrage, in order to promote investor protection and fair, efficient and transparent markets and reduce systemic risks?

Yes. The same processes identified above in response to Principle 7, Question 2 are also used to address unregulated financial markets and products. *See also* response to Principle 7, Question 1.

4. Does the regulator seek legislative or other changes when it identifies a regulatory weakness or risk to investor protection, market fairness, efficiency and transparency that requires legislative or other changes?

Yes. The Chairman, Commissioners, and CFTC staff testify before various committees of Congress, and it is not uncommon for such testimony to identify potential areas for legislative change.

| | |
|---|---|
| Principle 9 | Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities. |
| Key Questions | |
| <i>Authorization or Delegation Subject to Oversight</i> | |
| 1. | As a condition to authorization, does the legislation or the regulator require the SRO to demonstrate that it: |
| | (a) Has the capacity to carry out the purposes of its governing laws, regulations and SRO rules consistent with the responsibility of the SRO, and to enforce compliance by its members and associated persons subject to its laws, regulations and rules? |
| | <p>Yes.</p> <p>DCMs. The CEA, through DCM Core Principle 1, provides that as a condition to designation as a contract market, the applicant must demonstrate that it complies with 23 core principles:</p> <ol style="list-style-type: none"> 1. Designation as contract market 2. Compliance with rules 3. Contracts not readily subject to manipulation 4. Monitoring of trading 5. Position limits or accountability 6. Emergency authority 7. Availability of general information 8. Daily publication of trading information 9. Execution of transactions 10. Trade information 11. Financial integrity of contracts 12. Protection of markets and market participants 13. Disciplinary procedures 14. Dispute resolution 15. Governance fitness standards 16. Conflicts of interest 17. Composition of governing boards of contract markets 18. Recordkeeping 19. Antitrust considerations 20. System safeguards 21. Financial resources 22. Diversity of board of directors 23. Securities and Exchange Commission <p><i>See also</i> CFTC regulation 38.3.</p> <p>DCM Core Principle 2 requires a DCM to have rules that provide the board of trade with the ability and authority to obtain any necessary information to perform any</p> |

function, including the capacity to carry out such international information-sharing agreements as the Commission may require.

To ensure compliance with DCM Core Principle 2, the Commission promulgated regulations in Part 38 requiring a DCM to: (i) prohibit abusive trading practices on its markets by members and market participants, CFTC regulation 38.152; (ii) have arrangements and resources for effective enforcement of its rules, CFTC regulation 38.153; (iii) establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring, CFTC regulation 38.155; (iv) maintain an automated trade surveillance system capable of detecting and investigating potential trade practice violations, CFTC regulation 38.156; (v) conduct real-time market monitoring of all trading activity on its electronic trading platform(s) to identify disorderly trading and any market or system anomalies, CFTC regulation 38.157; (vi) establish and maintain procedures that require its compliance staff to conduct investigations of possible rule violations, CFTC regulation 38.158; and (vii) have the ability and authority to obtain any necessary information to perform any function required under Core Principle 2.

CFTC regulation 38.154, promulgated under Core Principle 2, allows a DCM to use an RFA or other registered entity to provide services to assist in complying with the core principles. However, notwithstanding any delegation of function, the DCM retains responsibility for carrying out any function delegated or contracted to a third party. A DCM must ensure that the services received will enable the DCM to remain in compliance with the CEA.

Appendix B to Part 38 provides more specific information on guidance and acceptable practices to comply with the core principles.

See also CFTC regulation 1.52 (SRO adoption and auditing of minimum financial and related reporting requirements); CFTC regulation 38.257 (to comply with regulations under Core Principle 4, the DCM must use a dedicated regulatory department, or by delegation of that function to an RFA or a registered entity).

SEFs. In order to register and maintain registration as a SEF, Section 5h of the CEA requires the SEF must demonstrate compliance with 15 core principles:

1. Compliance with core principles
2. Compliance with rules
3. Swaps not readily subject to manipulation
4. Monitoring of trading and trade processing
5. Ability to obtain information
6. Position limits or accountability
7. Financial integrity of transactions
8. Emergency authority
9. Timely publication of trading information
10. Recordkeeping and reporting
11. Antitrust considerations

12. Conflicts of interest
13. Financial resources
14. System safeguards
15. Designation of chief compliance officer

In the same way as described for DCMs, the CEA, through Core Principle 2 for SEFs, requires a SEF to establish and enforce compliance with any rule of the SEF, establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, establish rules governing the operation of the facility, and require by its rules that when a SD or MSP enters into or facilitates a swap that is subject to mandatory clearing under Section 2(h)(1) of the CEA, the SD or MSP shall be responsible for compliance with the mandatory trading requirement under Section 2(h)(8) of the CEA.

To ensure compliance with SEF Core Principle 2, the Commission's regulations require a SEF to: (i) establish rules governing the operation of the SEF and impartially enforce compliance with the rules of the SEF, CFTC regulation 37.201; (ii) prior to granting any eligible contract participant access to its facilities, require that the eligible contract participant consent to its jurisdiction, CFTC regulation 37.202; (iii) establish and enforce trading, trade processing and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, CFTC regulation 37.203; (iv) establish procedures to capture and retain information that may be used in establishing whether rule violations have occurred, CFTC Regulation 37.205; and (v) establish trading, trade processing, and participation rules that will deter abuses and have the capacity to enforce such rules through prompt and effective disciplinary action, including suspension or expulsion of members or market participants that violate the rules of the SEF, CFTC regulation 37.206. Additionally, a SEF may choose to contract with an RFA, or the Financial Industry Regulatory Authority for the provision of services to assist in complying with the CEA and Commission regulations. See CFTC regulation 37.204.

DCOs. Core Principle A for DCOs, CEA Section 5b(c)(2)(A), requires compliance with eighteen core principles.

1. Compliance
2. Financial resources
3. Participant and product eligibility
4. Risk management
5. Settlement procedures
6. Treatment of funds
7. Default rules and procedures
8. Rule enforcement
9. System safeguards
10. Reporting
11. Recordkeeping
12. Public information
13. Information sharing

- 14. Antitrust considerations
- 15. Governance fitness standards
- 16. Conflicts of interest
- 17. Composition of governing boards
- 18. Legal risk

CFTC regulation 39.12(a)(6) requires a DCO to have the ability to enforce compliance with its participation requirements pursuant to Core Principle C (participant and product eligibility) for DCOs and to establish procedures for the suspension and orderly removal of clearing members that no longer meet the requirements. Core Principle H, Rule Enforcement, requires a DCO to maintain adequate arrangements and resources for the effective monitoring and enforcement of compliance with its rules and resolution of disputes. In addition, as discussed above, DCO Core Principle H requires a DCO to have the authority and ability to discipline, limit, suspend, or terminate the activities of a member or participant due to a violation by the member or participant of any rule of the DCO. CFTC regulation 39.17 implements Core Principle H and requires a DCO to have adequate arrangements and resources for the effective monitoring and enforcement of compliance with the rules of the DCO and the resolution of disputes.

RFAs. To be registered and maintain registration as an RFA, Section 17(b)(1) of the CEA requires that the RFA demonstrate through documentation submitted to the CFTC that the RFA is in the public interest, that it will comply with the provisions of Section 17 and the rules and regulations promulgated by the CFTC thereunder, and will fulfill the purposes of Section 17. Section 17(b)(8) of the CEA requires that the RFA demonstrate that the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules.

(b) Treats all members of the SRO, applicants for membership and similarly situated market participants subject to its rules in a fair and consistent manner?

Yes.

DCMs. DCM Core Principle 2 requires a DCM to establish, monitor, and enforce compliance with access requirement rules. CFTC regulation 38.151 requires that prior to granting any member or market participant access to its markets, a DCM must require the member or market participant to consent to its jurisdiction. Additionally, a DCM must provide its members, persons with trading privileges, and independent software vendors with impartial access to its markets and services, including access criteria that are impartial, transparent, and applied in a non-discriminatory manner; and (2) comparable fee structures for members, persons with trading privileges and independent software vendors receiving equal access to, or services from, the DCM. See CFTC regulation 38.151(b). A DCM must also

establish and impartially enforce rules governing denials, suspensions, and revocations of a member's and a person with trading privileges' access privileges to the DCM, including when such actions are part of a disciplinary or emergency action by the DCM.

DCM Core Principle 12 requires a DCM to establish and enforce rules to promote fair and equitable trading on the contract market and to protect the market and market participants from abusive practices including fraudulent, noncompetitive, or unfair actions, committed by any party. The DCM must have methods and resources appropriate to the nature of the trading system and the structure of the market to detect trade practice and market abuses and to discipline such behavior, in accordance with Core Principles 2 and 4, and their associated Part 38 regulations. The DCM also must provide a competitive, open, and efficient market and mechanism for executing transactions in accordance with Core Principle 9.

In addition, there are specific core principles for DCMs with respect to minimizing conflicts of interest (Core Principle 16) and antitrust considerations (Core Principle 19), which have bearing on the fairness and consistency with which a DCM interacts with members. See CFTC regulations 38.850-851 and 38.1000-1001.

SEFs. SEF Core Principle 2 requires a SEF to, among other things, provide market participants with impartial access to the market and establish and enforce compliance with any limitation on access to the SEF. CFTC regulations implementing the core principle require the SEF to provide any ECP and any independent software vendor with impartial access to its market(s) and market services, including any indicative quote screens or any similar pricing data displays, provided that the facility has: (1) Criteria governing such access that are impartial, transparent, and applied in a fair and nondiscriminatory manner; (2) Procedures whereby eligible contract participants provide the swap execution facility with written or electronic confirmation of their status as eligible contract participants, as defined by the CEA and Commission regulations, prior to obtaining access; and (3) Comparable fee structures for eligible contract participants and independent software vendors receiving comparable access to, or services from, the SEF. CFTC regulation 37.202(a). A SEF must also establish and impartially enforce rules governing any decision to allow, deny, suspend, or permanently bar eligible contract participants' access to the SEF, including when such decisions are made as part of a disciplinary or emergency action taken by the SEF. CFTC Regulation 37.202(c).

DCOs. DCO Core Principle C requires a DCO to have objective, publicly disclosed, fair, and open access requirements.¹⁰⁷ CFTC regulation 39.12(a) requires a DCO to establish appropriate admission and continuing participation requirements for clearing members of the DCO that are objective, publicly disclosed, and risk based.

RFAs. Section 17(b)(2) of the CEA mandates that an RFA's rules provide that any

¹⁰⁷ See CEA Section 5b(c)(2)(C)(iii).

person registered under the CEA, a registered entity, or any other person designated pursuant to the regulations of the CFTC as eligible for membership may become a member of such association. That section also states that the rules of the association may restrict membership in such association on the basis of the type of business conducted by its members. Further, Section 17(b)(5) of the CEA requires that the RFA's rules assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs. Consistent with the provisions of the CEA, CFTC regulation 170.3 provides for the fair and equitable representation of members with respect to the governing board of the association. In particular, the regulation provides that no single class or group of members may dominate or otherwise exercise disproportionate influence on the governing board.

(c) Develops rules that are designed to set standards for its members and to promote investor protection?

Yes.

DCMs. Trade practice, handling of customer funds, reporting, recordkeeping, and other business standards for commodity professionals, many of whom constitute the class of exchange membership, are established in the first instance by CEA Section 5(d), CFTC regulations (Part 38), DCM rules, and, as explained below, by RFA requirements.

DCM Core Principle 21, Financial Resources, requires a DCM to have adequate financial, operational, and managerial resources to discharge each responsibility of the board of trade. The financial resources of the board of trade shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the contract market to cover the operating costs of the contract market for a one-year period, as calculated on a rolling basis. Commission regulations implementing the core principle are found at CFTC regulation 38.1101.

DCMs must initially and on an ongoing basis demonstrate compliance with DCM Core Principle 12. DCM Core Principle 12, Protection of Market Participants, establishes that boards of trade must establish and enforce rules: (a) to protect market participants from abusive practices committed by any party, including abusive practices committed by a party acting as an agent for a participant; and (b) to promote fair and equitable trading on the contract market. See CFTC regulation 38.651.

DCM Core Principle 11 provides that the DCM must establish and enforce rules to ensure the financial integrity of FCMs and IBs, and the protection of customer funds. See CFTC regulations 38.600-607.

SEFs. Core Principle 13, Financial Resources, requires a SEF to have adequate financial, operational, and managerial resources to discharge each responsibility of the SEF. The financial resources of a SEF shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the swap execution facility to cover the operating costs of the SEF for a one-year period, as calculated on a rolling basis. Regulations implementing Core Principle 13 are found at CFTC regulations 37.1301-1307.

SEF Core Principle 7 requires a SEF to establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the SEF, including those that are required to be cleared under Section 2(h)(1). A SEF must establish minimum financial standards for its members, which at a minimum must be that members qualify as an ECP as defined in Section 1a(18) of the CEA, and must monitor its members to ensure that they remain ECPs. See CFTC regulations 37.701-703.

SEF Core Principle 15 requires a SEF to designate a CCO to ensure compliance with the CEA and the rules and regulations issued under the CEA. See CFTC regulation 37.1500.

DCOs. DCO Core Principle B, Financial Resources, requires a DCO to have, at a minimum, adequate financial, operational, and managerial resources that are sufficient to meet its financial obligations to its clearing members notwithstanding the default by the clearing member creating the largest financial exposure for the DCO. Regulations implementing this core principle are found in CFTC regulation 39.11. The Commission has additional regulations designed to implement the CEA and protect investors: participant and product eligibility, CFTC regulation 39.12; risk management, CFTC regulation 39.13; treatment of funds, CFTC regulation 39.15. Of particular relevance, CFTC regulation 39.12(b) provides that a DCO's participation requirements must require clearing members to have access to sufficient resources to meet obligations arising from participation in the DCO in extreme but plausible market conditions, and CFTC regulation 39.12(a)(3) provides that a DCO's participation requirements must require clearing members to have adequate operational capacity to meet obligations arising from participation in the DCO. In addition to the above, CFTC regulations 39.33, 39.35, and 39.36, respectively, impose enhanced financial resources, default rules and procedures, and risk management standards on SIDCOs and DCOs that elect to become subject to them. Finally, Section 4d of the CEA requires FCMs and DCOs to segregate customer property.

RFAs. Section 17(b)(3) of the CEA requires the rules of an RFA to provide that membership must be denied to certain firms and individuals, including those subject to an order by the CFTC suspending, denying, or revoking registration.

Section 17(b)(4) of the CEA requires that the RFA rules provide that applicants for membership conform with specific and appropriate standards with respect to the training, experience, and such other qualifications as the RFA deems necessary or desirable, including the financial responsibility of members. Section 17(p) of the CEA further requires each RFA to establish rules that require the association to:

- Establish training standards and proficiency testing for persons involved in the solicitation of transactions, supervisors of such persons and all persons for which it has registration responsibilities, and a program to audit and enforce compliance with such standards;
- Establish minimum capital, segregation, and other financial requirements applicable to its members for which such requirements are imposed by the CFTC and implement a program to audit and enforce compliance with such requirements;
- Establish minimum standards governing sales practices of its members and persons associated therewith for transactions subject to provisions of the CEA; and
- Establish supervisory guidelines to protect the public interest relating to the solicitation of new futures and options accounts and make such guidelines applicable to those members determined to require such guidelines in accordance with standards established by the CFTC.

In addition, NFA and DCMs must monitor and enforce compliance with CFTC regulations establishing standards for intermediaries, such as CFTC minimum financial and reporting requirements, and requirements for the protection of customer funds and communications with customers pursuant to CFTC regulations 1.52.

Common to SROs. CFTC regulation 1.59 prohibits certain trading on material, inside information by SRO members and by members of SRO governing boards and committees. *See also* response to Principle 9, Question 4(b).

(d) Submits to the regulator its rules and any amendments thereto, for review and/or approval, as the regulator deems appropriate, and ensures that the rules of the SRO are consistent with the public policy requirements established by the regulator?

Yes.

DCMs, SEFs, and DCOs. Section 5c(c) of the CEA requires DCMs, SEFs, and DCOs to file with the Commission new products, new rules, and rule amendments. Under rules promulgated by the Commission, a DCM or SEF may list a new product by providing the CFTC with written certification that the

product complies with the CEA and the Commission’s regulations. See CFTC regulation 40.2. The DCM or SEF may list the self-certified contract for trading no sooner than one full business day following receipt of the submission by the Commission. Alternatively, a DCM or SEF may request Commission approval of the new product. CFTC regulation 40.3. DCMs, SEFs, and DCOs may self-certify to the Commission new rules and rule amendments and implement such new rules and rule amendments no earlier than 10 business days following receipt by the Commission of the submission. See CFTC regulation 40.6. Alternatively, DCMs, SEFs, and DCOs may voluntarily submit rules or rule amendments for Commission review and approval. See CFTC regulation 40.5. Amendments to terms and conditions of futures on agricultural commodities enumerated in Section 1a(9) of the CEA must be approved by the Commission if the amendments are material and would be applied to existing positions. See CFTC regulation 40.4. There are also special certification procedures for SIDCOs that give the CFTC 60 days to review any proposed change to a SIDCO’s rules, procedures, or operations that could materially affect the nature or level of risks presented by the SIDCO. See CFTC regulation 40.10.

RFAs. Section 17(a)(2) of the CEA requires an applicant for RFA status to provide the CFTC with copies of its constitution, charter, or articles of incorporation or association, along with all bylaws. Section 17(j) of the CEA states that an RFA must file with the CFTC copies of any changes or additions to the RFA rules. Section 17(j) further provides that the RFA may make any proposed change or addition effective ten days after the receipt of such a filing by the Commission unless the RFA requests that the Commission review and approve the submission or the Commission informs the RFA of its intention to do so. If the Commission decides that it will review the rules for approval, the Commission must determine whether such change or addition is consistent with the requirements of Section 17 of the CEA and is not in violation of any other provision of the CEA. If the Commission disapproves the change or addition as inconsistent with the CEA, the Commission must provide the RFA with notice and opportunity to be heard. Further, if the Commission does not approve or institute disapproval proceedings with respect to a rule within 180 days after the receipt of such a rule, or if the Commission does not conclude disapproval proceedings within one year after the receipt of such rule, the RFA may implement the submitted rule until the Commission concludes the disapproval process.

| | |
|-----|--|
| (e) | Cooperates with the regulator and other domestic SROs to investigate and enforce applicable laws, regulations and rules? |
|-----|--|

| |
|--|
| Yes. The CEA and CFTC regulations establish an obligation on the SROs to |
|--|

cooperate with the CFTC and with other SROs to investigate and enforce applicable laws and regulations. SEFs, DCMs, and DCOs,¹⁰⁸ have SRO obligations under the CEA:

- SEF Core Principle 5 requires a SEF to have rules in place to provide the SEF with the ability to obtain any necessary information to perform any function required by the CEA.
- DCM Core Principle 2 requires a DCM to have rules in place to provide the DCM with the ability to obtain any necessary information to perform any function required by the CEA.
- DCOs have rule enforcement responsibilities under Core Principle H.

CEA Section 8(a)(1) provides that for the efficient execution of the provisions of the CEA, and in order to provide information for the use of Congress, the CFTC may make such investigations as it deems necessary to ascertain facts regarding the operations of boards of trade and other persons subject to the CEA. The CEA authorizes the CFTC to suspend or revoke the designation of any board of trade that fails or refuses to comply with any of the provisions of the CEA or any of the rules, regulations, or orders issued by the CFTC thereunder.

The CFTC's rules contemplate cooperation among exchanges. See CFTC regulation 1.52 authorizes any two or more DCM and RFA SROs to file with the CFTC a plan (e.g., the Joint Audit Committee's (JAC's) Joint Audit Agreement) for delegating to a designated self-regulatory organization (DSRO) the responsibility of monitoring and auditing for compliance with the minimum financial reporting and compliance requirements adopted by such SROs. Among other things, CFTC regulation 1.52(d) also authorizes such SROs to establish programs among themselves to provide access to any necessary financial or related information.

Cooperation with other SROs is not required for authorization to act as an SRO, and participation in the JAC is not mandatory, however, all current DCM SROs and NFA do participate. As discussed above, under CFTC regulation 1.52, SROs with FCM members in common may establish joint audit plans, and, pursuant to such plans, delegate the responsibility to audit and conduct financial surveillance of an FCM to one of the SROs as the DSRO. The Commission requires that DSROs ensure that each FCM is subject to an on-site examination within nine to 18 months of the "as of" date of the previous examination by the DSRO. The JAC has established uniform procedures for such on-site examinations.

¹⁰⁸ DCOs act as member organizations and enforce rules of participant eligibility. However, DCOs are not included in the definition of SRO. CFTC regulation 1.3 defines "self-regulatory organization" to mean a contract market (as defined in CFTC regulation 1.3), a SEF (as defined in CFTC regulation 1.3), or an RFA under Section 17 of the Act.

| | |
|---|---|
| 2. | Does the SRO: |
| (a) | Have statutory delegation or other formal recognition from the regulator? |
| <p>Yes. There are several categories of organizations authorized by the CEA which have self-regulatory responsibilities: futures exchanges (<i>e.g.</i>, DCMs), SEFs, DCOs, and RFAs. Although CFTC regulation 1.3 defines the term SRO as a contract market, SEF or RFA, DCOs also have self-regulatory obligations and are discussed (where appropriate) for completeness.</p> <p>DCMs are boards of trade (or exchanges) that operate under the regulatory oversight of the CFTC pursuant to Section 5 of the CEA. DCMs may list for trading swaps, futures, or option on futures contracts based on any underlying commodity, index, or instrument.</p> <p>SEFs operate under the regulatory oversight of the CFTC pursuant to Section 5h of the CEA. SEFs are trading systems or platforms in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility that facilitates the execution of swaps between persons and is not a DCM.</p> <p>DCOs operate under the regulatory oversight of the CFTC pursuant to Section 5b of the CEA. A DCO is a clearinghouse, clearing association, clearing corporation, or similar entity, facility, system, or organization that with respect to an agreement, contract, or transaction enables each party to an agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the DCO for the credit of the parties; arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the DCO; or otherwise provides clearing services or arrangements that mutualize or transfer among participants in the DCO the credit risk arising from such agreements, contracts, or transactions executed by the participants. A DCO must establish participant eligibility standards that establish appropriate admission and continuing eligibility standards (including sufficient financial resources and operational capacity to meet obligations arising from participation in the DCO) for members of, and participants in, the DCO. Also, each DCO must establish and implement procedures to verify, on an ongoing basis, the compliance of each participation and membership requirement of the DCO</p> <p>Section 17 of the CEA establishes a framework for one or more RFAs to exist under the oversight of the CFTC. Part 170 of the CFTC's regulations address RFAs. Section 17(m) of the CEA provides that the CFTC may approve rules of RFAs that require persons eligible for membership to become members of a least one such association. The NFA is the only existing RFA.</p> <p>As noted in the response to Principle 9, Question 1(a), DCMs and SEFs may comply with any applicable core principle through delegation of any relevant function to</p> | |

an RFA or another CFTC registered entity. However, a DCM of SEF that utilizes an RFA must retain exclusive authority in all substantive decisions made by its regulatory service provider, including, but not limited to, decisions involving the cancellation of trades, the issuance of disciplinary charges against members or market participants, and denials of access to the trading platform for disciplinary reasons. CFTC regulations 38.154 and 37.204, respectively.

With certain exceptions, all persons and organizations that intend to do business as professionals with respect to transactions regulated by the CFTC must register under Section 8a of the CEA. All individuals and firms that wish to act as market intermediaries must apply for NFA membership or associate status.

(b) Have MoUs or other arrangements in place to secure cooperation between it and the regulator?

No. The obligation for an SRO to cooperate with the CFTC is statutory. In addition, enforceable Commission regulations implementing the SRO functions of registered entities ensure cooperation.

(c) Have its own rules which are enforced and whose non-compliance is appropriately sanctioned?

Yes.

DCMs. DCM Core Principle 2, Compliance with Rules, requires a DCM to monitor and enforce compliance with the rules of the DCM. The Commission’s regulations interpreting this core principle are in CFTC regulations 38.150-160; *see also* CFTC regulation 1.52(a).

DCM Core Principle 13, Disciplinary Procedures, requires the board of trade to establish and enforce disciplinary proceedings that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties. The Commission’s regulations interpreting this core principle are in CFTC regulations 38.700-38.712.

SEFs. SEF Core Principle 2, Compliance with Rules, requires a SEF to establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules. Through CFTC regulation 37.206, a SEF must have rules in place that will deter abuses and have the capacity to enforce such rules through prompt and effective disciplinary action, including suspension or expulsion of members or market participants that violate the rules of the SEF. *See also* CFTC regulations 37.201-205.

DCOs. DCO Core Principle H, Rule Enforcement, requires a DCO to (a) maintain adequate arrangements and resources for: (i) the effective monitoring and

enforcement of compliance with the rules of the DCO; and (ii) the resolution of disputes; (b) have the authority and ability to discipline, limit, suspend, or terminate the activities of a member or participant due to a violation by the member or participant of any rule of the DCO; and (c) report to the CFTC regarding rule enforcement activities and sanctions imposed against members and participants. CFTC regulation 39.17 implements these requirements, and requires a DCO to have adequate arrangements and resources for the effective monitoring and enforcement of compliance with the rules of the DCO and the resolution of disputes.

RFAs. Section 17(b)(8) of the CEA requires that an RFA develop rules that provide for the appropriate discipline of its members, whether by expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules. Section 17(i) provides that the CFTC may review the disciplinary action taken by an RFA. The review would identify the rules of the RFA violated by the person in question and confirm whether such rules were applied in a manner consistent with the purposes of the CEA. Pursuant to this authority, the CFTC also may, having found that a penalty is excessive or oppressive, cancel, reduce or require remission of the penalty. NFA's bylaws and rules provide for the imposition of sanctions on members and associates of members for non-compliance with NFA's rules.

Please refer to NFA for data on examinations and enforcement activities.

See response to Principle 9, Question 3(a) below regarding the CFTC Rule Enforcement Review Program.

(d) Where applicable, e.g., a mutualized organization, assures a fair representation of members in selection of its board of directors and administration of its affairs?

Yes.

DCMs. DCM Core Principle 17 requires the governance arrangements of the board of trade be designed to permit consideration of the views of market participants.

DCM Core Principle 22 requires the board of trade, if a publicly-traded company, must endeavor to recruit individuals to serve on the board of directors and the other decision-making bodies (as determined by the Commission) of the board of trade from among, and to have the composition of the bodies reflect, a broad and culturally diverse pool of qualified candidates.

DCM Core Principle 15 requires the board of trade to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of contract market and any other persons with direct access to the facility. The Commission's Guidance in Part 38, Appendix B details:

- (1) A designated contract market should have appropriate eligibility criteria for the categories of persons set forth in the core principle that should include standards for fitness and for the collection and verification of information supporting compliance with such standards. Minimum standards of fitness for persons who have member voting privileges, governing obligations or responsibilities, or who exercise disciplinary authority are those bases for refusal to register a person under Section 8a(2) of the Act. In addition, persons who have governing obligations or responsibilities, or who exercise disciplinary authority, should not have a significant history of serious disciplinary offenses, such as those that would be disqualifying under CFTC Regulation 1.63. Members with trading privileges but having no, or only nominal, equity, in the facility and non-member market participants who are not intermediated and do not have these privileges, obligations, responsibilities, or disciplinary authority could satisfy minimum fitness standards by meeting the standards that they must meet to qualify as "market participants." Natural persons who directly or indirectly have greater than a ten percent ownership interest in a DCM should meet the fitness standards applicable to members with voting rights.
- (2) The Commission believes that such standards should include providing the Commission with fitness information for such persons, whether registration information, certification to the fitness of such persons, an affidavit of such persons' fitness by the contract market's counsel or other information substantiating the fitness of such persons. If a contract market provides certification of the fitness of such a person, the Commission believes that such certification should be based on verified information that the person is fit to be in his or her position.

DCM Core Principle 16 requires the board of trade to establish and enforce rules to minimize conflicts of interest in the decision making process of the contract market and establish a process for resolving such conflicts of interest. The Commission's Guidance in Part 38, Appendix B specifies:

The means to address conflicts of interest in decision-making of a contract market should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict. In addition, the Commission believes that the contract market should provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by board members, committee members, and contract market employees or gained through an ownership interest in the contract market.

The Commission also includes Acceptable Practices in Appendix B to Part 38:

All DCMs bear special responsibility to regulate effectively, impartially, and with due consideration of the public interest, as provided for in Section 3 of the CEA. Under DCM Core Principle 16, they are also required to minimize conflicts of interest in their decision-making processes. To comply with this core principle, contract markets should be particularly vigilant for such conflicts between and among any of their self-regulatory responsibilities, their commercial interests, and the several interests of their management, members, owners, customers and market participants, other industry participants, and other constituencies. Acceptable Practices for minimizing conflicts of interest must include the following elements:

(1) Board Composition for Contract Markets

(i) At least thirty-five percent of the directors on a contract market's board of directors shall be public directors; and

(ii) The executive committees (or similarly empowered bodies) shall be at least thirty-five percent public.

(2) Public Director

(i) To qualify as a public director of a contract market, an individual must first be found, by the board of directors, on the record, to have no material relationship with the contract market. A "material relationship" is one that reasonably could affect the independent judgment or decision making of the director.

(ii) In addition, a director shall not be considered "public" if any of the following circumstances exist:

(A) The director is an officer or employee of the contract market or a director, officer or employee of its affiliate. In this context, "affiliate" includes parents or subsidiaries of the contract market or entities that share a common parent with the contract market;

(B) The director is a member of the contract market, or a person employed by or affiliated with a member. "Member" is defined according to Section 1a(34) of the CEA and CFTC regulation 1.3.

(C) The director, or a firm with which the director is affiliated, as defined above, receives more than \$100,000 in combined annual payments

from the contract market, any affiliate of the contract market, or from a member or any person or entity affiliated with a member of the contract market. Compensation for services as a director does not count toward the \$100,000 payment limit, nor does deferred compensation for services prior to becoming a director, so long as such compensation is in no way contingent, conditioned, or revocable;

(D) Any of the relationships above apply to a member of the director's "immediate family," *i.e.*, spouse, parents, children, and siblings.

(iii) All of the disqualifying circumstances described in subsection (2)(ii) shall be subject to a one-year look back.

(iv) A contract market's public directors may also serve as directors of the contract market's affiliate if they otherwise meet the definition of public director in this section (2).

(v) A contract market shall disclose to the Commission which members of its board are public directors, and the basis for those determinations.

(3) Regulatory Oversight Committee

(i) A board of directors of any contract market shall establish a Regulatory Oversight Committee (ROC) as a standing committee, consisting of only public directors as defined in section (2), to assist it in minimizing actual and potential conflicts of interest. The ROC shall oversee the contract market's regulatory program on behalf of the board. The board shall delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the ROC to fulfill its mandate.

(ii) The ROC shall:

(A) Monitor the contract market's regulatory program for sufficiency, effectiveness, and independence;

(B) Oversee all facets of the program, including trade practice and market surveillance; audits, examinations, and other regulatory responsibilities with respect to member firms (including ensuring compliance with financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and the conduct of investigations;

(C) Review the size and allocation of the regulatory budget and

resources; and the number, hiring and termination, and compensation of regulatory personnel;

(D) Supervise the contract market's chief regulatory officer, who will report directly to the ROC;

(E) Prepare an annual report assessing the contract market's self-regulatory program for the board of directors and the Commission, which sets forth the regulatory program's expenses, describes its staffing and structure, catalogues disciplinary actions taken during the year, and reviews the performance of disciplinary committees and panels;

(F) Recommend changes that would ensure fair, vigorous, and effective regulation; and

(G) Review regulatory proposals and advise the board as to whether and how such changes may impact regulation.

(4) Disciplinary Panels

All contract markets shall minimize conflicts of interest in their disciplinary processes through disciplinary panel composition rules that preclude any group or class of industry participants from dominating or exercising disproportionate influence on such panels. Contract markets can further minimize conflicts of interest by including in all disciplinary panels at least one person who would qualify as a public director, as defined in subsections (2)(ii) and (2)(iii) above, except in cases limited to decorum, attire, or the timely submission of accurate records required for clearing or verifying each day's transactions. If contract market rules provide for appeal to the board of directors, or to a committee of the board, then that appellate body shall also include at least one person who would qualify as a public director as defined in subsections (2)(ii) and (2)(iii) above.

See Appendix B to Part 38.

SEFs. SEF Core Principle 12 requires a SEF to establish and enforce rules to minimize conflicts of interest in its decision-making process and to establish a process for resolving the conflicts of interest. Additionally, the Commission requires that the CCO resolve conflicts of interest. See CFTC regulation 37.1501.

DCOs. DCO Core Principle O requires each DCO to have: (i) governance arrangements that are transparent to fulfill public interest requirements and to

permit the consideration of the views of owners and participants; and (ii) fitness standards for directors, members, any individual or entity with direct access to the settlement or clearing activities of the DCO, and any party affiliated with such director, member, or entity.

Core Principle P requires each DCO to establish and enforce rules to minimize conflicts of interest in the decision making process and to establish a process to resolve conflicts of interest.

Core Principle Q requires each DCO to ensure that the composition of the governing board or committee of the DCO includes market participants.

In addition, CFTC regulation 39.32 sets forth governance requirements for SIDCOs that are consistent with Principle 2 of the Principles for Financial Market Infrastructures (PFMIs). For example, a SIDCO must have governance arrangements that clearly specify the roles and responsibilities of the board of directors and its committees, including the establishment of a clear and documented risk management framework, and that establish procedures for identifying, addressing, and managing conflicts of interest involving members of the board of directors. Additionally, a SIDCO also must maintain policies to make certain that the performance of the board of directors and the performance of individual directors are reviewed on a regular basis.

RFAs. Section 17(b)(5) of the CEA requires that an RFA's rules assure a fair representation of its members in the adoption of any rule of the association, the selection of its officers and directors, and in all other phases of the administration of its affairs.

Section 17(b)(11) also requires that an RFA must provide for meaningful representation on the governing board of such an association a diversity of membership interests and provides that no less than 20 percent of the regular voting members of such board be comprised of qualified non-members or persons who are not regulated by such association.

Section 17(b)(12) requires that the RFA provide on all major disciplinary committees for a diversity of membership sufficient to ensure fairness and to prevent special treatment or preference for any person in the conduct of disciplinary proceedings and the assessment of penalties.

Consistent with the provisions of the CEA, CFTC regulation 170.3 provides for the fair and equitable representation of members with respect to the governing board of the association. In particular, the regulation provides that no single class or group of members may dominate or otherwise exercise disproportionate influence

on the governing board. Additionally, CFTC regulation 170.6 mandates a fair and orderly procedure with respect to disciplinary actions brought against association members or persons associated with members.

CFTC regulation 1.64(b) requires that each SRO and RFA maintain rules that ensure that 20 percent of its governing board is comprised of knowledgeable individuals who are not members or employees of the SRO or RFA, who are not otherwise performing services for the SRO or RFA, and who are not officers, principals or employees of a firm that is a member of the SRO or RFA. Additionally, the SRO must be able to demonstrate that the board membership fairly represents the diversity of interests at that SRO and is otherwise consistent with the composition requirements of CFTC regulation 1.64. CFTC regulation 1.64(c)(1) mandates that each SRO must have in effect rules ensuring that at least one member of each major disciplinary committee or hearing panel is a person who is not a member of the SRO where the disciplinary action is being taken against a member of the SRO, a member of the governing board, or the member of a major disciplinary committee, or if the alleged or adjudicated rule violations involve manipulation or attempted manipulation, or conduct which directly results in financial harm to a non-member of a contract market. With respect to RFAs, CFTC regulation 1.64(c)(3) requires that RFAs include persons representing membership interests other than that of the subject of the disciplinary proceeding being considered on each major disciplinary committee or hearing panel thereof. Further, Section 17(k) of the CEA provides that the CFTC is authorized to abrogate any rule of an RFA if, after notice and opportunity for hearing, it appears to the CFTC that such abrogation is necessary or appropriate to assure fair dealing by the members of the association, to assure a fair representation of its members in the administration of its affairs, or effectuate the purposes of the CEA. The CFTC also may alter or supplement RFA rules, after notice and hearing. Section 17(c) of the CEA provides that the CFTC may, after notice and opportunity for hearing, suspend the registration of an RFA if it finds that the rules thereof do not conform to the requirements of the CFTC.

CFTC regulation 1.69 requires that a member of an SRO's governing board, disciplinary committee or oversight panel must abstain from voting on any matter and from deliberating on the same where that member is a named party in interest; is an employer, employee, or fellow employee of a named party in interest; is associated with a named party in interest through a broker association; has significant, ongoing business relationship with a named party in interest; or has a family relationship with the named party in interest. Moreover, each member of the SRO's governing board, disciplinary committee, or oversight panel must disclose to the appropriate SRO staff whether such relationships exist. The SRO must establish procedures for determining whether a member of the SRO's governing board disciplinary committee or oversight panel is subject to a conflict restriction in any matter involving a named party in interest based on information

provided by the member and any other source of information reasonably available to the SRO. Under CFTC regulation 1.69(b)(2), if a member of an SRO's governing board, disciplinary board or oversight board has a direct and substantial financial interest in the result of the vote based upon either exchange or non-exchange position that could reasonably be affected by the action, such member must abstain from deliberations and voting regarding the same. Pursuant to that regulation, the member must also disclose such interest to SRO staff and the SRO must have appropriate procedures in place to evaluate the conflict.

Among other requirements enumerated in Section 17 of the CEA and CFTC regulations in Part 170, an RFA must:

- Assure fair and equitable representation of the views and interests of all association members;
- Impose dues equitably among all members, and may not be structured in a manner constituting a barrier to entry of any person seeking to engage in commodity-related business;
- Establish and maintain a program for the protection of customers, including the adoption of rules to protect customers and customer funds and to promote fair dealing with the public;
- Provide a fair and orderly procedure with respect to disciplinary actions brought against association members or persons associated with members;
- Provide a fair and orderly procedure for processing membership applications and for affording any person to be denied membership an opportunity to submit evidence in response to the grounds for denial; and
- Demonstrate its capacity to promulgate rules and to conduct proceedings that 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 or any employee of a member.

Section 17(a) of the CEA requires that an applicant to become an RFA, as part of the application process, must submit to the CFTC a registration statement in such form as the CFTC may prescribe. CFTC regulation 170.11 provides that the applicant must file with the CFTC a letter requesting registration as an RFA, as well as, the constitution, charter or articles of incorporation of the association, the bylaws of the association, any other rules, resolutions, or regulations of the association corresponding to the aforementioned documents, a detailed description of the association's organization, membership, and rules of procedure, and a detailed statement of the association's capability to comply with the provisions of Section 17 of the CEA and Part 170 of the CFTC regulations. Pursuant to CFTC regulation 170.12, the review of such registration statement has been delegated by the Commission to the Director of the Division of Swap Dealer and Intermediary Oversight (DSIO). Following such review, the Commission may by order grant the registration if the requirements are satisfied or, after appropriate

notice and opportunity to be heard, deny such registration if the application is deficient.

(e) Avoid rules that may create anti-competitive situations as defined in the Explanatory Note?

Yes. Section 15 of the CEA requires the CFTC to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of the CEA in, among other things, issuing any order or in approving any rule of a contract market or RFA. CFTC regulation 170.9 requires that an applicant to become an RFA must demonstrate, among other things, that the association will promote fair and open competition among its members and will conduct its affairs consistent with the public interest to be protected by the antitrust laws.

DCM Core Principle 19 provides that unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall not—(A) adopt any rule or take any action that results in any unreasonable restraint of trade; or (B) impose any material anticompetitive burden on trading on the contract market.

Appendix B to Part 38 of the CFTC’s regulations provides the following Guidance:

An entity seeking designation as a contract market may request that the Commission consider under the provisions of Section 15(b) of the CEA any of the entity's rules, including trading protocols or policies, and including both operational rules and the terms or conditions of products listed for trading, at the time of designation or thereafter. The Commission intends to apply Section 15(b) of the CEA to its consideration of issues under this core principle in a manner consistent with that previously applied to contract markets.

See Appendix B to Part 38.

SEFs. SEF Core Principle 11 provides that unless necessary or appropriate to achieve the purposes of the Act, the SEF must not (a) adopt any rules or take any actions that result in any unreasonable restraint of trade; or (b) impose any material anticompetitive burden on trading or clearing.

Appendix B to Part 37 provides Guidance similar to the DCM guidance.

DCOs. DCO Core Principle N provides that unless necessary or appropriate to achieve the purposes of the Act, a DCO shall not adopt any rule or take any action

that results in any unreasonable restraint of trade, or impose any material anticompetitive burden.

RFAs. Section 17(b)(2) of the CEA mandates that an RFA’s rules provide that any person registered under the CEA, a registered entity, or any other person designated pursuant to the regulations of the CFTC as eligible for membership may become a member of such association. That section also states that the rules of the association may restrict membership in such association on the basis of the type of business conducted by its members. Further, Section 17(b)(5) of the CEA requires that the RFA’s rules assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs. Consistent with the provisions of the CEA, CFTC regulation 170.3 provides for the fair and equitable representation of members with respect to the governing board of the association. In particular, the regulation provides that no single class or group of members may dominate or otherwise exercise disproportionate influence on the governing board.

(f) Avoid using the oversight role to allow any market participant unfairly to gain an advantage in the market?

Yes.

DCMs. DCM Core Principle 4, Monitoring of Trading, provides that the board of trade shall have the capacity and responsibility to prevent market manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

DCM Core Principle 12, Protection of Market Participants, provides that the board of trade shall establish and enforce rules to protect market participants from abusive trade practices committed by any party acting as an agent for the participants and to promote fair and equitable trading. Core Principle 12 would also apply to prohibit abusive practices by the DCM itself.

DCM Core Principle 16, Conflicts of Interest, provides that a board of trade shall establish and enforce rules to minimize conflicts of interest in the decision making process of the contract market. The Guidance to Part 38, Appendix B (discussed above in response to Principle 9, Question 2(d)), includes managing such conflicts through the use of a ROC of the Board of Directors, as well as maintaining a certain number of Public (disinterested) directors.

SEFs. SEF Core Principle 4, Monitoring of Trading and Trade Processing, requires a SEF to establish and enforce rules or terms and conditions defining or

specifications detailing trading procedures to be used in entering and executing orders traded on or through the facilities of the SEF, procedures for trade processing of swaps on or through the SEF and monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance and disciplinary practices and procedures, including methods for conduction real-time monitoring of trading and comprehensive and accurate trade reconstructions.

SEF Core Principle 12, Conflicts of Interest, requires a SEF to establish and enforce rules to minimize conflicts of interest in its decision making process and to establish a process for resolving conflicts of interest.

DCOs. Core Principle P, Conflicts of Interest, requires each DCO to have and enforce rules to minimize conflicts of interest in the decision making process of the DCO and establish a process to resolve such conflicts.

RFAs. Section 17(b)(2) of the CEA mandates that an RFA’s rules provide that any person registered under the CEA, a registered entity, or any other person designated pursuant to the regulations of the CFTC as eligible for membership may become a member of such association. That section also states that the rules of the association may restrict membership in such association on the basis of the type of business conducted by its members. Further, Section 17(b)(5) of the CEA requires that the RFA’s rules assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs. Consistent with the provisions of the CEA, CFTC regulation 170.3 provides for the fair and equitable representation of members with respect to the governing board of the association. In particular, the regulation provides that no single class or group of members may dominate or otherwise exercise disproportionate influence on the governing board.

Oversight

3. Does the regulator:

(a) Have in place an effective ongoing oversight program of the SRO, which may include:

(i) inspection of the SRO;

(ii) periodic reviews;

(iii) reporting requirements;

(iv) review and revocation of SRO governing laws, regulations, and rules; and

(v) the monitoring of continuing compliance with the conditions of

authorization or delegation.

Yes, to all of the above. The CFTC's regulatory scheme is based upon the assumption of self-regulatory responsibilities by its registrants following their registration under applicable provisions of the CEA and by an RFA following registration under Section 17 of the CEA. Each registrant must show compliance with core principles to obtain registration and maintain compliance with core principles to retain registration.

CFTC regulation 38.5 requires a DCM to provide, upon the Commission's request, certain compliance-related information, such as information related to the DCM's business, and information demonstrating that the DCM is in compliance with one or more core principles or obligations under the Act.

DCM Core Principle 2, Compliance with Rules, requires DCMs to monitor and enforce compliance with the rules of the contract market, including access requirements, the terms and conditions of any contracts to be traded and rules prohibiting abusive trading practices on the contract market. DCM Core Principle 2 also requires DCMs to have the ability and authority to obtain any necessary information to perform its self-regulatory obligations, including the capacity to carry out information-sharing agreements.

DCM Core Principle 4, Monitoring of Trading, requires a DCM to have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures.

DCM Core Principle 10, Trade Information, requires a DCM to maintain rules and procedures to provide for the recording and safe storage of all identifying trade information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

DCM Core Principle 18, Recordkeeping, requires a DCM to maintain records of all activities related to the business of the contract market in a form and manner acceptable to the Commission for a period of at least 5 years.

CFTC regulation 37.5 requires a SEF to provide, upon the Commission's request, certain compliance-related information, such as information related to the SEF's business, and information demonstrating that the SEF is in compliance with one or more core principles or obligations under the Act.

SEF Core Principle 2, Compliance with rules, requires a SEF to establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means to provide

market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred.

SEF Core Principle 4, Monitoring of Trading and Trade Processing, requires a SEF to monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures.

SEF Core Principle 5, Ability to Obtain Information, requires a SEF to establish and enforce rules that will allow it to obtain any necessary information to perform any of its functions described in Section 5h of the Act. This includes information a SEF needs to fully perform its operational, risk management, governance, and regulatory functions and any requirements under part 37, including the capacity to carry out information-sharing agreements.

SEF Core Principle 10, Recordkeeping and Reporting, requires a SEF to maintain records of all activities relating to the business of the facility, including a complete audit trail in a form and manner acceptable to the CFTC for a period of 5 years.

Rule Enforcement Program

The rule enforcement review (RER) program for DCMs generally encompasses “selected elements” of exchange market surveillance, trade practice surveillance, and disciplinary programs. Selected elements means the review includes a targeted sample of investigations/disciplinary cases and/or a subset of regulations for the core principles under review.

DMO’s Compliance Branch has established a risk-based determination of priorities for RERs so that key entities and subject areas receive the most attention. The Compliance Branch considers factors such as a DCM’s market share; the time elapsed since the entity’s last review; findings during the last review, including any need for follow-up in the short- to medium-term; concerns expressed by market participants and other Commission offices and divisions; new products, rules, or technology implemented by a DCM; significant organizational changes at the DCM, including changes in staffing, management, or ownership. In general, the large volume DCMs are subject to at least one RER annually, the medium volume DCMs are subject to one RER about every two years, and the DCMs with little or no trading volume are reviewed occasionally. In all cases, the Compliance Branch holds periodic calls with the DCMs during the year to discuss regulatory matters. These calls allow the Compliance Branch to stay up-to-date on the DCMs’ regulatory investigations and disciplinary cases of note, as well as any significant staffing or rule changes.

Objectives. Compliance Branch staff typically reviews a six-month target period and, depending on the core principles covered, thoroughly examines a DCM's audit trail reviews, trade practice and market surveillance investigations, investigation logs, hedge exemptions, surveillance systems, compliance manuals, summary fine schedules, disciplinary files, settlement agreements, and arbitration files. Staff may also conduct on-the-record interviews with a DCM's compliance officials. The RER report includes three types of findings. First, a *deficiency* concerns an area that DMO believes is having a material impact on the exchange's (1) self-regulatory program; or (2) compliance with a core principle or regulation. In this case, the exchange must take corrective action. Second, a *recommendation* concerns an area that DMO believes (1) could, if left unchecked, have a material impact on the exchange's self-regulatory program; (2) would reduce the possibility of future non-compliance with a core principle or Commission regulation; or (3) the exchange has failed to comply with a Commission regulation, but such failure is non-material. In this case, DMO strongly suggests that the exchange implement the recommendation or otherwise improve its self-regulatory program. Third, an *issue* concerns all other areas, such as DMO suggestions for good compliance practices. In this case, DMO suggests that the exchange consider whether more effective practices are available. The report is presented to the Commission, and the Commission votes on whether to accept the report. The report is also sent to the DCM. Although a DCM may not fully agree with the Commission staff's findings, responses from DCMs, which are typically required within 30 days, usually explain how the DCM intends to correct deficiencies or implement staff's recommendations and suggestions, if any.

As discussed above, periodic RERs normally examine selected elements of trade practice surveillance, market surveillance, and disciplinary programs for compliance with the relevant DCM Core Principles, which include DCM Core Principle 2 (Compliance with Rules) and DCM Core Principle 12 (Protection of Market Participants), with respect to trade practice surveillance programs (*see also* CFTC regulations 38.150-160 and 38.650-651); DCM Core Principle 4 (Monitoring of Trading) and DCM Core Principle 5 (Position Limitations or Accountability) with respect to market surveillance programs (*see also* CFTC regulations 38.250-258 and 38.300-301); DCM Core Principle 13 (Disciplinary Procedures), with respect to disciplinary programs (*see also* CFTC regulations 38.700-712). Since the last FSAP report in 2015, the Compliance Branch has not detected any diminution in the self-regulatory efforts among the DCMs. As part of the analysis in conducting RERs for all of the DCMs, the Compliance Branch evaluates whether the DCM maintains sufficient compliance staff and resources to ensure that it can conduct effective audit trail reviews, trade practice and market surveillance, real-time monitoring (*see* CFTC regulation 38.155), and to promptly prosecute possible rule violations within the disciplinary jurisdiction of the DCM (*see* CFTC regulation 38.701). Additionally, with respect to market surveillance and trade practice RERs, the Compliance Branch

evaluates the overall adequacy of the reviews or investigations conducted by the DCMs (see CFTC regulation 38.158). With respect to disciplinary RERs, staff evaluates whether the sanctions imposed by the DCM are commensurate with the violations committed and clearly sufficient to deter recidivism or similar violations by other market participants (see CFTC regulation 38.710).

In 2019, the Compliance Branch plans to initiate regulatory consultations with a number of SEFs and begin designing an examination program for SEFs. The regulatory consultations will serve as a preliminary step to help provide effective oversight while the Commission considers finalizing its new part 37 rules for SEFs. These regulatory consultations will seek, in part, to establish a baseline of information regarding each SEF's regulatory and business operations. In addition, the regulatory consultations will also help the Compliance Branch educate SEFs regarding the examination program and its other interactions with regulated entities to evaluate their compliance with the CEA and Commission regulations.

DMO's 2019 examination priorities for SEFs and DCMs are available through the Commission's website.

System Safeguards

DMO's Compliance Branch also conducts ongoing oversight, including regular, periodic system safeguards examinations (SSEs), of all DCMs and SEFs registered with the Commission. SSEs examine entity compliance with the system safeguards and cybersecurity requirements of the CEA and related Commission regulations.

The CEA requires each of these regulated entities to have a program of system safeguards risk analysis and oversight to identify and minimize sources of operational risk, both through the development of appropriate controls and procedures, and through the development of automated systems that are reliable, secure, and have adequate scalable capacity. Each entity is also required to maintain emergency procedures, backup facilities, and a disaster recovery plan that enables timely recovery and resumption of operations and fulfillment of the entity's regulatory responsibilities, and to periodically conduct test to verify that these backup resources fulfill those goals.

Commission system safeguards regulations call for an entity's system safeguards program to address seven categories of risk analysis and oversight, including: (1) enterprise risk management and governance; (2) information security; (3) business continuity and disaster recovery; (4) capacity and performance planning; (5) systems operations; (6) systems development and quality assurance; and (7) physical security and environmental controls (see CFTC regulation 37.1401 for SEFs and regulation 38.1051 for DCMs). In what is perhaps their key provision, the

system safeguards rules require each registered entity to follow generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of their automated systems.

The regulations also require registered entities to conduct several types of system safeguards and cybersecurity testing, including vulnerability testing, internal and external penetration testing, controls testing (particularly testing of key controls), and security incident response plan testing. They also require registered entities to conduct annual enterprise technology risk assessments.

In addition, the regulations require registered entities to notify Commission staff promptly of all: (1) electronic trading halts and significant system malfunctions; (2) cyber security incidents or targeted threats that actually or potentially jeopardize automated system operation, reliability, security, or capacity; or (3) activations of the entity's business continuity-disaster recovery plan. They also require the entity to give Commission staff timely advance notices of all planned changes to automated systems that may impact their reliability, security, or capacity, and of all planned changes to the entity's program of system safeguards risk analysis and oversight.

The Division's SSEs evaluate the registered entity's compliance with these requirements, in light of best practices. SSEs result in examination reports that may include findings and recommendations for improvement. These reports are confidential and non-public due to the highly sensitive nature of their subject matter and the need to protect registered entity systems from cybersecurity threats.

Audit Program

Review of Exchange Financial and Sales Practice Compliance Programs.

DCM Core Principle 11, Financial Integrity of Contracts, requires a DCM to establish and enforce rules providing for the financial integrity of any contracts traded on the contract market, and rules to ensure the financial integrity of any FCMs and IBs and the protection of customer funds.

Objectives. CFTC staff examines the design and implementation of an exchange's financial and sales practice compliance program for a target period. In addition to assessing the overall effectiveness of such programs, staff's reviews are also intended to identify specific deficiencies or areas that could be improved or enhanced.

As discussed above, all current DCMs, SROs, and NFA participate in a joint audit program under the auspices of the JAC, which must meet the requirements of CFTC Regulation 1.52. Those requirements include, among other things, that the program

be separately evaluated by an “examination expert” at least once every three years, and that a report containing the content and any related responses to the findings of the examination be provided to the CFTC.

CFTC staff also may conduct limited scope examinations of selected registrants from time to time.

Market Surveillance

The CFTC market surveillance program is structured to detect and prevent price manipulation in futures and option markets and compliance with Commission regulations and rules. A principal goal of market surveillance is to spot adverse situations in these markets and to pursue appropriate remedial actions, in coordination with the involved exchange, to avoid market disruption. To accomplish these objectives, the market surveillance staff must determine when a trader’s position in a futures market becomes so large relative to other market factors that the trader is capable of causing prices to diverge from legitimate supply and demand conditions. The surveillance staff regularly collects and analyzes daily data concerning overall supply and demand conditions and cash market price data, cash and future prices and price relationships, and the size of hedgers’ and speculators’ positions in the futures market. Additionally, surveillance staff also issues special calls for participant portfolio data including cash trading, physical trades and all derivatives and structured products.

At the heart of the CFTC’s market surveillance system is a surveillance staff developed application that combines the large trader reporting system with transaction data and large swaps position data. In order to identify potentially disruptive futures positions, staff uses this reporting system to collect and analyze data on large trader positions in all commodities and related reported positions. Further, surveillance staff access SDRs to link other related positions to futures and options data. Reportable positions—daily reports of futures positions above specified levels set for reporting purposes—are obtained from FCMs, clearing members and foreign brokers. Exchanges also provide the daily positions that each clearing member is carrying in each futures and options contract on each underlying commodity.

Because traders frequently carry futures positions through more than one FCM and because individuals sometimes control, or have a financial interest in more than one account, the CFTC routinely collects information that enables its CFTC staff to aggregate related accounts for use by DOE surveillance staff. FCMs must file a form which identifies each new account with reportable positions for each futures contract. In addition, if a trader’s position reaches a reportable level, the trader may be required to file a more detailed identification report to identify accounts and reveal any relationships that may exist with other accounts or traders.

An additional monitoring mechanism allows surveillance analysts to investigate further the positions of large traders by instituting a “special call,” which requires a trader to report their futures and option positions with all brokerage firms, or their cash market or OTC positions. The trader may be required to give information on his or her trading and delivery activity. Special calls also may be used to examine cash market positions and commitments in relation to futures market positions to access the economic rationale of the trader’s overall activities. The CFTC thus has the authority and techniques to investigate and discover the identities of the true account owners and controllers of large positions, whether domestic or foreign, and understand their market activities including physically-settled swaps and futures.

Importantly, the CEA’s core principles applicable to DCOs require each DCO to maintain and enforce rules that address, among other things, the adequacy of financial resources, participant and product eligibility, risk management, settlement procedures, treatment of funds, default rules and procedures, rule enforcement, system safeguards, reporting to the CFTC, recordkeeping, public information, information sharing and antitrust concerns. DCR routinely conducts examinations of registered DCOs pursuant to applicable CFTC regulations.

In addition, DCR’s RSG monitors the risk posed to and by DCOs, clearing members, and market participants, including market risk, liquidity risk, credit risk, and concentration risk. Relevant margin and financial resources are included within this monitoring program. CFTC staff regularly conducts back-testing to review margin coverage at the product level and follows up with the relevant clearinghouse regarding exceptional results. Independent stress testing of portfolios is conducted regularly. The independent stress tests often lead to individual trader reviews and/or FCM risk reviews. Traders and FCMs that have a higher risk profile are then reviewed during the Commission’s on-site review of a clearinghouse’s risk management procedures. In addition, DCR’s RSG also coordinates with other domestic and foreign regulators on matters of common jurisdictional interest. DCR staff also participates in implementation monitoring programs related to the PFMI.

NFA Oversight

The CFTC has general oversight responsibility for all NFA functions (as an RFA) to ensure compliance with the CEA and Commission regulations. The CFTC also monitors NFA for enforcement of its own rules and bylaws.

As an RFA, NFA is considered an SRO and, as noted above, must, in carrying out its financial audit and surveillance activities, comply with the requirements of the CFTC’s regulatory program.

In addition to the FCMs for which it is responsible under the joint audit program, NFA is responsible for regulatory compliance matters with respect to its member IBs, except for IBs that are guaranteed by an FCM that does not have NFA as its DSRO. NFA also is responsible for sales practice surveillance over all member CPOs and CTAs. NFA's oversight of CPOs and CTAs also extends to review of annual reports and disclosure documents filed pursuant to Part 4 of the CFTC's regulations consistent with the CFTC's delegation of the same,¹⁰⁹ and the conduct of examinations of such firms on a periodic basis.¹¹⁰

The CFTC ensures compliance by NFA with its self-regulatory obligations and DCMs with core principles by conducting periodic reviews of NFA's compliance programs and core principle oversight reviews of DCMs. NFA oversight reviews focus on the specific program responsibilities of NFA, including review of the financial and sales practice compliance programs for registered intermediaries, as well as review of NFA's programs for arbitration, registration and fitness, and disciplinary actions.

In the implementation of such reviews, staff meets with NFA or DCM staff reviews program materials and databases, evaluates procedures, and performs reviews of samples of NFA's or the DCM's files to determine whether the SRO's procedures are consistent with its regulatory obligations, whether the SRO has properly executed its program, and that the files contain sufficient documentation. The results of these reviews are presented to the CFTC and reported back to NFA or the DCM. Consecutive reviews of the same program may focus on a particular aspect of the program in question, including following up on recommendations made in prior reviews.

As an example of the CFTC's oversight of NFA, the CFTC oversees NFA's registration program through frequent contacts between staff members on specific matters, as well as formal reviews by CFTC staff of the operation of NFA's program. These reviews have two general purposes: (1) to determine whether NFA's written program properly addresses all relevant CFTC regulations and guidelines; and (2) to confirm that the execution of the written program is complete and is consistently applied in accordance with NFA's written program. Following the completion of the review, the CFTC generates a report detailing its findings with respect to the reviewed program, including recommendations for correction of problems or improvements. CFTC staff also attends regular meetings of the JAC to deal with examination or supervision issues that arise among the SROs.

¹⁰⁹ 62 FR 52088 (Oct. 6, 1997); 67 FR 77470 (Dec. 18, 2002).

¹¹⁰ See Article III of NFA's Articles of Incorporation available on the NFA's website.

The CFTC has conducted various reviews of NFA’s programs during the period of 2014-2019, including: risk based examinations, CPO and CTA compliance, telemarketing supervision, FCM and IB financial reports, SRO staffing, disciplinary actions, and arbitration. CFTC staff also has conducted oversight reviews of all other DSROs during the same time period.

Section 17(k) of the CEA provides that the CFTC is authorized to abrogate any rule of an RFA if it appears to the CFTC that such abrogation is necessary or appropriate to assure fair dealing by the members of the association, to assure a fair representation of its members in the administration of its affairs, or to effectuate the purposes of the CEA. The CFTC also may alter or supplement RFA rules, after notice and hearing. Section 17(c) of the CEA provides that the CFTC may suspend the registration of an RFA if it finds that the rules thereof do not conform to the requirements of the CFTC. If the CFTC determines that a DCM (or other registered entity such as a DCO) is violating core principles it will provide notice to the entity in writing of such determination and afford the registered entity an opportunity to make appropriate changes to come into compliance, after which the CFTC may take further steps, including suspension/revocation of certification.

(b) Retain full authority to inquire into matters affecting the investors or the market?

Yes. Section 8 of the CEA allows the Commission to make such investigations as it deems necessary to ascertain the facts regarding the operations of the boards of trade and other persons subject to the provisions of the CEA. This includes the authority to investigate the market conditions of commodities, including the supply and demand for such commodities.

With regards to NFA, pursuant to Section 17 of the CEA, the CFTC broadly retains full authority over all matters undertaken by an RFA.

See also response to Principle 9, Question 1(a).

(c) Take over or support an SRO’s responsibilities where the powers of an SRO are inadequate for inquiring into or addressing particular misconduct or allegations of misconduct or where a conflict of interest necessitates it?

Yes. Section 8a(9) of the CEA authorizes the CFTC to direct a registered entity, (*e.g.*, a DCM, DCO, SEF, and SDR), whenever it has reason to believe that an emergency exists, to take such action as in the CFTC’s judgment is necessary to maintain or restore orderly trading in or liquidation of any futures contract.

Section 8a(7) of the CEA authorizes the CFTC to alter or supplement the rules of a registered entity under certain circumstances. In order for the CFTC to take such action under Section 8a(7), the CFTC must first make the appropriate request to a registered entity in writing specifying the desired rule change and, after appropriate notice and hearing, determine that the registrant did not make the

requested changes and that such changes are necessary or appropriate for the protection of persons producing, handling, processing, or consuming any commodity traded for future delivery on such registered entity, or the product or byproduct thereof, or for the protection of traders or to insure fair dealing in commodities traded on such registered entity.

Enforcement can support the SRO responsibilities where their powers are inadequate for inquiring (*e.g.*, where the investigation requires subpoenaing third-party records) or sanctioning (*e.g.*, in the case of a recidivist) by initiating its own investigation or enforcement proceeding. Also, the CEA gives the CFTC authority in some cases to enforce some exchange rules, for example, pursuant to Section 4a(e) of the CEA, violations of exchange speculative limit rules approved by the Commission are subject to enforcement action by the Commission.

RFAs. Section 17(k) of the CEA provides that the CFTC is authorized to abrogate any rule of an RFA if, after notice and opportunity for hearing, it appears to the CFTC that such abrogation is necessary or appropriate to assure fair dealing by the members of the association, to assure a fair representation of its members in the administration of its affairs, or to effectuate the purposes of the CEA. The CFTC also may alter or supplement RFA rules, after notice and hearing.

Section 17(c) of the CEA provides that the CFTC may, after notice and opportunity for hearing, suspend the registration of an RFA if it finds that the rules thereof do not conform to the requirements of the CFTC.

Additionally, where the SRO does not have the ability to obtain necessary information (*e.g.*, where the investigation requires subpoenaing third-party records) or impose sanctions (*e.g.*, in the case of a recidivist), DOE will “support” the SRO responsibilities. Also, as noted elsewhere, the CEA give the Commission the authority to enforce exchange rules (*e.g.*, violations of exchange speculative position limit rules approved by the Commission are subject to enforcement action by the Commission).

Professional Standards similar to those Expected of a Regulator

4. Does the regulator, the law or other applicable regulation require the SRO to follow similar professional standards of behaviour as would be expected of a regulator:

(a) On matters relating to confidentiality and procedural fairness?

Yes.

Confidentiality. The CEA requires SROs to maintain the confidentiality of material non-public information and information obtained from the CFTC in connection with the exercise of their self-regulatory responsibilities.

Section 9(e)(1) of the CEA makes it a felony for any person who is an employee, member of the governing board, or member of any committee of a board of trade,

registered entity, SDR, or RFA, in violation of a regulation issued by the CFTC, willfully and knowingly . . . to disclose for any purpose inconsistent with the performance of such person's official duties as an employee or member, any material non-public information obtained through special access related to the performance of such duties.

CFTC regulation 1.59(d)(1)(ii), prohibits employees, governing board members, committee members, and consultants of SROs, from disclosing material non-public information obtained through their position with the SRO for any purpose that is not consistent with the performance of their duties with respect to the SRO, and requires that SROs and RFAs promulgate rules that prohibit governing board members, committee members and consultants from disclosing material, non-public information obtained as a result of the performance of such person's official duties.

An exchange or RFA must maintain the confidentiality of information disclosed to it by the CFTC, except in limited circumstances. The CFTC is authorized under CEA Section 8a(6) to communicate to the proper committee or officer of any contract market, RFA or SRO the full facts concerning any transaction or market operation, including the names of parties, that in the judgment of the CFTC disrupts or tends to disrupt any market or is otherwise harmful or against the best interests of producers, consumers, or investors, or which is necessary or appropriate to effectuate the purposes of the CEA. However, Section 8a(6) provides that any information furnished by the CFTC under this authority "shall not be disclosed by such contract market, registered futures association, or SRO except in any self-regulatory action or proceeding." *See also* CFTC regulation 140.72, delegating such authority to certain CFTC staff.

An exchange must maintain the confidentiality of, and is prohibited from disclosing to third parties, information developed by the exchange in an investigation. A contract market is required by CEA Section 8c(a)(2) to make public its findings in any exchange disciplinary proceeding pursuant to its internal rules (that is, a proceeding to suspend, expel, discipline or deny access to an exchange member), but may not disclose the evidence for its findings except to the person suspended, expelled, disciplined or denied access to the exchange or to the CFTC. The CFTC has clarified that its delegation of registration and disqualification functions to NFA permits exchanges to disclose to NFA all evidence underlying exchange disciplinary actions.¹¹¹

Procedural Fairness. DCM Core Principle 12, Protection of Market Participants,

¹¹¹ See CFTC Interpretative Letter No. 00-56 (Apr. 13, 2000).

requires a DCM to establish and enforce rules designed to promote fair and equitable trading and to protect the market and market participants from abusive practices. DCMs should have rules prohibiting conduct by intermediaries that is fraudulent, noncompetitive, unfair, or an abusive practice in connection with the execution of trades and a program to detect and discipline such behavior. The DCM should have methods and resources appropriate to the nature of the trading system and the structure of the market to detect trade practice abuses. Additionally, DCM Core Principle 13 requires the DCM establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violated the rules of the board of trade.

In addition, various CFTC regulations impose standards of procedural fairness on SRO programs.

DCM Core Principle 2, Compliance with Rules, requires DCMs to monitor and enforce compliance with the rules of the contract market, including access requirements, the terms and conditions of any contracts to be traded and rules prohibiting abusive trading practices on the contract market. A DCM must also have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market.

In much the same way as DCM Core Principle 2, SEF Core Principle 2, Compliance with Rules, requires a SEF to establish and enforce trading, trade processing, and participation rules that will deter abuses. Additionally, under SEF Core Principle 2, the SEF must have rules governing the operation of the facility, including rules specifying trading procedures to be used, in entering and executing orders traded or posted on the facility including block trades.

Section 17(b)(9) of the CEA requires that an RFA have rules that provide for a fair and orderly procedure with respect to the disciplining of members and persons associated with members for the denial of membership. Each person subject to such a proceeding must be given an opportunity to be heard and must be informed of the specific grounds for discipline. Further, a record must be kept and, in the event that disciplinary action is taken, specific grounds supporting such action must be provided to the disciplined entity.

In addition, an RFA, pursuant to CFTC regulation 170.6, must conduct proceedings in a manner consistent with fundamental due process. Similarly, CFTC regulation 170.8, requires RFAs to demonstrate a capability to promulgate rules and conduct proceedings which provide a fair, equitable, and expeditious procedure, through arbitration or otherwise, for the voluntary settlement of customers' claims or grievances brought against any member of the association or any employee thereof.

The CFTC has delegated to NFA responsibility for processing and granting applications for registration of various categories of registrants under the CEA. The various delegation orders have imposed procedural conditions and/or were accompanied by the approval of NFA rules that contained procedural protections. For example, in 1985 the CFTC approved rules adopted by NFA pursuant to which NFA would conduct proceedings to deny, condition, suspend, restrict or revoke the registration of any applicant for registration or registrant who may be subject to a statutory disqualification under Sections 8a(2) through 8a(4) of the CEA and for whom NFA has been authorized to perform the CFTC's registration functions. The procedures embodied in those NFA rules closely parallel those specified by the CFTC in Subpart C of Part 3 of its regulations. Specifically, NFA adopted the CFTC's standards defining the scope of evidence that may be presented by the applicant or registrant to challenge allegations of statutory disqualification, as well as the standards to be followed by the party reviewing the matter and making determinations. Wherever NFA has modified those procedures, the CFTC's review concluded that the modifications would not adversely affect the rights of applicants and registrants.¹¹²

- (b) On the appropriate use of information obtained in the course of the SRO's exercise of its powers and discharge of its responsibilities?

Yes. See response to Principle 9, Questions 2(a) and 4(a). Furthermore, Section 9(e)(2) of the CEA makes it a felony for any person who is an employee, member of the governing board, or member of any committee of a board of trade, registered entity, swap data repository, or RFA, in violation of a regulation issued by the CFTC, willfully and knowingly to trade for such person's own account, or for or on behalf of any other account, in contracts for future delivery or options thereon, or swaps, on the basis of, or willfully and knowingly to disclose for any purpose of such person's official duties as an employee or member, any material nonpublic information obtained through special access related to the performance of such duties.

CFTC regulation 1.59(d)(1)(i) prohibits any employee, member of the governing board or member of any committee of an SRO from trading for such person's own account, or for or on behalf of any other account, in any commodity interest based on any material, nonpublic information obtained through special access related to the performance of such person's official duties. CFTC regulation 1.59(d)(2) similarly prohibits any person from trading for such person's own account on the basis of any material, nonpublic information that such person knows was obtained in violation of CFTC regulation 1.59(d)(1)(i).

¹¹² See 50 FR 34885, 34886 (Aug. 28, 1985).

Conflicts of Interest

5. Does the regulator, the law or other applicable regulation assure that potential conflicts of interest at the SRO are avoided or appropriately managed?

Yes. See response to Principle 9, Question 4(b).

Principle 24 **The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.**

Key Questions

Eligibility Criteria

1. Does the regulatory system set standards for the eligibility of those who wish to:

(a) Market a CIS?

(b) Operate a CIS?

Yes, to all of the above. The CEA defines a CPO in Section 1a(11) as any person engaged in a business that is of the nature of a commodity pool, investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests. Commodity interest is defined in CFTC regulation 1.3 and includes, among other things, futures, options, and swap transactions. Section 1a(10) of the CEA and CFTC regulation 4.10(d) define a commodity pool as any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests. Under Section 4m of the CEA, all individuals and firms, with limited exceptions, that intend to do business as a CPO must register with the CFTC.

In 1984, the CFTC delegated to NFA the registration of CPOs. NFA reviews applications for registration to determine, among other things, whether an application is subject to statutory disqualification under Sections 8a(2) and (3) of the CEA. NFA performs an extensive background check, which includes fingerprinting of natural person principals and related Federal Bureau of Investigations (FBI) clearances, to determine whether a statutory disqualification exists. For foreign applicants, NFA may perform additional background checks such as checks with foreign regulatory and self-regulatory bodies, and Interpol. NFA also imposes proficiency testing requirements upon individual applicants.

The fitness requirements for all market intermediaries are incorporated into the basic registration application form, Form 7-R. Form 7-R requires disclosure of the applicant's name, address, branch offices, and principals, as well as detailed information about the disciplinary and criminal history of the firm. A Form 8-R, which requires similar information to the Form 7-R, is required for each natural person principal and AP applicant. CFTC regulation 1.3 defines an AP of a CPO as a partner, officer, employee, consultant, or agent (or any natural person occupying a similar status or performing similar functions) in any capacity which involves the solicitation of funds, securities, or property for participation in a commodity pool, or the supervision of any person or persons so engaged. Additionally, applicants for CPO registration who have previously operated a CIS under an exemption from registration pursuant to CFTC regulation 4.13 must accompany their Form 7-R with financial statements consistent with the applicable provisions of Part 4 of the

| | |
|----|---|
| | <p>CFTC's regulations.</p> <p>Part 4 of the CFTC's regulations mandate the filing with NFA, as a delegate of the CFTC, of disclosure documents for the pools and trading programs they offer for review prior to their use by a CPO in its solicitation of participants in the commodity pool. Additionally, the CPO must file with NFA the annual financial statements for the pool to determine compliance with the provisions of Part 4 of the Commission's regulations.</p> |
| 2. | Do the eligibility criteria for a CIS operator include the following: |
| | (a) Honesty and integrity of the operator? |
| | |
| | (b) Having appropriate and sufficient human and technical resources to ensure that is capable of carrying out the necessary functions of a CIS operator? |
| | |
| | (c) Financial capacity of the CIS or the CIS operator that would allow the launching and operation of the CIS in appropriate conditions? |
| | |
| | (d) Ability to perform specific powers and duties? |
| | |
| | (e) Having, or employing, appropriate identification, monitoring and management of risks, based on, among other things, the size, the complexity and the risk profile of the CIS? |
| | |
| | (f) Having internal controls and compliance arrangements sufficient to ensure it can carry out its business diligently, effectively, honestly and fairly? |
| | <p>Yes, to all of the above. The CEA specifies certain factors that would disqualify an applicant from registering with the CFTC, including prior proceedings in which the applicant was found to have violated the law or in which the applicant was formally enjoined from engaging in certain activities. The CFTC has authorized NFA to receive and review registration applications and grant or deny registrations, subject to appeal by the applicant to the CFTC and the courts. NFA performs an extensive background check to determine whether a disqualification exists. Three essential elements of the background check are:</p> <ul style="list-style-type: none"> • The Disciplinary Information questions on the application forms, which require the applicant to disclose and supply detailed information concerning possible disqualifications; • A check against the Financial Industry Regulatory Authority's (FINRA's) Central Registration Depository database; and • The fingerprint cards provided by individuals. <p>Although Form 7-R is only required of entities applying for registration, Form 8-R, as discussed above in response to Principle 24, Question 1, is required of each</p> |

natural person who is a principal of the applicant, as well as for individuals seeking AP registration. Persons filing a Form 8-R also must provide fingerprints on a card provided by NFA. In addition, Form 8-R requires disclosure of information on the employment, residential, educational, disciplinary and criminal history of the individual principal or applicant. The CFTC defines "principal" under CFTC regulation 3.1 as a sole proprietor, general partner, director, officer, manager or managing member, or person who is in charge of a principal business unit, division, or function subject to CFTC regulation, or any person occupying a similar position who exercises a controlling influence over the regulated activities of the firm. In addition, any holder or beneficial owner of 10 percent or more of the outstanding shares of stock in the firm, or any person who has contributed 10 percent or more of the firm's capital, is a principal. It is through this requirement that the CFTC and NFA can consider the knowledge, resources, skills, and ethical attitude of senior management, directors and substantial owners/shareholders. However, it should be noted that the CFTC uses an objective approach to assessing ethical attitude, based, in part, on past conduct that could indicate a potential lack of appropriate ethical standards. No subjective inquiry is performed with respect to the business model or management capabilities of the applicant for registration. With regard to APs, however, each AP applicant must take and pass proficiency tests before being able to market commodity interest investments to potential customers.

Moreover, all CFTC registrants, including CPOs, are subject to Section 4o(1) of the CEA, which prohibits, among other things, engaging in any transaction practice, or course of business that operates as a fraud or deceit upon any client or participant, or prospective client or participant.

There are no specific requirements in the CEA or CFTC regulations mandating specific human and technical resources to register as a CPO. However, as explained below, the CFTC and NFA monitor CPOs on an ongoing basis to determine their compliance with a myriad of obligations in the Part 4 regulations, *e.g.*, audited financial statements and Disclosure Documents, and entities intending to register as CPOs and operate commodity pools are implicitly required to have the human and technical resources necessary to meet these compliance obligations. Additionally, the CFTC has recently implemented data collection on Form CPO-PQR, which requires in-depth reporting of a pool's positions, counterparties, risk metrics, and other operational considerations. Together, these requirements necessitate the use of often substantial technical and human resources.

CPOs are not required to comply with any minimum financial requirements.

APs are required to pass certain proficiency tests before soliciting customers for participation in a pool operated by a CPO. Principals are not required to have the ability to perform any specific powers or duties, aside from those implicit in meeting the established compliance obligations of CFTC regulations and NFA rules. Their educational and professional backgrounds are required by CFTC regulation 4.24(f) to be included in Disclosure Documents distributed to pool participants.

Pursuant to CFTC regulation 4.21, CPOs are required to provide potential

participants in their commodity pools a Disclosure Document prepared in accordance with CFTC regulations 4.24 and 4.25. CFTC regulation 4.24(g) requires CPOs to include in the Disclosure Document a summary of the principal risk factors of the offered commodity pool. The principal risk factor discussion must be tailored to the individual commodity pool, including risks related to the volatility, leverage, and counterparty creditworthiness, as applicable to the types of trading programs to be followed, trading structures to be employed, and investment activities expected to be engaged in by the offered commodity pool. CFTC regulation 4.24(g) therefore requires CPOs to be able to identify and understand the principal risk factors of their investment schemes, in order to accurately and fully disclose said risks to potential commodity pool participants. Additionally, CFTC regulation 4.26 provides that if a CPO knows or should know that the Disclosure Document is materially inaccurate or incomplete in any respect, including the principal risk factors, the CPO must correct that defect and distribute the correction to all existing participants, as well as any previously solicited potential participants prior to the CPO accepting or receiving their funds, with limited exceptions, within 21 calendar days of the date upon which the CPO first knows or has reason to know of the defect. The combination of these CFTC regulations requires CPOs to continuously monitor and assess the risks of their commodity pools, and to not only make pool participants aware of these risks prior to their initial investment, but to ensure that the participants are aware of any material changes for as long as they are invested in the commodity pool.

Additionally, all CPOs that are registered or required to be registered are subject to compliance with CFTC regulation 4.27, which requires CPOs, depending upon their assets under management, to provide information regarding the relationships and investments of their operated pools. CPOs with assets under management in excess of \$500 million are required to provide the following information: pool borrowings, counterparty credit exposure, pool strategy, derivatives exposure, and a full schedule of investments. Further, CPOs with greater than \$1.5 billion in assets under management must provide the following information to the CFTC: their operated pools' geographical exposure, liquidity, and risk testing based upon a number of specific scenarios.

The CEA and CFTC regulations form a regulatory system for CPOs that is primarily disclosure-based. This requires CPOs to, among other things, evaluate the materiality of events and transactions; to include material information in their periodic Account Statements, Disclosure Documents, and Annual Reports containing financial statements certified by an independent accountant; and to adequately disclose the risks of commodity interest investments, the educational and business background of CPOs' principals and senior management staff, and any potential or actual conflicts of interest involving the CPO or its staff to potential CIS participants. The CFTC believes its detailed compliance obligations require CPOs to establish internal controls and procedures in order to maintain and demonstrate compliance with the CEA and CFTC regulations. Furthermore, as noted above, NFA assists the CFTC in the oversight of CPOs. NFA also requires CPOs to be NFA Members, and therefore, to be subject to and comply with the

panoply of NFA Member rules, which sometimes require the establishment of policies and procedures to address certain issues. One example is NFA Compliance Rule 2-38, which requires all NFA Members to establish written business continuity and disaster recovery plans – a related interpretive notice requires the plan to be distributed to key personnel and to be tested periodically. NFA also has rules that are applicable to all entities required to be NFA Members. The combination of the two systems is designed to require CPOs to operate their commodity pools diligently, effectively, honestly, and fairly.

3. Does the regulatory system provide for effective mechanisms to assess compliance with the criteria referred to in Questions 2(a) to 2(f)?

Yes. As discussed below, NFA conducts regular examinations of CPOs operating commodity pools, pursuant to authority delegated to it by the CFTC. NFA also reviews Annual Reports from CPOs containing, among other things, independently certified financial statements of the pools, and regularly reviews Disclosure Documents drafted by CPOs before they can be distributed to potential pool participants. Additionally, Part 21 of the CFTC's regulations allows the CFTC to engage in special calls, facilitating CFTC access to account ownership and commodity interest transaction information in the form and manner, and at the time, the CFTC requests it.

4. Does the regulatory system set standards for the CIS governance seeking to ensure that CIS are organized and operated in the interests of CIS investors, and not in the interests of CIS connected persons?

Yes. CFTC regulation 4.20 requires a CPO to operate its pool as an entity cognizable as a legal entity separate from the CPO. That regulation also requires that the pool accept funds, securities, or other property from its participants in the name of the pool, rather than the CPO, and it prohibits the commingling of pool assets with the property of any other person. NFA regulations also provide specific prohibitions and limitations on the circumstances under which a CPO may enter into transactions with a pool it operates for the benefit of the pool. The CFTC regulatory system further ensures that commodity pools are operated in the interests of the participants, rather than persons connected to the CPO or pool, through a highly detailed disclosure regime. CFTC regulation 4.24 requires CPOs to disclose to participants, in addition to the principal risks and performance of the investment activity of the commodity pool, a detailed description of any fees and expenses expected to be incurred; any actual or potential conflicts between the CPO, the trading manager, the CTA, or any principals, or any other material conflicts; a full description of any material transactions between the CPO and any person affiliated with a person providing services to the pool, among other significant factors; the extent of any ownership in the pool by the CPO, trading manager, major CTAs, or principals. CFTC regulation 4.24(w) requires the CPO to disclose all material information to prospective and existing pool participants, even if the information is not explicitly required by any other CFTC regulation.

| | |
|--|---|
| <p>5. Does the authorization/registration of CIS take into account the possible need for international cooperation in the case of CIS marketed across jurisdictions or where promoters, managers or custodians are located in several different jurisdictions?</p> | <p>Yes. For foreign applicants, NFA may perform additional background checks such as checks with foreign regulatory and self-regulatory bodies and Interpol. In certain cases, NFA consults with foreign regulatory authorities to assess the fitness of applicants for registration whose applications disclose prior employment with a non-U.S. firm, or where the U.S. registrant has foreign principals. In addition, the CFTC has entered into MOUs with 29 European authorities related to supervision of CIS and the alternative investment fund industry. Moreover, other less specific cooperative arrangements could be used in order to cooperate with respect to CIS.</p> |
| <p><i>Supervision and Ongoing Monitoring</i></p> | |
| <p>6. Is the regulator responsible for monitoring ongoing compliance with the standards applicable to CIS and CIS operators? In particular, does the regulator have clear responsibilities and powers with respect to:</p> | |
| <p>(a) Registration or authorization of a CIS?</p> | |
| <p>(b) Inspections to ensure compliance by CIS operators?</p> | |
| <p>(c) Investigation of suspected breaches?</p> | |
| <p>(d) Remedial action in the event of breach or default?</p> | |
| | <p>Yes, to all of the above. The CFTC and NFA are responsible for oversight of CPOs. As discussed in the response to Principle 24, Question 1, the CFTC has delegated to NFA responsibility for registration of CPOs.</p> <p>NFA, as an RFA, has oversight responsibility for CPOs and has instituted a program that monitors compliance by CPOs with all applicable CFTC regulations and NFA rules.</p> <p>Pursuant to Section 17 of the CEA, as an RFA, NFA must:</p> <ul style="list-style-type: none"> • Establish training standards and proficiency testing for persons involved in the solicitation of transactions, supervisors of such persons and all persons for which it has registration responsibilities, and a program to audit and enforce compliance with such standards; and • Establish minimum standards governing sales practices of its members and persons associated therewith for transactions subject to provisions of the CEA. <p>Additionally, when an entity seeks to be registered as a CPO, it must submit a Disclosure Document to NFA, as the CFTC’s delegate, for review to determine</p> |

| | |
|------------|--|
| | <p>compliance with CFTC regulations as well as NFA rules prior to holding itself out to be a duly-registered CPO and soliciting participants. CFTC staff regularly reviews NFA's review of Disclosure Documents as part of the CFTC's oversight of NFA.</p> <p>NFA also conducts examinations of registered CPOs generally within the first year after becoming active and then every 3 to 4 years thereafter to ensure compliance with the CFTC's regulations and NFA's rules. NFA conducts a risk-based analysis to determine the frequency with which it conducts examinations of CPOs. This analysis considers many different business factors, as well as information such as customer complaints or concerns that arise during NFA's review of a firm's Disclosure Document, financial statement or promotional material.</p> <p>In the event that a registered CPO fails to comply with its regulatory obligations, NFA's Business Conduct Committee (BCC) is empowered to take action against the entity and impose sanctions, including expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules. Similarly, the CFTC, through its DOE, may impose civil penalties for violations of CFTC regulations ranging from a ban from registration to a monetary penalty, as well as seek criminal penalties.</p> |
| <p>7.</p> | <p>Does the ongoing monitoring involve a review of reports submitted to the regulator with regard to CIS and entities involved in the operation of a CIS (CIS operators, custodians, etc.) on a routine basis or on a risk-assessment basis?</p> |
| | <p>Yes. NFA routinely reviews annual financial statements and Disclosure Documents filed by registered CPOs, and CFTC staff conducts ongoing oversight of NFA with respect to these responsibilities.</p> |
| <p>8.</p> | <p>Does the ongoing monitoring involve, where appropriate, performance of on-site inspections of entities involved in operating CIS (CIS operators, custodians, etc.)?</p> |
| | <p>Yes. NFA conducts regular on-site inspections of registered CPOs as part of its ongoing monitoring of their operations. Additionally, as stated previously, NFA conducts a risk-based analysis to determine the frequency with which it conducts examinations of CPOs. This analysis considers many different business factors, as well as information such as customer complaints or concerns that arise during NFA's review of a firm's Disclosure Document, financial statement or promotional material. NFA generally conducts examinations of registered CPOs within the first year after becoming active and then every 3 to 4 years thereafter.</p> |
| <p>9.</p> | <p>Do the regulatory authorities proactively perform investigative activities in order to identify suspected breaches with respect to entities involved in the operation of a CIS?</p> |
| | <p>Yes. Although the CFTC retains authority to conduct inspections, NFA has primary responsibility for inspections of CPOs, and performs periodic examinations as discussed above.</p> |
| <p>10.</p> | <p>Is the operator of a CIS subject to a general and continuing obligation to report to the</p> |

| | |
|--|--|
| <p>regulatory authority or investors, either prior to or after the event, any information relating to: material changes in its management or organization, or in the by-laws of the CIS, or the CIS operator?</p> | |
| <p>Yes. CFTC regulation 4.26 requires each CPO to correct any defect in its Disclosure Document that it knows to be materially inaccurate or incomplete in any respect. The correction must be made to all existing participants within 21 days of the date upon which the CPO first knows or has reason to know of the defect. Any amendments to the Disclosure Document must be filed electronically with NFA. In addition, CFTC regulation 4.22(a) requires that the periodic Account Statement distributed for the pool disclose any material business dealings involving the CPO and any other persons providing services to the pool if they have not previously been disclosed to the pool's participants. NFA also requires CPOs to provide annual updates regarding their registration information and business operations. CPOs relying on registration exemptions or definitional exclusions provided under CFTC regulations 4.13 and 4.5 must annually affirm their reliance on the exemption or exclusion through an electronic filing with NFA, or if applicable, notify NFA of a material change in their operations, such that the CPO can no longer rely on the exemption or exclusion and must apply for registration, within 60 days of the calendar year end. Also, with respect to CFTC regulations 4.13 and 4.5, with each new commodity interest position, CPOs continually assess their pools' compliance with the <i>de minimis</i> thresholds outlined in those regulations.</p> | |
| <p>11. Does the regulatory system assign clear responsibilities for maintaining records on the organization and business of the CIS operator? Does the regulatory system provide for the keeping of books and records in relation to transactions involving CIS assets, and all transactions in CIS shares or units or interests?</p> | |
| <p>Yes. CFTC regulation 4.23 states that each CPO must make and keep books and records relating to the pool as well as to its operation as a CPO in an accurate, current, and orderly manner in its main business office and in accordance with CFTC regulation 1.31. According to these regulations, records must be made available to the CFTC and DOJ.</p> | |
| <p><i>Conflicts of Interest and operational conduct</i></p> | |
| <p>12. Are there provisions:</p> | |
| <p>(a) To prohibit, restrict or manage (including, if appropriate, by disclosure) certain conduct likely to give rise to conflicts of interest between a CIS and its operators or their associates or connected parties?</p> | |
| <p>Yes. CFTC regulation 4.24(j) requires a CPO to include in its Disclosure Document a full description of any actual or potential conflicts of interest regarding any aspect of the pool on the part of the CPO, the trading manager (if any), any major CTA, the CPO of any major investee pool, any principal of the foregoing entities, and any other persons providing services to the commodity pool. The CPO also must describe any other material conflict of interest with respect to the pool.</p> | |

| | |
|-----|--|
| | (b) To require a CIS operator to seek to minimize potential conflicts of interest and ensure that any conflicts that do arise are identified and properly managed by taking appropriate actions (including, where appropriate, through disclosure) so that the interests of investors are not adversely affected? |
| | No. CFTC regulations do not mandate that a CPO take any actions to minimize conflicts of interest; rather, CFTC regulation 4.24(j) requires the disclosure of a full description of any actual or potential conflicts of interest regarding any aspect of the pool on the part of the CPO, the trading manager (if any), any major CTA, the CPO of any major investee pool, any principal of the foregoing entities, and any other persons providing services to the commodity pool. |
| 13. | |
| | (a) Does the regulatory system require the CIS operator to comply with operational conduct standards? |
| | |
| | (b) In particular, is the CIS operator required to act in the best interest of investors and in accordance with the principle of fair treatment? |
| | Yes, to all of the above. See responses to Principle 24, Questions 2, 4, 11, and 12. A CPO of commodity pools that are organized as limited liability companies or limited partnerships, and who serves as the managing member or general partner of such pools, may also have specific obligations regarding its conduct and a duty to act in the best interests of the pool’s participants arising out of the applicable state statutory or common law. |

| | |
|-----|--|
| 14. | Does the regulatory system address the regulatory issues associated with: |
| | (a) Best execution? |
| | |
| | (b) Appropriate trading and timely allocation of transactions? |
| | |
| | (c) Churning? |
| | |
| | (d) Related party transactions? |
| | |
| | (e) Underwriting arrangements? |
| | |
| | (f) Due diligence in the selection of investments? |
| | |
| | (g) Fees and expenses, in order to ensure that no unauthorized charges or expenses are levied against a CIS, or CIS investors, and that: commission rebates; soft commission arrangements; and inducements, do not conflict with the CIS operator’s duty to act in the best interest of investors? |

Yes, to all of the above. Within the CFTC's disclosure-based regime, CPOs are responsible for adhering to trading strategies and other information set forth in the Disclosure Document and other documents governing the operation of the pool, and are required under CFTC regulation 4.24(h)(2) to disclose any material restrictions or limitations on trading.

With respect to CPOs, CFTC regulation 4.24(k) requires that, if there are any material transactions or arrangements for which there is no publicly disseminated price between the pool and any person affiliated with a person providing services to the pool, the CPO must disclose a full description of such arrangements, including a discussion of the costs associated therewith.

Additionally, CFTC regulation 1.35(b)(5) specifically governs post-execution allocation of bunched orders and provides that specific account identifiers for accounts included in bunched orders need not be recorded at the time of order placement or upon report of execution if: (1) the person placing and directing the allocation of an order eligible for post-execution allocation has been granted written investment discretion with respect to the customer account; (2) eligible account managers must make certain information available to customers, including the general nature of the allocation methodology to be used, whether accounts in which the manager has an interest have been included in the bunched order, and a summary of data sufficient to compare one customer's results with another customer's or the manager's; (3) the orders eligible for post-execution allocation must be allocated by an eligible account manager as soon as practicable after the entire transaction is executed or not later than the end of the day on which the order is executed, be allocated in a fair and equitable manner, and be in accordance with an allocation methodology that is objective and specific to permit independent verification of its fairness; and (4) eligible account managers must make available upon request of any representative of the CFTC, DOJ, or other appropriate regulatory agency records sufficient to demonstrate that all allocations meet the standards articulated in CFTC regulation 1.35(b)(5) and to permit reconstruction of the handling of the order from the time of placement to the allocation.

Further, CFTC regulation 1.46 governs the application and closing out of offsetting and short positions by FCMs and provides that where an FCM purchases any commodity for future delivery for a customer when the account of such customer at the time of such purchase has a short position in the same future of the same commodity on the same market or sells any commodity for future delivery for a customer when the account of such customer at the time of such sale has a long position in the same future of the same commodity on the same market, the FCM must apply such purchase or sale against such previously held short or long futures position and promptly furnish the customer with a statement showing the financial result of the transactions involved. The FCM is required to perform the same function with respect to the purchase or sale of puts and calls with respect to options, with the exception of providing a statement to the customer. Under CFTC

regulation 1.46(b), where the short or long futures or option position in such customer's or option customer's account immediately prior to such offsetting purchase or sale is greater than the quantity purchased or sold, the FCM must apply such offsetting purchase or sale to the oldest portion of the previously held short or long position, absent specific instructions from the customer to the contrary. CFTC regulation 4.24(h)(2) requires the CPO to disclose the manner in which the FCMs holding the pool's accounts will treat offsetting positions pursuant to CFTC regulation 1.46, if the method is other than to close out all offsetting positions, or to close out offsetting positions other than on a first-in, first-out basis.

While there are no requirements in the CEA or CFTC regulations regarding the CPO's due diligence in the selection of investments for its commodity pool, CFTC regulation 4.24(h) requires CPOs to provide a detailed description of the commodity pool's investment program, including the types of commodity interests and other investments the pool will trade, the trading programs of any CTAs the CPO will employ, and the trading programs of funds or commodity pools in which the CPO plans to invest pool assets. CFTC regulation 4.25 also requires detailed past performance statistics and information to be included in a CPO's Disclosure Document.

CFTC regulation 4.24(i) requires CPOs to include in their Disclosure Documents a complete description of each fee, commission, and other expense which the CPO knows or should know has been incurred by the commodity pool for its preceding fiscal year and is expected to be incurred by the pool in its current fiscal year, including fees or other expenses incurred in connection with the pool's participation in investee commodity pools and funds. CFTC regulation 4.22(c) requires the distribution to pool participants of an Annual Report, including among other things financial statements of pool investments, and CFTC regulation 4.22(d)(1) requires that such statements be presented and computed in accordance with generally accepted accounting principles consistently applied, and that the financial statements be audited by an independent public accountant. This serves as an independent check on the operations of the commodity pool by the CPO.

(h) Requirements for CIS operators or CIS to establish and implement sound liquidity risk management processes taking into account normal and stress market conditions?

No. CFTC regulations do not mandate that a CPO establish liquidity risk management processes under normal or stressed market conditions due to limitations in statutory authority under the CEA. However, CFTC regulation 4.27 requires CPOs that manage greater than \$1.5 billion in assets under management to provide portfolio metrics regarding liquidity and stress testing.

Delegation

15. Does the regulatory system provide for a clear indication of circumstances under which delegation is allowed and is there prohibition of systematic and complete delegation of core functions of the CIS operator to the extent that there is a transformation, gradual or

| | |
|-----|---|
| | <p>otherwise, into an empty box?</p> <p>Neither the CEA nor CFTC regulations prohibit a CPO from delegating functions to another person or entity. Although the CPO may delegate its functions to another person or entity, the CPO remains legally responsible for its obligations under the CEA and CFTC regulations despite any delegations to any other parties. Through CFTC staff letters allowing for such delegation, the person or entity to whom the CPO delegates its functions is required to register with the CFTC as a CPO with regard to the commodity pool in question.</p> <p>Additionally, CFTC regulation 4.23 allows CPOs to rely on third-party recordkeepers, who may be the commodity pool administrator, distributor, or custodian, or a bank or registered broker or dealer acting in a similar capacity with respect to the commodity pool. The books and records are maintained by the third-party must be kept in accordance with CFTC regulation 1.31 and the conditions in CFTC regulation 4.23, and made available for inspection by the CFTC, generally within 24 hours of such a request.</p> |
| 16. | <p>If delegation is permitted, is the delegation done in such a way so as not to deprive the investor of the means of identifying the company legally responsible for the delegated functions? In particular:</p> |
| (a) | <p>Is the CIS operator responsible for the actions or omissions, as though they were its own, of any party, to whom it delegates a function, including compliance with the rules of conduct and other operating conditions?</p> |
| (b) | <p>Does the regulatory system require the CIS operator to retain adequate capacity and resources and have in place suitable processes to monitor the activity of the delegate and evaluate the performance of the delegate?</p> |
| (c) | <p>Can the CIS operator terminate the delegation and make alternative arrangements for the performance of the delegated function where appropriate?</p> |
| (d) | <p>Are there requirements for disclosure to investors in relation to the delegation arrangements and the identity of the delegates?</p> |
| (e) | <p>Does the regulatory system allow the regulator to take appropriate actions in case of delegations which may give rise to a conflict of interest between the delegate and the investors?</p> |
| | <p>As set forth above, CPOs are not prohibited from delegating functions to another person or entity. A CPO, however, remains legally responsible for its obligations under the CEA and CFTC regulations, as it is held jointly and severally liable with the entity to whom the CPO delegates its functions where the delegate is a related party. Furthermore, the entity to whom the CPO delegates its functions and responsibilities must be registered with the CFTC as a CPO, and its registration</p> |

status is publicly available through NFA's website. Regulatory oversight is maintained through periodic audits of CPOs by NFA, with oversight of reviews of NFA by the CFTC. Generally speaking, delegation by a CPO is performed through a contractual arrangement, and the CPO's ability to terminate that arrangement would be dependent upon the terms of the contract between the CPO and the person or entity to whom the CPO is delegating its functions. Moreover, the CPO is required under CFTC regulation 4.24 to disclose information about entities and individuals who provide services to the commodity pool as well as any conflicts of interest that may arise and any related party transactions, *i.e.*, transactions between the CPO or commodity pool and any person affiliated with a person or entity providing services to the commodity pool.

17. If delegation is permitted, is the delegation done in such a way so as not to jeopardize the ability of the regulator to effectively access data related to the delegated functions, either directly through the delegate(s) or through the CIS operator?

Yes. Historically, in approving requests for relief allowing CPOs to delegate their functions to another CPO, CFTC staff has required that the delegate CPO be registered with the CFTC (and thus, also an NFA Member subject to NFA's membership rules). The delegate CPO, as a CFTC registrant, is subject to all of the compliance obligations discussed above, including, but not limited to, the recordkeeping requirements in CFTC regulations 4.23 and 1.31, which requires the CPO to maintain books and records in an accurate, current, and orderly manner, and to allow the CFTC or DOJ access to the CPO's books and records upon request. Third-party service providers, to the extent they assist the CPO in meeting its compliance obligations under the CEA and CFTC regulations, are required to provide the CFTC access to the records and information meeting those obligations.

| | |
|-------------------------------------|---|
| Principle 25 | The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets. |
| Key Questions | |
| <i>Legal Form/Investors' Rights</i> | |
| 1. | Does the regulatory system provide for requirements as to the legal form and structure of CIS that delineates the interests of participants and their related rights? |
| | Yes. CFTC regulation 4.20(a) generally requires that a CPO operate its pool as an entity cognizable as a legal entity separate from that of the CPO. The CFTC may exempt a CPO from this requirement if it sets up a corporation that: (1) represents in writing that each participant will be issued stock or other evidence of ownership in the corporation for all property received from participants; (2) demonstrates that it has adequate procedures in place to ensure that all property from participants is received in the corporation's name and that no property of the pool is commingled with any other person; and (3) is not found by the CFTC to be organized contrary to the public interest. The creation of any legal entity does, of necessity, require the preparation of an organizational document (<i>e.g.</i> , by-laws, articles of incorporation, or similar documents), which delineates the structure of the entity and the rights and obligations associated with holding an ownership interest therein. |
| 2. | Does the regulatory system provide that the legal form and structure of a CIS, as well as the implications thereof for the nature of risks associated with the CIS, be disclosed to investors in such a way that they are not dependent upon the discretion of the CIS operator? |
| | Yes. CFTC regulation 4.24(d) requires a CPO to disclose the form of organization of the pool in the Disclosure Document of the pool that is distributed to prospective participants by its CPO. As a matter of course, the offering of an interest in the pool generally involves the provision of the organizational documents for the pool in conjunction with the Disclosure Document. Further, pursuant to CFTC regulation 4.24(g), a CPO is required to disclose in the Disclosure Document the principal risk factors relating to participation in the pool, including, but not limited to, risks relating to volatility, leverage, liquidity, and counterparty creditworthiness with respect to the trading structures employed and investment activity expected to be engaged in by the pool. CFTC regulation 4.24(h) also requires the disclosure of "any material restrictions or limitations on trading required by the pool's organizing documents or otherwise," as well as the provision of summary descriptions regarding trading programs used and third-party advisors hired by the CPO and/or other investee pools in which the offered pool invests. |
| 3. | Is there a regulatory authority responsible for ensuring that the form and structure requirements are observed? |
| | Yes. When an entity seeks to be registered as a CPO, it must submit a Disclosure Document to NFA, as the CFTC's delegate, for review to determine compliance with |

| | |
|----|--|
| | <p>the CFTC's regulations as well as NFA's rules prior to holding itself out to be a duly-registered CPO and soliciting participants. CFTC staff regularly reviews NFA's review of Disclosure Documents as part of the CFTC's oversight of NFA. NFA also conducts periodic examinations of CPOs, as discussed above.</p> |
| 4. | <p>Does the regulatory system provide that where material changes are made to investor rights that do not require prior approval from investors, notice is given to them before the changes take effect?</p> |
| | <p>Yes. CFTC regulation 4.26(a)(1) requires that all information contained in the Disclosure Document must be current as of the date of the document, including information relating to rights of participants. CFTC regulation 4.26 states that a CPO must provide participants with notice of changes to the information in the Disclosure Document within 21 days of the date on which the CPO knows or has reason to know about such changes. Additionally, CFTC regulation 4.24(w) requires a CPO to disclose all material information to existing or prospective pool participants even if the information is not specifically required by CFTC regulations.</p> |
| 5. | <p>Does the regulatory system provide that where material changes are made to investor rights, notice is given to the relevant regulatory authority?</p> |
| | <p>Yes. CFTC regulation 4.26 provides that a CPO must file with NFA any amendments to the Disclosure Document, including those changes made to the rights of commodity pool participants.</p> |
| 6. | <p>Does the regulator have powers aimed at ensuring that any restrictions on type, or level, of investment, or borrowing, are being complied with?</p> |
| | <p>CFTC regulation 4.24(h)(2) requires a CPO to disclose in the Disclosure Document any material restrictions or limitations on trading required by the pool's organizational documents or otherwise. The Disclosure Document is required to be up to date and materially correct pursuant to CFTC regulation 4.26. CFTC regulation 4.24(w) requires a CPO to disclose all material information to existing or prospective pool participants even if the information is not specifically required by CFTC regulations. NFA's rules also generally prohibit loans between a commodity pool and a registered CPO and its affiliates.</p> <p>In the event that a registered CPO fails to comply with its regulatory obligations, NFA's BCC is empowered to take action against the entity and impose sanctions, including expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules. Similarly, the CFTC, through its DOE, may impose civil penalties for violations of CFTC regulations ranging from a ban from registration to a monetary penalty, as well as seek criminal penalties.</p> <p>Furthermore, Part 165 of CFTC regulations provide a whistleblower program which allows for the payment of monetary awards to eligible whistleblowers, and provides</p> |

| |
|--|
| anti-retaliation protections for whistleblowers that share information with or assist the CFTC. |
| <i>Separation of Assets/Safekeeping</i> |
| 7. Does the regulatory system require adequate segregation of CIS assets from the assets of the CIS operator and its managers or other entities? |
| <p>Yes. CFTC regulation 4.20(b) states that all funds, securities and property received by a CPO must be received in the name of the commodity pool. CFTC regulation 4.20(c) states that no CPO may commingle the property of any commodity pool with the property of any other person. NFA's rules also generally prohibit loans between a commodity pool and a registered CPO and its affiliates.</p> <p>CFTC regulation 4.24(h)(1)(iii)(A) requires a CPO to disclose in a Disclosure Document the identity of the custodian or other entity (<i>e.g.</i>, bank or broker-dealer) which will hold the pool's assets. CFTC regulation 4.24(h)(4)(i) requires a CPO to disclose in a Disclosure Document the manner in which the pool's assets will be held in segregation.</p> |
| 8. Does the regulatory system provide for either of the following requirements governing the safekeeping of CIS assets: |
| (a) the obligation to entrust the assets to custodians and/or depositories that are in appropriate circumstances independent; or |
| (b) special legal or regulatory safeguards in cases where the functions of custodian and/or depository are performed by the same legal entity as is responsible for investment functions (or related entities). |
| <p>Yes, to all of the above. CFTC regulation 4.24(h)(1)(iii)(A) requires a CPO to disclose in a Disclosure Document the identity of the custodian or other entity (<i>i.e.</i>, bank or broker-dealer) which will hold the pool's assets. CFTC regulation 4.24(h)(4)(i) requires a CPO to disclose in a Disclosure Document the manner in which the pool's assets will be held in segregation. CFTC regulation 4.20(a) generally requires a CPO to operate its pool as an entity cognizable as a legal entity separate from that of the CPO. CFTC regulation 4.20(b) states that all funds, securities, and property received by a CPO must be received in the name of the commodity pool. CFTC regulation 4.20(c) states that no CPO may commingle the property of any commodity pool with the property of any other person. NFA's rules generally prohibit loans between a commodity pool and a registered CPO and its affiliates.</p> |
| 9. Does the regulatory system provide for adequate protection of client assets from losses or insolvency of the CIS operator, and the obligation that, where third party custodians are used, client assets are identified as such to any such custodian and equivalent protection is afforded to the client assets, including when the custodian has entrusted all or some of the assets in its safekeeping to a third party? |
| |

See responses to Principle 25, Questions 8(a) and (b).

10. Does the regulatory system adequately provide for an orderly winding up of CIS business, if needed?

Yes. CFTC regulation 4.22(c) requires the filing and distribution of a final Annual Report containing financial statements within 90 days of the pool's permanent cessation of trading or the return of funds to participants. Additionally, CFTC regulation 4.22(c)(7) permits the filing of and distribution to participants of an abbreviated, unaudited Annual Report, within 90 days of the permanent cessation of trading, subject to certain requirements. These provisions require that the CPO obtain waivers from all pool participants consenting to the alternate form of disclosure and reporting, and that the report contains "an explanation of the winding down of the pool's operations" and detailed disclosure as to the status of any remaining pool assets. If necessary, Section 6c of the CEA provides the CFTC with the ability to obtain court orders to freeze pool and/or CPO assets and have receivers appointed to operate the commodity pool for the benefit of participants.

Principle 26 **Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor’s interest in the scheme.**

Key Questions

1. Does the regulatory system require that all matters material to the valuation of a CIS are disclosed to investors and potential investors on a timely basis?

Yes. The CFTC regime for oversight of commodity pools and CPOs is disclosure-based. CFTC regulations require that a CPO provide a detailed Disclosure Document to prospective pool participants before accepting their subscriptions for interests in a commodity pool. This Disclosure Document includes: the name, address, phone number, and form of organization of the commodity pool and the CPO; whether the commodity pool is privately offered, continuously offered, traded by multiple advisors, or has a principal-protection feature; the date when the Disclosure Document may be used; and the break-even point per unit of initial investment. The document must also disclose the business background of the operator and advisors of the pool as well as their respective principals; all fees and expenses of the pool; conflicts of interest relating to the operation of the pool; relevant material actions against persons managing, trading, or maintaining accounts for the pool; risks of futures trading and specific risks of the pool; information on the pool’s investment program and use of proceeds; and provisions relating to redemption. In addition, performance information must be in a prescribed capsule format, the performance of the offered pool must be presented prior to any other performance disclosures, and any information that is not specifically required to be disclosed generally must appear after required information.

Additionally, the CPO must provide an Account Statement to each participant (either monthly for pools with assets greater than \$500,000, or otherwise quarterly), which contains, among other things, the realized and unrealized gains and losses for the pool, all management and advisory fees and brokerage commissions paid by the pool, and the net asset value of the pool.

The CPO must further provide to each participant an Annual Report, which must contain all of the items of the monthly report, plus additional financial disclosures by way of a Statement of Financial Condition, Operations, and Changes in Net Assets of the pool for both the current and preceding fiscal year.

2. Does the regulatory system require that the information referred to in Question 1 above be disclosed to investors and potential investors in an easy to understand format and language having regard to the type of investor?

Yes. NFA rules require that the Disclosure Document be written using plain English principles, including:

- Avoiding legal jargon;

| | |
|----|--|
| | <ul style="list-style-type: none"> • Using short sentences and paragraphs; • Breaking up the document into short sections, using titles and sub-titles that specifically describe the contents of each section; • Using words that are definite and part of everyday language; • Using glossaries to define technical terms that cannot be avoided; and • Using table and bullet lists, where appropriate. |
| 3. | Does the regulatory system require the use of standard formats for disclosure of offering documents and periodic reports to investors? |
| | <p>Yes. As mentioned in the response to Principle 26, Question 1, the CFTC’s regulations are prescriptive with respect to the content and timing of the delivery of statements to pool participants. This standardization can also be seen with respect to the mandatory cautionary language that is required to be contained in the Disclosure Document provided to prospective participants, as well as both the contents and construction of performance data contained therein.</p> |
| 4. | Does the regulatory system include a general disclosure obligation to allow investors, and potential investors, to evaluate the suitability of the CIS for that investor or potential investor? |
| | <p>Yes. As discussed in the response to Principle 26, Question 1, the CFTC’s disclosure-based regime requires that a CPO provide a Disclosure Document to prospective participants in each pool that it offers, and to inform existing participants with respect to material changes regarding the operation of the pool. The Disclosure Document includes information, such as the minimum subscription amount required to participate, the risks of the investments to be undertaken, and the costs associated with the investment, that would allow the investor or potential investor to evaluate the suitability of the investment.</p> |
| 5. | Does the regulatory system specifically require that the offering documents, or other publicly available information, include the following: |
| | (a) The date of issuance of the offering document? |
| | (b) Information concerning the legal constitution of the CIS? |
| | (c) The rights of investors in the CIS? |
| | (d) Information on the operator and its principals? |
| | (e) Information on the methodology of asset valuation? |
| | (f) Procedures for purchase, redemption and pricing of units/shares? |
| | (g) Relevant, audited financial information concerning the CIS? |

| | |
|-----|---|
| | |
| (h) | Information on the custodial arrangements (if any)? |
| (i) | The investment policy(ies) of the CIS? |
| (j) | Information on the risks involved in achieving the investment objectives? |
| (k) | The appointment of any external administrator or investment managers or advisers who have a significant and independent role in relation to the CIS (including delegates)? |
| (l) | Fees and charges in relation to the CIS, in a way that enables investors to understand their nature, structure and impact on the CIS' performance? |
| | <p>Yes, to all of the above. In response to questions (a)-(l), the Disclosure Document must include:</p> <ul style="list-style-type: none"> • The date on which the CPO first intends to use the Disclosure Document; • The form of organization of the pool; • Whether or not a participant's liability is limited and restrictions on the transferability of a participant's interest; • Identity, business background, and past performance of the CPO, CTAs, and their principals; • The net asset value, which is included in the pool's past performance and financial reports and is required to be calculated in accordance with generally accepted accounting principles; • The minimum and maximum subscriptions that may be contributed to the pool, where funds will be held prior to trading, how the redemption value of a participant's interest is calculated, conditions or restrictions on redemption, any fees associated with redemption, and liquidity risks relative to the pool's redemption capabilities; • The most recent Account Statement and audited Annual Report for the pool must be attached to the Disclosure Document; • The custodian that will hold the pool's assets; • A description of the trading and investment programs and policies that will be followed by the pool, including an explanation of how the pool's advisors, investee funds, and types of investments are selected; • The general risks of investing in a commodity pool, including the financial risks presented by futures contracts, options on futures contracts, and swaps, and the fact that the commodity pool may be subject to substantial charges for management, advisory, and brokerage fees which will require the pool to make substantial trading profit in order to cover the fees; also, the particular risks of the pool, including risks related to volatility, leverage, liquidity, and counterparty creditworthiness, as applicable to the types of trading and investing strategies expected to be employed; |

| |
|--|
| <ul style="list-style-type: none"> • Information on external administrators or any other person providing services to the pool, such as disclosure of fees paid by the pool or potential conflicts of interest relating to such arrangements; and • A complete description of each fee and expense incurred or expected to be incurred by the pool, and the "break-even" point where profits exceed fees and expenses. |
| <p>6. Does the regulatory authority have the power to hold back, or intervene, with regard to offering documents? For example, are there regulatory actions available in the event that the information is inaccurate, misleading or false, or does not satisfy the filing/approval requirements?</p> |
| <p>Yes. Pursuant to authority delegated from the CFTC, NFA is responsible for reviewing all Disclosure Documents. Prior to using a Disclosure Document, a CPO must submit the Disclosure Document to NFA and receive an acceptance letter confirming that the Disclosure Document can be used to solicit. NFA conducts this review for all Disclosure Documents, and not just a sample of them. If the Disclosure Document does not meet regulatory requirements, which may include the existence of inaccurate, misleading or false information in the Disclosure Document, NFA will provide notice of deficiencies and state that the Disclosure Document may not be used until all issues are addressed. All Disclosure Documents are filed through the NFA's Electronic Disclosure Document Filing System.</p> |
| <p>7. Does the regulatory system cover advertising material outside of the offering documents? In particular, does it prohibit inaccurate, false or misleading advertising? Are there regulatory actions available to the regulator with regard to advertising material outside of the offering document?</p> |
| <p>Yes. Pursuant to CFTC regulation 4.41, no CPO may advertise in a manner which:</p> <ul style="list-style-type: none"> • Employs any device, scheme or artifice to defraud any participant or prospective participant; • Involves any transaction, practice or course of business which operates as a fraud or deceit on any participant or prospective participant; and • Refers to any testimonial unless the advertisement or sales literature providing the testimonial prominently discloses that the testimonial may not be representative of all participants, the testimonial is no guarantee of future performance, and, if applicable, a non-nominal sum was paid for the testimonial. <p>The CFTC has the authority to bring a civil lawsuit against a CPO for violating the aforementioned regulation.</p> <p>In addition, CPOs are subject to NFA rules that prohibit any false or misleading communications with the public, and also provide specific guidance regarding the</p> |

| | |
|-----|--|
| | content and use of promotional material. NFA also has the authority to bring its own regulatory action against CPOs for violating NFA's rules. |
| 8. | Does the regulatory system require that the offering documents be kept up to date to take account of any material changes affecting the CIS? |
| | Yes. CFTC regulation 4.26 requires that all information contained in a Disclosure Document must be current as of the date of the document; provided, however, that performance information may be current as of a date not more than three months prior to the date of the document. No CPO may use a Disclosure Document dated more than 12 months prior to the date of its use. If a CPO knows or should know that the Disclosure Document is materially inaccurate or incomplete, with limited exceptions, it must correct that defect and distribute the correction within 21 calendar days. |
| 9. | Does the regulatory system require a report to be prepared in respect of a CIS's activities either on an annual, semi-annual or other periodic basis? |
| | Yes. CFTC regulations require both periodic and Annual Reports. CFTC regulation 4.22(a) requires each CPO to distribute a periodic report (either monthly for pools with assets greater than \$500,000, otherwise quarterly) within 30 calendar days of the end of each reporting period. The periodic report must contain a statement of operations and a statement of changes in net assets. CFTC regulation 4.22(c) requires each CPO to distribute an Annual Report to each participant within 90 calendar days after the end of the pool's fiscal year. The Annual Report, which also must be filed with NFA, must contain certain information, including, but not limited to: the pool's Net Asset Value and Statements of Financial Condition, Operations, and Changes in Net Assets. |
| 10. | Does the regulatory system require the timely distribution of periodic reports? |
| | Yes. As described in the response to Principle 26, Question 9, CFTC regulation 4.22(a) requires each CPO to distribute a periodic report (Account Statement) to each pool participant in each pool that it operates within 30 calendar days after the last date of the reporting period. |
| 11. | Does the regulatory system require that the accounts of a CIS be prepared in accordance with high quality, internationally acceptable accounting standards? |
| | Yes. CFTC regulation 4.22 requires that the financial statements in the periodic Account Statements and Annual Reports must be presented and computed in accordance with generally accepted accounting principles consistently applied. In addition, the pool's Annual Report must be certified by an independent public accountant. |
| 12. | Does the regulator have powers to ensure that the stated investment policy or trading |

strategy, the authorized investments that the CIS is able to undertake, or any policy required by regulation is being followed?

Yes. All offering materials and Account Statements provided by a CPO to its participants must also be filed with NFA pursuant to CFTC regulations. NFA reviews these documents, and conducts periodic on-site examinations of the CPO as a means of monitoring and assuring compliance with CFTC regulations. Examinations are performed regularly, as well as more frequently in response to potential risks posed to the participants in a pool. Document review by NFA that gives rise to a concern regarding the trading or soundness of the pool may trigger an examination.

| | |
|------------------------|--|
| Principle 27 | Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme. |
| Key Questions | |
| <i>Asset Valuation</i> | |
| 1. | Are there specific regulatory requirements in respect of the valuation of CIS assets? |
| | Yes. CFTC regulations 4.10(b), 4.22, and 4.25 specifically require the use of generally accepted accounting principles in calculating the net asset value of a pool. |
| 2. | Are there regulatory requirements that the NAV of CIS be calculated: |
| | (a) On a regular basis? |
| | (b) Each day that CIS units are purchased or redeemed? |
| | (c) In accordance with high-quality, accepted accounting standards used on a consistent basis? |
| | Yes, to all of the above. CFTC regulation 4.22 requires that valuations are to be reported in the Statement of Changes in Net Assets included in the periodic and Annual Reports of the pool. As noted above, net asset value is required to be computed in accordance with generally accepted accounting principles consistently applied. |
| 3. | Are there specific regulatory requirements in respect of the fair valuation of assets where market prices are not available? |
| | Yes. Because CFTC regulations require the use of generally accepted accounting principles in calculating pool valuations, CPOs are subject to ASC 820, Fair Value Measurement, issued by Financial Accounting Standards Board. This statement defines fair value for commodity pools, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosure about fair value measurements. |
| 4. | Are there specific regulatory requirements where amortized cost accounting is permitted? |
| | Yes. Part 4 of the CFTC's regulations requires the use of generally accepted accounting principles or international financial reporting standards, which specify the circumstances under which each is to be used. |
| 5. | Are third parties (e.g., independent auditors) required to check the valuations of CIS assets? |
| | Yes. Annual financial reports of commodity pools are required to be audited by an |

| | |
|--------------------------------------|---|
| | independent public accountant. |
| 6. | Where MMFs display a stable NAV, does the regulatory system include measures that are designed to reduce the specific risks associated with their stable NAV feature and reinforce their resilience and their ability to face significant redemptions? |
| | The CFTC does not have regulatory authority over MMFs. |
| <i>Pricing and Redemption Issues</i> | |
| 7. | Does the regulatory system: |
| (a) | Require the basis upon which investors may redeem units/shares to be made clear in the constituent documents and/or the prospectus? |
| (b) | Provide for specific regulatory requirements in respect of the pricing upon redemption or subscription of units/shares in a CIS? |
| | Yes, to both. CFTC regulation 4.24(p) requires a CPO to provide in its Disclosure Document a complete description of any restrictions upon the transferability of a participant's interest in the pool, and a complete description of the frequency, timing, and manner in which a participant may redeem interests in the pool. Specifically, the description regarding redemption must specify how the redemption value of a participant's interest will be calculated, the conditions under which redemption will be made (including time between request for redemption and payment) and any restrictions on redemptions. |
| 8. | Does regulation ensure that the valuations made are fair and reliable? |
| | Yes. See responses to Principle 27, Questions 1-4. |
| 9. | Does regulation require the price of the CIS be disclosed or published on a regular basis to investors or prospective investors? |
| | Yes. CFTC regulation 4.22 requires CPOs to distribute Account Statements to participants on at least a quarterly basis (and monthly if the pool has at least \$500,000 in assets). These reports include all material information relevant to the net asset value per participation of the pool. Similar information must be included in the Disclosure Document provided to any prospective participant. |
| 10. | Are there regulatory requirements, rules of practice, and/or rules addressing pricing errors? Are the relevant regulatory authorities able to enforce these rules? |
| | Yes. See responses to Principle 25, Question 6, and Principle 27, Questions 2, 4, and 7. |
| 11. | Does the regulatory system address the general or exceptional circumstances in which |

| |
|---|
| <p>there may be suspension, or deferral, of: routine valuation and pricing; or of regular redemption, of CIS units or shares?</p> |
| <p style="text-align: center;">Yes. See response to Principle 27, Question 5.</p> |
| <p>12. Does the regulator have the power to ensure compliance with the rules applicable to asset valuation, pricing and suspension of the redemption and subscriptions?</p> |
| <p>Yes. See response to Principle 25, Question 6. Section 4n of the CEA states that each CPO must regularly furnish statements of account to each participant. Such statements must include all the information contained in the relevant CFTC regulations. Violations of the CEA and CFTC regulations subject a person to a wide variety of sanctions, including, but not limited to, suspension or revocation of registration, monetary penalties, and restitution.</p> <p>The CFTC also takes a proactive approach to ensuring compliance by CPOs with respect to pool operations. For example, DSIO has historically issued a CPO guidance letter to assist CPOs and their public accountants with the preparation and filing of Annual Reports. Each CPO guidance letter highlights regulatory and accounting changes affecting CPOs with respect to financial filing and provides reminders of requirements in response to common deficiencies observed in prior years' Annual Reports. CPO guidance letters are available on the CFTC's website.</p> |
| <p>13. Does the regulatory system require that the regulator:</p> |
| <p>(a) Be kept informed of any suspension or deferral of redemption rights?</p> |
| |
| <p>(b) Have the authority to address situations where the CIS operator: is failing to honour redemptions; or is imposing a suspension of redemptions in a manner that is not consistent with the CIS constitutive documents and prospectus, or the contractual relationship between the CIS participants and the CIS operator; or is otherwise deemed to be in violation of national law?</p> |
| <p>Yes, to all of the above. CFTC regulation 4.26 requires a CPO to provide NFA with a copy of any amendments to its Disclosure Document, including notice of any suspension or deferral of redemption rights. The CFTC and NFA have the power to take action where a CPO has violated either CFTC regulations or NFA membership rules with respect to valuation and redemption.</p> |

| | |
|---|---|
| Principle 28 | Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight. |
| Key Questions | |
| <i>Registration/Authorization of Hedge Fund Managers/Advisers and/or, where relevant, the Hedge Fund</i> | |
| 1. | Does the regulatory system set standards for: |
| (a) | The registration/authorization and the regulation of those who wish to operate hedge funds (managers/advisers)? |
| (b) | And/or the registration of the fund? |
| <p>There is no definition of the term “hedge fund” in either the CEA or CFTC regulations. IOSCO has previously defined the term “hedge fund” to be any investment vehicle exhibiting a combination of some of the following characteristics: (1) borrowing and leverage restrictions are not applicable and the fund may use high levels of leverage; (2) significant performance fees (often in the form of a percentage of profits) are paid to the manager in addition to an annual management fee; (3) investors are typically permitted to redeem their interests periodically; (4) often there is significant investment by the manager of the fund; (5) derivatives are used, often for speculative purposes, and there is an ability to short sell securities; and (6) more diverse risks or complex underlying products are involved. <i>See Hedge Funds Oversight – Final Report, Report of the Technical Committee of IOSCO, June 2009, pp. 4-5.</i> To the extent that a “hedge fund” meets the definition of “commodity pool” in the CEA and CFTC regulations, and absent an applicable exclusion or exemption, the CPO for that pool is required to be registered with the CFTC. Commodity pools are not themselves registered with the CFTC.</p> | |
| 2. | Does the regulatory system specify the information contemplated by Key Issue 2 that must be provided to the regulator at the time of the registration/authorization? |
| Yes. <i>See responses to Principle 24, Questions 1 and 2.</i> | |
| <i>Standards for Internal Organization and Operational Conduct</i> | |
| 3. | Does the regulatory system set (in view of the risk posed) standards for internal organization and operational conduct to be observed, on an on-going basis, by the hedge fund manager/adviser, including appropriate risk management and protection, and segregation of client money and assets? |
| Yes. <i>See responses to Principle 24, Question 2, and Principle 25, Question 7.</i> | |
| <i>Conflicts of Interest and Other Conduct of Business Rules</i> | |
| 4. | Does the regulatory system set standards for hedge fund managers/advisers to appropriately manage conflicts of interest, and provide full disclosure and transparency to the regulator and investors (including potential investors) about such conflicts and how |

| | |
|---|--|
| they manage them? | |
| Yes. See response to Principle 24, Question 12. | |
| <i>Disclosure to the Regulator and to Investors</i> | |
| 5. Is the regulator able to obtain from hedge fund managers/advisers appropriate information about their operations and about the funds that they manage that allow it to assess the risks that hedge funds pose to systemic stability? | |
| <p>Yes. CFTC regulation 4.24 requires CPOs to prepare and file with NFA a Disclosure Document which describes in detail the investment strategy, costs, and risks associated with investment in the operated commodity pool. The CFTC oversees NFA's review of the filed Disclosure Documents through periodic review.</p> <p>CFTC regulation 4.27 requires all CPOs that are registered or required to be registered to file a Form CPO-PQR on a periodic basis depending upon their assets under management with detailed information regarding the investments held by their operated commodity pools, their relationships with service providers, and stress testing. Specifically, all CPOs with assets under management in the amount of \$500 million or greater are required to provide the CFTC with the following information: pool borrowings, counterparty credit exposure, fund strategy, derivatives exposure, and a full schedule of investments. Further, all CPOs with assets under management greater than \$1.5 billion must also provide the following information to the CFTC: their operated pools' geographical exposure, liquidity, and risk testing based upon several specific scenarios.</p> | |
| 6. Does the regulatory system, in view of the risks posed, set standards for the proper disclosure by hedge fund managers/advisers, or by the hedge fund, to investors? | |
| Yes. See responses to Principle 25, Questions 2, 6, and 8; Principle 26, Questions 4 and 5; and Principle 28, Question 5. | |
| <i>Prudential regulation</i> | |
| 7. Are hedge fund managers/advisers, which are required to register, subject to appropriate ongoing prudential requirements that reflect the risks they pose? | |
| Under the CEA, the CFTC does not have the authority to act as a <i>prudential</i> regulator of hedge funds. | |
| <i>Supervision and enforcement</i> | |
| 8. | |
| (a) | Does the regulatory system provide for ongoing supervision of the hedge fund managers/advisers which are required to register? |
| | |
| (b) | Does the regulator have the power to access and inspect the hedge fund |

| | |
|-----|---|
| | managers/advisers and their records and/or the hedge funds? |
| (c) | Does the regulator have the authority to enforce against wrongdoers? |
| | Yes, to all of the above. See responses to Principle 24, Questions 6, 7, 8, 9, 10, and 11; and Principle 25, Question 6. |
| 9. | Subject to appropriate confidentiality safeguards and national law restrictions, from the point of view of supervision and enforcement, does the regulator have the power to: |
| (a) | Collect where necessary relevant information from hedge fund managers/advisers and/or hedge funds (and through cooperation with other domestic regulators from hedge fund counterparties) also on behalf of a foreign regulator? |
| (b) | Exchange information on a timely and ongoing basis, as deemed appropriate, with other relevant regulators on internationally active hedge funds that may pose systemic or other significant risks? |
| | <p>Yes, to all of the above.</p> <p>The CFTC has the power both to provide assistance to a foreign regulator and to share information with a foreign regulator. With respect to collecting information on behalf of a foreign regulator, Section 12(f)(1) of the CEA states that, upon request from a foreign futures authority, the CFTC may, in its discretion, provide assistance in conducting an investigation that the foreign futures authority¹¹³ “deems necessary to determine whether any person has violated, is violating, or is about to violate any laws, rules or regulations relating to futures or options matters that the requesting authority administers or enforces. The Commission may conduct such investigation as the Commission deems necessary to collect information and evidence pertinent to the request for assistance. Such assistance may be provided without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States.” Section 12(f)(2) of the CEA states that, in deciding whether to provide assistance, the CFTC shall consider whether “the requesting authority has agreed to provide reciprocal assistance to the Commission in futures and options matters” and whether compliance with the request would prejudice the U.S. public interest.</p> <p>With respect to exchanging information, the CFTC has the authority to share information with any foreign futures authority or with any department, central bank, ministry or agency of any foreign government or any political subdivision thereof acting within the scope of its jurisdiction, provided that the requirements in Section 8(e) of the CEA are satisfied. The CFTC shares <i>non-public</i> information</p> |

¹¹³ Section 2(d) of the CEA provides that several enumerated provisions, including CEA Sections 1a (which includes the definition of “foreign futures authority”) and Section 12(f), apply to swaps.

pursuant to an Arrangement that includes undertakings related to, among other things, confidentiality and use of the information. The CFTC has a long-standing practice of entering into Arrangements with foreign regulators and is a signatory to a wide range of Arrangements. For example, the CFTC has entered into Arrangements with 29 European authorities related to supervision of CIS and the alternative investment fund industry. Copies of formal Arrangements with foreign regulators generally are available on the CFTC's website.

In terms of domestic coordination, the CFTC recently entered into an MOU with the SEC under which the SEC and CFTC agreed to exchange supervisory information relating to firms that are of common regulatory interest, including but not limited to, firms registered both as investment advisers with the SEC and CPOs and/or CTAs with the CFTC.

CFTC staff communicates with its counterparts domestically and in other jurisdictions regarding information related to CPOs and CTAs as necessary.

10. Is the securities' regulator able to obtain from the hedge fund operator/adviser – if necessary working with other regulators – non-public reporting of information on the hedge funds' exposure to counterparties, (which may include prime brokers, banks or OTC derivative counterparties)?

Yes. CFTC regulation 4.27 requires all CPOs that are registered or required to be registered to file a Form CPO-PQR on a periodic basis depending upon the assets under management by the CPO. This form includes information regarding the CPO's brokers, counterparties, custodians, and other service providers. CPOs that are also registered with the SEC as investment advisers to private funds provide substantively identical information on Form PF, which is filed with FINRA and made available to the CFTC.

| | |
|---|---|
| Principle 29 | Regulation should provide for minimum entry standards for market intermediaries. |
| Key Questions (please answer with respect to market intermediaries that are direct participants in trading venues, providers of direct electronic access to such venues and/or first tier direct electronic access clients, and operators of trading venues) | |
| <i>Authorization</i> | |
| 1. | Does the jurisdiction require that, as a condition of operating a securities business, the market intermediaries (as defined above) are licensed? |
| <p>Yes. Section 8a of the CEA requires individuals and firms that intend to do business in the markets regulated by the Commission (intermediaries), with certain exceptions, to be "licensed" with the CFTC, which is implemented through registration requirements. The primary purposes of registration are to screen an applicant's fitness to engage in business as an intermediary and to identify those individuals and organizations whose activities are subject to federal regulation. In addition, all individuals and firms that wish to act as market intermediaries must apply for NFA membership or associate status.</p> <p>The CFTC divides market intermediaries into distinct categories according to the types of commodity transaction intermediated and the intermediary's function, and each of these categories is generally subject to registration requirements as a condition to operating as an intermediary. Registration of intermediaries is performed for the CFTC by NFA pursuant to authority delegated by the CFTC to NFA. Registration categories include SDs, MSPs, FCMs, CPOs, CTAs, IBs, and RFEDs. Individuals performing certain functions and principals of the foregoing must also be individually registered or listed. There are exemptions from registration for certain categories and registration for one category is not transferable to another.</p> <p>Direct electronic access to futures markets and/or swap execution facilities is subject to standards and qualifications set by those trading venues for all participants. Thus, market intermediaries accessing those markets as direct participants for their own account would be subject to the same standards as non-intermediaries. See response to Principle 31, Question 8 for standards applicable to direct market access.</p> <p>With respect to swap transactions, Sections 4s(a) and 4s(b) of the CEA prohibit any person from acting as an SD or MSP unless such person is registered with the CFTC, and prohibits an SD or MSP from permitting any person associated with it to effect</p> | |

or be involved in effecting swaps on its behalf if such person is subject to a statutory disqualification. CFTC regulations provide a limited exception to this prohibition for any person associated with an SD or MSP who has been duly listed as a principal¹¹⁴ or registered as an AP¹¹⁵ of another registrant (*e.g.*, an FCM, CPO, or CTA).

Section 4s of the CEA requires SDs and MSPs to meet specific requirements with regard to, among other things, capital and margin, reporting and recordkeeping, daily trading records, business conduct standards, documentation standards, trading duties, designation of a CCO, and with respect to uncleared swaps, segregation of customer funds (the "Section 4s Requirements").¹¹⁶

Persons who apply for registration as an SD or MSP must file a Form 7-R, and a Form 8-R and a fingerprint card for each principal of the applicant who is a natural person, accompanied by such documentation as may be required to demonstrate compliance with applicable CFTC risk management requirements and an attestation of compliance with or ability to comply with all other CFTC requirements. For an FCM, RFED, IB, CPO, or CTA, registration also requires the submission of a Form 7-R, which requires:

- Disclosure of business information, including information concerning any holding company and/or branch offices;
- Disclosure of criminal or regulatory actions, as well as financial information; and
- Nomination of contact persons for membership, accounting arbitration, compliance and enforcement issues.

Additionally, FCMs, RFEDs, and IBs may be required to submit for approval their procedures and/or materials concerning some or all of the following: (a) anti-money laundering; (b) business continuity; (c) electronic order routing systems (for FCMs) or automated order routing systems (for IBs); (d) promotional materials; (e) supervision of APs; (f) handling of customer complaints; and (g) margins and/or segregation procedures (for FCMs). FCMs, RFEDs, and IBs may also be required to provide copies of their Source of Assets letters and any subordinated loan agreements.

¹¹⁴ A "principal" is defined by CFTC regulation 3.1(a) as a sole proprietor, general partner, director, officer, manager or managing member, or person who is in charge of a principal business unit, division or function subject to CFTC regulation, or any person occupying a similar position who exercises a controlling influence over the regulated activities of the firm. In addition, any holder or beneficial owner of 10 percent or more of the outstanding shares of stock in the firm, or any person who has contributed 10 percent or more of the firm's capital, is a principal.

¹¹⁵ An AP is an individual who solicits orders, customers, or customer funds (or who supervises persons so engaged) on behalf of an FCM, RFED, IB, CTA, or CPO.

¹¹⁶ Segregation of customer funds for cleared swaps is governed by CEA Section 4d(f)(2).

| |
|---|
| <p>Principals or APs of an FCM, RFED, IB, CPO, or CTA, and floor traders and floor brokers, must submit a Form 8-R, which requires:</p> <ul style="list-style-type: none"> • Criminal, civil, regulatory, financial, professional, educational and residential background disclosures; • Evidence of the satisfaction of proficiency examination requirements; and • Completion of a fingerprint card (to be used by the FBI in conducting a background check on the applicant). <p>As is discussed in further detail below, in addition to the CFTC’s registration requirement, certain categories of market intermediaries are subject to minimum capital requirements as a condition to operating as a market intermediary.</p> |
| <p>2. Are there minimum standards or criteria that all applicants for licensing must meet before a licence is granted (or denied) that are clear and publicly available, which:</p> |
| <p>(a) Are fair and equitable for similarly situated market intermediaries?</p> |
| <p>Yes. The CFTC’s and NFA’s registration requirements are applied fairly and equitably to all similarly situated intermediaries.</p> <p>As explained in the answer to Question 1 of this Principle, the CFTC and NFA both impose minimum standards and criteria that all applicants for registration must meet as a condition to becoming registered as an intermediary. The minimum standards concerning registration of intermediaries are published on the CFTC and NFA websites. The CFTC’s rules concerning registration are set forth in Parts 3 and 23 of its regulations. NFA’s requirements and procedures for registration are set forth in Part 200 of its Manual/Rules.</p> |
| <p>(b) Are consistently applied?</p> |
| <p>Yes. The CFTC’s and NFA’s minimum standards and criteria for registration of market intermediaries are consistently applied. As explained in the answer to Question 1 of this Principle, all similarly situated entities of the same category of registrant (<i>i.e.</i>, all similarly situated FCMs, all similarly situated IBs, etc.) are subject to identical registration requirements.</p> |

| | |
|-----|---|
| (c) | <p>Include an initial capital requirement, as applicable?</p> <p>Yes. Section 4s(e) of the CEA requires the adoption of rules establishing capital and margin requirements for SDs and MSPs, and applies a bifurcated approach that requires each SD and MSP for which there is a prudential regulator¹¹⁷ to meet the capital and margin requirements established by the applicable prudential regulator, and each SD and MSP for which there is no prudential regulator to comply with the CFTC’s capital and margin regulations. The CFTC published final margin requirements for SDs and MSPs for which there is no prudential regulator in January 2016.¹¹⁸ The CFTC published proposed capital requirements for SDs and MSPs for which there is no prudential regulator in December 2016.¹¹⁹</p> <p>CFTC regulation 1.17 prescribes the minimum levels of adjusted net capital that FCM and IBs must possess. CFTC regulation 5.7 prescribes the minimum level of adjusted net capital for RFEDs.</p> |
| (d) | <p>Include a comprehensive assessment of the applicant and all those in a position to control, or materially influence, the applicant, which requires a demonstration of appropriate knowledge, business conduct, resources, skills, ethical attitude (including a consideration of past conduct)?</p> <p>Yes. As explained in the response to Question 1 of this Principle, NFA’s registration process does include an examination of an applicant’s past conduct and satisfaction of proficiency requirements. NFA requires the submission of a Form 8-R by any individual serving as a principal or an AP of the applicant. It is through this requirement that the CFTC and NFA can consider the knowledge, resources, business conduct, skills and ethical attitude of senior management, directors and substantial owners/shareholders.</p> <p>As previously discussed, Form 8-R examines an individual’s background as concerns any criminal, civil or regulatory issues, any financial issues, professional work experience, and education. Additionally, Form 8-R requires evidence of the satisfaction of any necessary proficiency examination requirements. The individual applicant also is required to complete a fingerprint card, which is used by the FBI in</p> |

¹¹⁷ The term “prudential regulator” is defined in Section 1a(39) of the CEA to include the Federal Reserve; the OCC; the FDIC; the Farm Credit Administration; and the FHFA. The definition also specifies the entities for which these agencies act as prudential regulators, and these consist generally of federally insured deposit institutions; farm credit banks; federal home loan banks; the Federal Home Loan Mortgage Corporation; and the Federal National Mortgage Association. In the case of the Federal Reserve, it is the prudential regulator not only for certain banks, but also for bank holding companies and any foreign banks treated as bank holding companies. The Federal Reserve also is the prudential regulator for subsidiaries of these bank holding companies and foreign banks, but excluding their nonbank subsidiaries that are required to be registered with the CFTC as SDs or MSPs.

¹¹⁸ See *Margin Rule*, 81 FR 636. The CFTC Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission’s regulations. See CFTC regulations 23.150-159, 23.161.

¹¹⁹ See *Capital Requirements for Swap Dealers and Major Swap Participants*, 81 FR 91252 (Dec. 16, 2016).

conducting a background check on the applicant.

It should be noted that the CFTC uses the information gained during the registration process as part of an objective approach to assessing ethical compliance, based, in part, on past conduct that could indicate a potential lack of appropriate ethical standards. No subjective inquiry is performed.

- (e) Include an assessment of the sufficiency of internal organization and risk management and supervisory systems in place, including relevant written policies and procedures, which enable ongoing monitoring as to whether the minimum standards are still met?

Yes. As described in response to Question 1 of this Principle, SDs and MSPs submit documentation to NFA demonstrating compliance with the Section 4s Requirements and CFTC regulations with respect to risk management. As a part of the review process, NFA may request additional information or supporting materials from an SD or MSP.

With respect to ongoing monitoring, the CFTC reserves the right to conduct on-site examinations of the operations and activities of SDs and MSPs. Further, market intermediaries are required to report to NFA deficiencies, inaccuracies, and changes in the forms previously filed with NFA.

As explained in the response to Question 1 of this Principle, FCMs, RFEDs, and IBs may be required to submit for approval their procedures and/or materials concerning: (a) anti-money laundering; (b) business continuity; (c) electronic order routing systems (for FCMs) or automated order routing systems (for IBs); (d) promotional materials; (e) supervision of APs; (f) handling of customer complaints; and (g) margins and/or segregation procedures (for FCMs). FCMs and IBs may also be required to provide copies of their Source of Assets letters and any subordinated loan agreements. However, NFA is not required to conduct a specific assessment of the sufficiency of an applicant's internal controls and risk management prior to granting an FCM or IB registration. Nonetheless, it should be noted that certified financial statements are required for such entities prior to registration and, should material inadequacies in the accounting system, internal accounting control, or in the procedures for safeguarding customer funds or firm assets, exist, the certified accountant must notify the applicant/registrant, who must notify NFA, the DSRO, and the CFTC.

3. Does the regulator, or the SRO subject to the regulator's oversight, have in place processes and resources to effectively carry out a review of applications for licence?

Yes. If an SD or MSP files a Form 7-R, Form 8-R and fingerprint card, application fee and documentation required to demonstrate compliance with the Section 4s Requirements, then NFA will notify the SD or MSP that it is provisionally registered. Subsequent to providing notice of provisional registration to an applicant for registration as an SD or MSP, the applicant must provide an attestation as to its compliance with, or ability to comply with, all applicable CFTC regulations. NFA must also determine whether the documentation submitted by the applicant demonstrates compliance with applicable CFTC regulations concerning risk management. On and after the date on which NFA confirms that the applicant for registration as an SD or MSP has demonstrated its initial compliance with the Section 4s Requirements and all other applicable registration requirements under the CEA and CFTC regulations, the provisional registration of the applicant shall cease and it shall be registered as an SD or MSP, as the case may be.

FCM and RFED applicants must submit the online Form 7-R, and file financial information, copies of their policies and procedures, and certain other documents.¹²⁰ The financial statements can be either a certified financial statement as of a date no more than 45 days before it is filed or a certified financial statement as of a date no more than one year before it is filed and an uncertified financial statement as of a date no more than 17 business days before it is filed.

IB applicants must provide the information requested on NFA's Online Registration System. An independent IB applicant must file financial information and copies of its policies and procedures. A guaranteed IB must file a guarantee agreement and copies of its policies and procedures. The financial filing requirement can be fulfilled by filing a financial statement certified by an independent public accountant as of a date not more than 45 days prior to the date on which such report is filed; a financial statement as of a date not more than 17 business days prior to the date on which such report is filed and a financial statement certified by an independent public accountant as of a date not more than one year prior to the date on which such report is filed; or a financial statement as of a date not more than 17 business days prior to the date on which such report is filed.

NFA will grant a temporary license to a guaranteed IB after all filings have been made for the IB and NFA has determined that the IB and each of its individual principals meet the eligibility requirements for obtaining a temporary license. The FCM or RFED that guarantees the IB must also file its certification before the temporary license can be issued.

¹²⁰ A list of the additional documents that may be required are available on NFA's website.

All applicants for registration as an FCM, RFED, or independent IB must submit a letter written on the applicant's business stationery describing the source of its current assets and representing that its capital has been contributed for the purpose of operating the business for which it is applying for registration and that it will continue to be used for that purpose. The letter must be signed by a principal of the firm.

With respect to the CFTC's resources, the total number of registrants and registered entities that are subject to the CFTC's jurisdiction, depending on the measure, has increased by at least 40 percent in the last four years. This includes 105 SDs as of June 30, 2019.¹²¹ In addition, there are more than 4,000 advisers and operators of managed funds, some of which have significant outward exposures in and across multiple markets.

Additionally, there are another approximately 64,000 registrants, mostly APs that solicit or accept customer orders or participate in certain managed funds, or that invest customer funds through discretionary accounts. The CFTC provides guidance and interpretations to the SROs which oversee these registrants.

The Commission today performs high-level, limited-scope reviews of the approximately 63 FCMs holding over \$260 billion in customer funds. The Commission has a staff of 44 examiners to review these firms and analyze, among other things, over 1,200 financial filings each year.

In FY2019, the Commission overall will have approximately 100 staff positions dedicated to examinations of the thousands of different registrants and registered entities subject to its jurisdiction.

For FY2018, the CFTC operated under an operating budget of \$249 million. For FY2019, the CFTC appropriation was \$268 million. As directed by Congress, the agency has submitted a FY2019 Spend Plan outlining its allocation of current resources, which reflects an increased emphasis on examinations and technology-related staff.

With respect to the NFA's resources, costs associated with a substantial expansion of regulatory duties resulted in a 120 percent increase in NFA's operating budget from FY2012 to FY2020, which began July 1, 2019. NFA projects operating expenses in FY2020 will be \$107.2 million. NFA's Board of Directors approved the proposed budget at its meeting on May 18, 2019 in Washington, DC. With these increased regulatory responsibilities comes the need for additional staffing. NFA's staffing level increased by about 240 (79%) employees between FY2012 and

¹²¹ Provisionally registered SDs are listed on the CFTC's website.

| | |
|-------------------------------|--|
| | <p>FY2020, with FY2020 staffing expected to be 536 employees. NFA continues to operate on the premise that each regulatory program (futures, swaps, forex, market regulation) should be financially self-sufficient, and that each program should generate enough revenue to recover the costs associated with operating the program. See NFA Board Update, May 10 meeting video available on NFA’s website.</p> |
| <i>Authority of Regulator</i> | |
| 4. | Does the relevant authority have the power to: |
| (a) | Refuse licensing, subject only to administrative or judicial review, if authorization requirements have not been met? |
| | <p>Yes. With respect to SDs and MSPs, CFTC regulation 3.10(a)(1)(v)(D)(1) provides that where an applicant for registration fails to demonstrate compliance with the Section 4s requirements, NFA will notify the applicant that its application is deficient, whereupon the applicant must withdraw its application, must not engage in any new activity as a SD or MSP, and shall cease to be provisionally registered. In the event the applicant fails to withdraw its application or cure the deficiency within 90 days following receipt of notice from NFA that the applicant’s application is deficient, the applicant will be deemed withdrawn and thereupon its provisional registration shall cease. Upon written request, the CFTC may, in its discretion, extend the time by which the applicant must cure the deficiency.</p> <p>With respect to FCMs, IBs, floor brokers, floor traders, CTAs, CPOs, and APs, CEA Section 8a(2), 8a(3), and 8a(4) provide the CFTC with authority to statutorily disqualify the person’s or entity’s registration in certain enumerated situations. Pursuant to this authority, the CFTC has enacted CFTC regulations 3.60 through 3.64, which establish the procedures by which the CFTC may deny, condition, suspend, revoke or place restrictions upon registration.</p> |
| (b) | Withdraw, suspend or apply a condition to a licence where a change in control or other change results in a failure to meet relevant requirements on an ongoing basis? |
| | <p>Yes. NFA rule 501 allows NFA to suspend or revoke the registration of any registrant based on the standards of fitness set forth in the CEA. CFTC regulation 3.31(a)(3) requires a registrant to file a Form 8-R on behalf of each new natural person principal who was not listed on the registrant’s Form 7-R promptly after the change occurs. (NFA Rule 208 prescribes a 20-day period after the inclusion of a new natural principal in which the Form 8-R must be filed.)</p> <p>CFTC regulation 1.17 provides that, should an FCM not be in compliance with its net capital requirements, it must transfer all customer accounts and immediately cease doing business as an FCM, subject to a 10-business day period during which the CFTC may have discretion to permit it to continue operating pursuant to a demonstration that it will be able to achieve compliance. CFTC regulation 5.7 has a</p> |

| |
|--|
| <p>similar provision for RFEDs.</p> |
| <p>(c) Take effective steps to prevent the employment of persons (or seek the removal of persons) who have committed securities violations or who are otherwise unsuitable, so that they cannot continue to engage in intermediary activities, even if these persons are not separately licensed market intermediaries, if they can have a material influence on the firm?</p> |
| <p>Yes. CEA Section 4s(b)(6) states that except to the extent otherwise specifically provided by rule, regulation, or order, it shall be unlawful for an SD or MSP to permit any person associated with an SD or MSP who is subject to a statutory disqualification to effect or be involved in effecting swaps on behalf of the SD or MSP, if the SD or MSP knows or in the exercise of reasonable care should have known, of the statutory disqualification.</p> <p>CFTC regulation 23.22 provides that SDs and MSPs cannot permit a person who is subject to a statutory disqualification under CEA Sections 8a(2) or 8a(3) to effect or be involved in effecting swaps on behalf of the SD or MSP, if the SD or MSP knows, or in the exercise of reasonable care should know, of the statutory disqualification.</p> <p>Section 8a(4) of the CEA permits the CFTC to suspend, revoke or place restrictions upon the registration of any person registered under the CEA based on certain criteria set forth in Section 8a(3). These include, but are not limited to, violations of the CEA or rules thereunder, any wilful material misstatement or omission on an application, as well as for "other good cause." Section 8a(2) empowers the CFTC, upon notice, but without a hearing, or to register conditionally, suspend, or place restrictions upon the registration of any person, and, with such a hearing as may be appropriate, to revoke the registration of any person, whose prior registration is under suspension or has been revoked, or if such person is subject to certain other disqualifying circumstances (such as conviction of certain felonies, or being subject to certain court or administrative orders).</p> <p>Additionally, CFTC regulation 3.51 provides that, when information comes to the attention of the CFTC that an applicant for initial registration in any capacity under the CEA is subject to statutory disqualification, the CFTC may take steps to have the application withdrawn on a voluntary basis, or through the institution of legal proceedings.</p> |
| <p><i>Ongoing Requirements</i></p> |
| <p>5. Are market intermediaries required: to update periodically relevant information with respect to their licence; and to report immediately to the regulator (or licensing authority) material changes in the circumstances affecting the conditions of the licence?</p> |
| <p>Yes. Pursuant to CFTC regulation 3.31, each registrant or applicant for registration must promptly correct any deficiency or inaccuracy in its registration information including information about its principals and APs.</p> |

| | |
|----------------------------|---|
| 6. | Is the following relevant information about licensed market intermediaries available to the public: |
| (a) | The existence of a licence, its category and status? |
| (b) | The scope of permitted activities and the identity of senior management and names of other authorized individuals who act in the name of the intermediary? |
| | Yes, to both of the above. NFA's Background Affiliation Status Information Center (BASIC), which can be accessed from NFA's website, includes information on each registrant, the category of license held by the firm or individual, the main office, its listed principals, and membership/registration history. Disciplinary actions against the firm or individual are also included. |
| <i>Investment Advisers</i> | |
| 7. | Does the regulatory scheme for investment advisers require that, as applicable: |
| (a) | If an investment adviser deals on behalf of clients, the capital and other operational controls (explained in Principles 29 to 32) applicable to other market intermediaries also should apply to the adviser? |
| | Not applicable to the CFTC. A CTA is any person who, for compensation or profit, is engaged in the business of providing commodity interest advisory services to others. CTAs are not permitted to deal on behalf of customers under this license. If a CTA engages in other activities requiring separate registration, then it must comply with the applicable requirements. |
| (b) | If the investment adviser does not deal but is permitted to have custody of client assets, regulation provides for the protection of client assets, including segregation and periodic or risk-based inspections (either by the regulator or an independent third party) and capital and organizational requirements as explained under Principles 29 to 32? |
| | Not applicable to the CFTC. CTAs are not permitted to have custody of client assets. There is a limited exclusion from the definition of a CTA for FCMs, with respect to advising which occurs and is solely incidental to its other business as an FCM, in such case, all the FCM requirements regarding protection of client assets, including, segregation and periodic risk-based inspections, capital, and organizational requirements would fully apply. |
| (c) | In the case of both (a) and (b), as well as investment advisers who manage client portfolios without dealing on behalf of clients or holding client assets, does regulation impose relevant requirements that cover recordkeeping, disclosure and |

conflicts of interest as explained in Principle 31?

Yes. CFTC regulation 4.33 requires CTAs to keep accurate, current and orderly books and records concerning the clients and subscribers of the CTA and of the activities of the CTA itself.

Yes. CFTC regulations 4.34 and 4.35 require that a CTA disclose specific information, including the business background of the CTA and its principals that will make trading or operational decisions, any material actions against the CTA and principals, a description of the trading program and related risk factors, fees, any actual or potential conflicts of interest, and past performance of its client accounts.

CFTC regulation 4.35(a)(9) requires the prominent disclosure of the following statement with past performance information presented in CTA Disclosure Documents: "PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS."

CFTC regulation 4.34(j) requires a CTA to provide a full description of any actual or potential conflicts of interest regarding any aspect of the CTA's trading program on the part of:

- The CTA;
- Any FCM with which the client will be required to maintain its commodity interest account;
- Any IB through which the client will be required to introduce its account to an FCM; and
- Any principal of the foregoing.

The CTA also must disclose any other material conflict involving any aspect of the offered trading program, including any arrangement whereby the CTA or principal thereof may benefit, directly or indirectly, from the maintenance of the client's commodity interest account with an FCM or IB (such as payment for order flow or soft dollar arrangements).

Section 4o of the CEA and CFTC regulation 4.41 prohibit, among other things, a CTA from employing any device, scheme or artifice to defraud any client.

FCMs are required to maintain books and records (CFTC regulation 1.31) and offer very specific disclosures to customers (CFTC regulation 1.55), and must have in place policies and procedures to ensure advertising and solicitations are not misleading (CFTC regulation 1.55(l)).

Derivatives Market Intermediaries

8. In jurisdictions where DMIs are treated separately from market intermediaries, as explained in the Scope Section, does the regulatory system require that DMIs be subject to

registration or licensing, recognizing that in certain limited circumstances full application of requirements and standards may not be appropriate for certain types of entities?

Yes. Dealers in OTC derivatives are regulated by the CFTC as SDs. The CFTC's regulatory regime for SDs is separate from that of market intermediaries and applies standards specific to the business of dealing in OTC derivatives. Please refer to responses in Principle 29, Questions 1-6 for registration requirements for SDs.

Principle 30 There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.

Key Questions (please answer with respect to market intermediaries that are direct participants in trading venues, providers of direct electronic access to such venues and/or first tier direct electronic access clients, and operators of trading venues)

1. Are there initial and ongoing minimum capital requirements for market intermediaries? Are there also liquidity standards? Do the capital and liquidity standards address solvency?

Yes. As discussed in response to Principle 29, Question 2(c), CEA Section 4s(e) requires the adoption of rules establishing capital and margin requirements for SDs and MSPs, and applies a bifurcated approach that requires each SD and MSP for which there is a prudential regulator to meet the capital and margin requirements established by the applicable prudential regulator, and each SD and MSP for which there is no prudential regulator to comply with the CFTC's capital and margin regulations. The CFTC has adopted and is in the process of implementing SD margin¹²² and has proposed SD and MSP capital requirements.¹²³

Specifically, the SD capital proposal, depending on the characteristics of the registered entity, would: (i) permit SDs to elect a capital requirement that is based on existing bank holding company capital rules adopted by the Federal Reserve (the "bank-based capital, approach"); (ii) permit SDs to elect a capital requirement that is based on the existing CFTC FCM capital rule, the existing SEC broker-dealer capital rule, and the SEC's proposed capital requirements for SBSs, (the "net liquid assets capital approach"); or (iii) permit SDs that meet defined conditions designed to ensure that they are "predominantly engaged in nonfinancial activities" to compute their minimum regulatory capital based upon the firms' tangible net worth (the "tangible net worth capital approach"). With respect to MSPs, the CFTC proposed a minimum regulatory capital requirement based upon the tangible net worth of the MSP.

The proposed rules address qualifying capital and the minimum levels of such qualifying capital that the SD or MSP would be required to maintain. The proposed requirements also include amendments to existing CFTC regulations governing FCM capital requirements, in addition to new capital rules that would apply to SDs and MSPs that are not FCMs. The proposed rules address when internal models may be used for purposes of the required capital calculations.

SDs and MSPs that are also FCMs are required to meet existing FCM requirements to hold minimum levels of adjusted net capital, with a higher minimum fixed dollar net capital requirement of \$20 million. As proposed, SDs may also apply to use

¹²² See *Margin Rule*, 81 FR 636.

¹²³ See *Capital Requirements of Swap Dealers and Major Swap Participants*, 81 FR 91252 (Dec. 16, 2016).

certain types of Value at Risk Models (VaR Models) to compute capital requirements, which are subject to proposed qualitative and quantitative requirements and an approval method. As proposed there is also a substituted compliance mechanism. This would permit SDs and MSPs already subject to capital requirements of foreign regulators to seek a Capital Comparability Determination in lieu of otherwise applicable SD and MSP capital requirements.

Certain SDs predominantly engaged in non-financial activities may qualify for a tangible net worth capital approach, which for SDs in certain businesses would permit less liquid capital to satisfy the capital requirement.

SDs and MSPs are not permitted to clear swaps for customers. Under the CEA, customer clearing for swaps must be performed through FCMs, which are subject to liquid assets capital requirements.

FCMs and IBs are subject to minimum capital requirements. Section 4f(b) of the CEA provides that FCMs and IBs must meet the minimum financial requirements that the CFTC "may by regulation prescribe as necessary to insure" that FCMs and IBs meet their obligations as registrants. The minimum capital requirements for FCMs and IBs are set forth in CFTC regulation 1.17. CFTC regulation 1.17 also provides an alternative means for IBs to satisfy net capital requirements, by operating pursuant to a guarantee agreement that meets the requirements set forth in CFTC regulation 1.10(j). Such guaranteed IBs must place their trades only with the FCM guaranteeing the IB. FCM capital requirements are designed to require a minimum level of liquid assets in excess of the FCM's liabilities to provide resources for the FCM to meet its financial obligations as a market intermediary. The capital requirements also are intended to ensure that an FCM maintains sufficient liquid assets to wind-down its operations by transferring customer accounts in the event that the FCM decides, or is forced, to cease operations as an FCM.

CFTC regulation 1.17 sets the minimum adjusted net capital requirement as the greatest of: (1) \$1,000,000; (2) 8 percent of the risk margin (as defined in CFTC regulation 1.17(b)(8)) of customer and non-customer exchange-traded futures positions and swap positions that are cleared by a clearing organization and carried by the FCM; (3) the amount of adjusted net capital required by a registered futures association of which the FCM is a member; and (4) for an FCM that also is registered as securities broker or dealer, the amount of net capital required by rules of the SEC. Separately CFTC regulation 5.7 provides that an FCM that engages in off-exchange foreign currency transactions with retail participants must have a minimum adjusted net capital requirement of \$20,000,000, plus 5 percent of the FCM's liabilities to the retail forex participants that exceeds \$10,000,000. The requirements for the calculation of the FCM's adjusted net capital represent the second component of the FCM capital rule. CFTC regulation 1.17(c)(5) generally defines the term "adjusted net capital" as an FCM's "current assets," *i.e.*, generally liquid assets, less all of its liabilities (except certain qualifying subordinated debt), and further reduced by certain capital charges (or haircuts) to reflect potential

market and credit risk of the firm's current assets.

It also should be noted that FCMs generally have treated "early warning" notice requirements under CFTC regulation 1.12(b) as establishing a *de facto* higher capital requirement for FCMs. Specifically, CFTC regulation 1.12(b) requires FCMs to provide immediate notification to the CFTC and their DSROs if the FCM's capital falls below the following levels:

- 110 percent of the risk-based capital requirement;
- 150 percent of the minimum dollar requirement, or of the requirement for minimum capital under NFA rules; or
- If the FCM is a securities broker-dealer, the early warning level established under SEC rules.

In order to avoid triggering the notice requirement under CFTC regulation 1.12(b), FCMs generally seek to maintain capital at levels above the early warning levels described above.

FCMs are registered entities which may intermediate customer business to clearing, and hold customer funds related thereto. Thus, they have net capital requirements designed to ensure current assets comprise adequate capital, with charges, or haircuts, designed to capture market risks of holding certain types of assets or proprietary trading, and the discounting of non-current assets as well as undermargined capital charges designed to address credit risk.

In addition, CFTC regulation 1.17(a)(4) provides that the CFTC may demand certification from an FCM, with verifiable evidence, of sufficient access to liquidity to continue operating as a going concern. If certification is not made immediately upon such request, or verifiable evidence is not provided, the FCM must transfer all customer accounts and cease doing business as an FCM until such time as the firm is able to demonstrate compliance. The CFTC may in its discretion permit the FCM up to a maximum of 10 business days grace period to achieve compliance if the FCM immediately demonstrates to the satisfaction of the Commission the ability to achieve compliance.

The minimum capital requirements for IBs are lower than for FCMs, as the CEA does not permit IBs to receive or hold customer funds. The capital requirements for IBs that are not guaranteed are the greatest of the following:

1. \$45,000;
2. The minimum amount required by the NFA; and
3. For IBs also registered as securities brokers or dealers, the amount of capital required by the SEC.

2. Are the capital adequacy requirements structured to result in capital addressed to the full range of risks to which market intermediaries are subject (e.g., market, credit, liquidity and operational risks)?

The CFTC's proposed capital regulations for SDs and MSPs are structured to result in capital addressed specifically to market and credit risk, however any SD that is also registered as an FCM and therefore permitted to clear, must comply with the more stringent net liquid assets capital approach of FCM capital requirements. The CFTC's capital treatment for liquidity risks is limited to the FCM registration category, which is the sole registration permitted to intermediate the clearing of futures and swaps transactions and holding of customer funds related thereto. The CFTC's early warning and notices provisions create likely additional capital buffers which may mitigate operational risks. The CFTC has imposed new risk management requirements relating to the holding of customer funds which may further mitigate operational risk outside of capital adequacy.

The key regulatory objective of the CFTC's FCM and IB net capital rule is to require registrants to maintain a minimum base of liquid assets in excess of their liabilities to finance their business activity. The requirements in CFTC regulation 1.17 are mostly focused on mitigating market risk, credit risk, and liquidity risk. The early warning notice requirements under CFTC regulation 1.12, and more particularly the *de facto* higher capital requirements under that regulation, also help increase the cushion available to address the various risks to firm capital, which would include operational and legal risk.

The definitions of the terms "net capital" and "current assets" in CFTC regulations 1.17(c)(1) and (c)(2) require the FCM to include only generally liquid assets when determining the amount of capital maintained by the firm. "Net capital" means the amount by which the FCM's "current assets," *i.e.*, cash and other assets "commonly identified as expected to be realized as cash or sold during the next 12 months", exceed the firm's total liabilities (except certain subordinated liabilities meeting the specific limitations of CFTC regulation 1.17(h)). When determining current assets, CFTC regulation 1.17(c)(2) specifically excludes certain items such as unsecured receivables, and further requires that unrealized losses shall be deducted, and unrealized profits shall be added to the extent that they are secured or on exchange-traded positions (as such, the CFTC's capital requirements take account of certain off-balance sheet items in addition to on-balance sheet items). Other assets must be marked to market, including all long and all short positions in commodity options which are traded on a contract market; all listed security options; and all long and all short securities and commodities positions. Further, the rule describes values to be attributed to any commodity option that is not traded on a contract market and to any unlisted security option.

In light of the regulatory emphasis on maintaining liquid assets, CFTC regulation 1.17(c)(5) also requires deductions from the market values of certain assets to reflect the possibility of price depreciation when liquidated. For example, the definition of “adjusted net capital” in CFTC regulation 1.17(c)(5) specifies certain required deductions with respect to the FCM’s or IB’s proprietary futures and options on futures positions; its inventory, fixed price commitments, and forward contracts; and also its securities and security options. The required deductions are also referred to as “haircuts”, and are reductions of the market values of these assets by a set percentage, *e.g.*, the firm must generally deduct twenty percent of the market value of its proprietary forward contracts.

The SEC’s net capital rule for securities broker-dealers also specifies “haircuts” for certain assets of the broker-dealer. The CFTC generally has harmonized the haircuts applied to securities and securities options under CFTC regulation 1.17(c)(5) with the haircuts required under the SEC’s net capital rule. For example, both the SEC’s and the CFTC’s regulations require a deduction of fifteen percent of the value of equities. For certain firms, the SEC and CFTC also may permit the firm to apply internal models to determine “alternative” market risk and credit risk charges to be applied to a portfolio of trading securities.

3. Are capital adequacy requirements sensitive to the quantum of risks undertaken; that is, does required capital increase as risk increases (*e.g.*, in the event of large market moves)?

Yes. Section 4s(e)(2)(C) of the CEA requires the CFTC, in setting capital requirements for a person designated as a SD or MSP for a single type or single class or category of swap or activities, to take into account the risks associated with other types/classes/categories of swap and other activities conducted by that person that are not otherwise subject to regulation by virtue of their status as an SD or MSP. Section 4s(e)(3)(A) of the CEA also refers to the need to offset the greater risk that swaps that are not cleared pose to SDs, MSPs, and the financial system, and the CFTC, SEC, and prudential regulators are directed to adopt capital requirements that: (1) help ensure the safety and soundness of the registrant; and (2) are appropriate for the risk associated with the uncleared swaps held by the registrants.

The “risk-based” capital requirements of FCMs are directly related to increases in margin requirements for the futures and options positions of their customers and noncustomers. Further, FCMs and IBs with proprietary positions in futures or options on futures must deduct from their net capital 100 percent of the margin requirements for such positions (or 150 percent if the FCM is not a clearing member of the organization clearing such positions). Also, FCMs’ and IBs’ capital requirements reflect market moves because their assets are required to be marked to market.

The proposed SD capital requirements would also increase relative to risk. The

proposal discusses the risk based approach to the capital requirements, inherent in both the bank based capital approach and the net liquid assets capital approach available to SDs. Aspects of required capital computed from margin are risk based. Further including capital requirements from such computation, even when margin collection exceptions exist, fulfills the separate purpose of capital being to capture residual risk for the entity itself. The proposal also addresses risk in the computation of market and credit risk charges applicable to the SD's dealing swap and security-based swap portfolios, including requirements which may be based upon VaR models which have been approved and meet qualitative and quantitative requirements.

4. Are capital standards designed to allow an intermediary to absorb some losses, and to wind down its business over a relatively short period without loss to its clients or disrupting the orderly functioning of the markets?

Yes, as noted above in response to Principle 30, Question 3, proposed capital requirements being risk based are intended to cover residual risk to protect the intermediary SD entity itself. Further, CFTC regulation 23.603 requires an SD or MSP to establish and maintain a written business continuity and disaster recovery plan that outlines the procedures to be followed in the event of an emergency or other disruption of its normal business activities. The business continuity and disaster recovery plan must be designed to enable the SD or MSP to continue or to resume any operations by the next business day with minimal disturbance to its counterparties and the market, and to recover all documentation and data required to be maintained by applicable law and regulation.

CFTC regulation 1.17, which is the net capital requirement for FCMs, is also designed for exactly such purpose, along with the CFTC regulations which govern the treatment of the customer funds of commodity and swaps customers. Reporting of customer funds custody is now daily, and the CFTC has independent access to verify balances with depositories should concerns arise. Should there be any discrepancy in the reported segregation of customer funds, the CFTC has the ability to order the transfer of customer accounts and cessation of FCM business. The net capital requirement is designed to provide a buffer of assets as a backstop to any customers bearing losses. Significant new customer protection regulations were adopted by the CFTC in the aftermath of the MF Global bankruptcy. Accounts were transferred in that bankruptcy to solvent FCMs and such bankruptcy did not result in market disruption despite a shortfall in customer funds, but customer accounts were not able to be transferred with full customer funds as there was a reported shortfall in the customer funds. However eventually, all customers were able to be fully repaid as capital and claims were liquidated.

5. Are relevant market intermediaries required to maintain records such that capital levels can be readily determined at any time?

Yes. CFTC regulation 23.201(b)(2) requires SDs and MSPs to maintain records

reflecting all assets and liabilities, income and expenses, and capital accounts as required by the CEA and CFTC regulations.

CFTC regulation 1.17(a)(3) expressly provides that each FCM and IB must be in compliance with capital requirements “at all times and must be able to demonstrate such compliance to the satisfaction of the CFTC or the designated SRO.” CFTC regulation 1.12 requires immediate notification to the CFTC and the designated SRO should an FCM not be in compliance with minimum capital requirements. Net capital computations are routinely reported to the Commission and SROs as of month end in the regular financial reporting required by CFTC regulation 1.10. Other relevant recordkeeping requirements relating to the financial condition of FCMs and IBs and to the customer funds held by FCMs are summarized below.

CFTC regulation 1.18 requires FCMs and IBs to prepare and keep current ledgers which show each transaction affecting asset, liability, income, expense and capital accounts consistently with the Form 1-FR (or the FOCUS Report if a securities broker-dealer). CFTC regulation 1.27 requires each FCM that invests customer funds under CFTC regulation 1.25 to keep a record which shows the details of the investment, including the size and type of investment, the date of the investment, and any disposition made of the investment. CFTC regulation 1.32 requires an FCM to compute each day the customer funds in segregated accounts and the FCM’s residual interest in those funds, and to keep a record of each such computation.

Pursuant to CFTC regulation 1.31, all books and records required by the CEA and CFTC regulations must be kept for a period of five years and must be readily accessible during the first 2 years of the 5-year period. All books and records must be open to inspection by any representative of the CFTC or DOJ.

6. Are the detail, format, frequency and timeliness of reporting to the regulator, and/or the SRO, sufficient to reveal a significant deterioration in the capital adequacy position of market intermediaries?

Yes. Section 4s(f)(1)(A) of the CEA requires each registered SD and MSP to make such reports as are required by CFTC rule or regulation regarding the SD’s or MSP’s financial condition. The CFTC has proposed Regulation 23.105, which requires certain SDs and MSPs to file monthly unaudited financial statements and annual audited financial statements with the CFTC and with any registered futures association of which they are members.¹²⁴

The required financial reporting proposed under Part 23 would include a statement

¹²⁴ CFTC Proposed Regulation 23.106 would apply to SDs and MSPs, except any SDs or MSPs that are subject to the capital requirements of a prudential regulator, or designated by the FSOC as a Systemically Important Financial Institution (SIFI). SDs and MSPs that are subject to regulation by a prudential regulator would comply with the applicable financial reporting obligations imposed by such prudential regulator. SDs and MSPs that are designated as SIFIs would comply with any financial reporting obligations imposed by the Federal Reserve.

of financial condition; a statement of income or loss; a statement of cash flows; and a statement of changes in stockholders', members', partners', or sole proprietor's equity. Under Proposed CFTC regulation 23.101, the financial statements also would include a schedule demonstrating compliance with the applicable regulatory capital requirement. The schedule would further disclose the firm's minimum required capital under Proposed CFTC regulation 23.101 as of the end of the month or end of its fiscal year, as applicable, and the amount of regulatory capital it held at such date.

The proposed financial statements would be required to be prepared in accordance with generally accepted accounting principles as established in the United States, however under certain circumstances SDs and MSPs may prepare and keep records in accordance with International Financial Reporting Standards if said SDs and MSPs are not organized under the laws of a state or other jurisdiction within the United States. The unaudited financial statements would be required to be filed within 17 business days of the end of each month and the annual audited financial statements would be required to be filed within 90 days of the end of the SD's or MSP's fiscal year.

Proposed CFTC regulation 23.105 would also require SDs and MSPs to provide the CFTC, and the registered futures association of which the SDs or MSPs are members, with written notice in the event of certain enumerated financial or operational issues. The proposed notice provisions would require an SD or MSP to give immediate notice to the CFTC should it fail to meet its minimum capital requirement, and also other notice requirements such as 24 hour notice should the SD or MSP have less than 120 percent of its minimum requirement under Proposed CFTC regulation 23.101.

Proposed CFTC regulation 23.105 also would require a registered SD or MSP to provide written notice of its failure to maintain current books and records, or of a substantial reduction in capital as previously reported to the CFTC. Pursuant to CFTC proposed Regulation 23.105(h), the CFTC could require the SD or MSP to file financial or operational information on a daily basis or at such other times as the CFTC may specify.

CFTC regulation 1.10(b) requires each FCM to prepare and to file unaudited financial condition reports, Form 1-FR-FCM, within 17 business days of the close of business each month with the CFTC and the FCM's DSRO. An FCM also is required to file a Form 1-FR-FCM audited by an independent public accountant as of the end of the FCM's fiscal year. The audited financial Form 1-FR-FCM is required to be filed with the CFTC and with the FCM's DSRO within 60 calendar days of the date of the FCM's fiscal year end. CFTC regulation 1.10(d) prescribes the contents of both monthly and annual financial reports, which must include net capital computations as well as separate reports of customer funds held for futures customers, foreign futures and options customers, and cleared swaps customers.

CFTC regulation 1.12(b) requires an FCM who knows or should know that its

adjusted net capital at any time is less than the minimum required by CFTC regulation 1.17, or by the capital rule of any SRO to which such person is subject, to give immediate notice to the CFTC and the FCM's DSRO. CFTC regulation 1.12(c)(3) requires a registrant to provide same-day reporting if it fails to make or keep current books and records required by CFTC regulations.

In addition, CFTC regulation 1.12(g)(1) requires that, if for any reason the net capital of an FCM declines by 20 percent or more from the amount last reported, the FCM must provide notice within 2 business days of the event or series of events causing the reduction in net capital. CFTC regulation 1.12(f)(3) also provides for immediate notice when an FCM has accounts that are undermargined or subject to a margin call that exceeds its excess net capital.

7. Is the financial position of the intermediary subject to audit by independent auditors to provide additional assurance that the financial position reflects the risk that the market intermediary undertakes?

Proposed CFTC regulation 23.105 requires certain SDs and MSPs to file annual audited financial statements with the CFTC and with any registered futures association of which they are members. This proposed rule applies to SDs and MSPs that are not subject to the capital requirements of a prudential regulator, or designed by the FSOC as a SIFI. SDs and MSPs described by the previous sentence would comply with the auditing obligations imposed by the prudential regulator or Federal Reserve Board, as applicable.

With respect to FCMs, RFEDs, and IBs, CFTC regulation 1.10 establishes requires the filing of certified financial reports with the CFTC. CFTC regulation 1.16 provides that the term "certified" means that a financial report has been audited and reported upon with an opinion expressed by an independent certified public accountant. For certification of FCM reports, an auditor must be registered with and subject to examinations by the PCAOB.

In order to satisfy the requirements of CFTC regulation 1.16(d), the audit performed by the independent accountant must be conducted in accordance with the auditing standards of the PCAOB. The procedures must include a review and appropriate tests of the accounting system, internal accounting controls, and the procedures for safeguarding customer and firm assets. These procedures must be adequate to provide reasonable assurance that they will discover any material deficiencies in the accounting system, in the internal accounting controls, and the procedures for safeguarding customer and firm assets. The accountant must also review the FCM's computations of minimum financial requirements and its daily computations of the segregation requirements under Section 4d(a)(2) of the CEA.

CFTC regulation 1.16(d)(2) provides that deficiencies in the FCM's or IB's procedures are considered to be material inadequacies if, in the absence of corrective steps, they could reasonably be expected to inhibit the FCM's or IB's ability to complete

| |
|--|
| <p>transactions promptly or to discharge responsibilities to customers or creditors; to result in material financial loss; to cause material misstatements in the FCM's or IB's financial statements and schedules; or to produce violations of the CFTC's segregation, secured amount, recordkeeping, or financial reporting requirements, which could reasonably be expected to result in impediments to meeting its obligations, material financial loss, or inaccurate financial reports.</p> <p>An accountant who discovers any such material inadequacy in the course of an audit is required under CFTC regulation 1.16 to notify the FCM or IB, who, in turn, must notify the CFTC, NFA and the appropriate DSRO. A copy of the notice must also be given to the accountant within three business days after it is filed. The accountant is to advise the NFA, in the case of an applicant, or the CFTC and the DSRO, in the case of a registrant, within three business days if he or she does not receive a copy of the notice and must notify those regulatory units of any disagreement with the FCM's submission within three business days after receiving the copy of the FCM's notice.</p> |
| <p>8. Does the regulator:</p> |
| <p>(a) Regularly review market intermediaries' capital levels?</p> |
| <p>Yes. The CFTC itself does not conduct routine on-site direct inspections of intermediaries, but may include an on-site visit to a firm as part of the responsive action taken when a firm files any early warning or other notification required under CFTC regulations. Under the CEA, SROs are required to develop programs to assess whether FCMs and IBs are in compliance with exchange and CFTC minimum financial and related reporting requirements. CFTC regulation 1.52 establishes the minimum components for a DSRO's examination program. Both the CFTC and the SROs also receive and review monthly financial reports that include the statement of the computation of minimum capital requirements. See response to Principle 30, Question 6.</p> |
| <p>(b) Take appropriate action when these reviews indicate material deficiencies?</p> |
| <p>Yes. If a review performed by either the SRO or the CFTC indicates a material deficiency in capital, the CFTC may impose the restrictions described in the response to Principle 30, Question 1.</p> |
| <p>9.</p> |
| <p>(a) Does the regulator have specific authority to impose: restrictions on a market intermediary's regulated business activities; and more stringent capital monitoring and/or reporting requirements, if a market intermediary's capital deteriorates so as to endanger its capacity to fulfil its obligations or when it falls below minimum requirements?</p> |
| <p>Yes. Several CFTC regulations enable the Commission to require more frequent reporting and/or to impose restrictions on the intermediary's business.</p> |

Proposed CFTC regulation 23.105 would require SDs and MSPs to provide the CFTC, and the registered futures association of which the SDs or MSPs are members, with written notice in the event of certain enumerated financial or operational issues. The proposed notice provisions would require an SD or MSP to give telephonic notice to the CFTC, followed by a written notice, whenever it knows or should know that the firm does not maintain required capital in excess of its minimum requirement under Proposed CFTC regulation 23.101. The SD or MSP also would be required to file documentation containing a calculation of its required capital with its notice of undercapitalization.

Proposed CFTC regulation 23.105 also would require a registered SD or MSP to provide written notice of its failure to maintain current books and records, or of a substantial reduction in capital as previously reported to the CFTC. Proposed CFTC regulation 23.104(c) provides equity withdrawal restrictions if the SD's capital is less than 120 percent of the minimum requirement, and Proposed CFTC regulation 23.104(d) provides that the CFTC by order may restrict any withdrawal of capital by an SD for a period of time if the CFTC based on information available concludes it may be detrimental to the financial integrity of the SD or expose the counterparties and creditors of the SD to loss.

Pursuant to CFTC regulation 1.17(a)(4), if an FCM holds less capital than the amount specified in its minimum capital requirement, then it generally must transfer all customer accounts and immediately cease conducting business as an FCM, until such time as the FCM is able to demonstrate compliance with its minimum capital requirement.

Pursuant to CFTC regulation 190.04(d)(2), the trustee appointed to administer the bankruptcy proceedings of an FCM is not permitted to purchase or sell new commodity contracts for the customers of such FCM, with the exceptions noted below. In general, CFTC regulation 190.04(d)(2) presumes that an FCM subject to bankruptcy proceedings is insolvent and, therefore, that such FCM does not have sufficient capital to operate its business, which business may include supporting the credit of its customers or performing on other obligations. Thus, in restricting the conduct of the trustee, CFTC regulation 190.04(d)(2) aims to minimize the risk of loss to customers of the FCM.

However, CFTC regulation 190.04(d)(2) recognizes that, even where an FCM is insolvent, certain purchases or sales of new commodity contracts may be risk-reducing, and thus may prevent material erosion in value of open commodity contracts constituting customer assets. Therefore, CFTC regulation 190.04(d)(2) permits the trustee to engage in such purchases or sales to achieve any of the following purposes: (i) to offset an open commodity contract; (ii) to transfer any transferable notice applicable to an open commodity contract; or (iii) to cover or

partially cover, with the approval of the CFTC, inventory or commodity contracts of the FCM that cannot be immediately liquidated due to market conditions (including price limits).

CFTC regulation 1.12(a) requires immediate notice and updated capital computations if the FCM's capital falls below the actual required minimum (as opposed to the capital levels that would merely trigger an early warning report under CFTC regulation 1.12(b) described above).

CFTC regulation 1.17(a)(4) provides that an FCM that fails to demonstrate that it holds sufficient capital to meet the required minimum must transfer all customer accounts and immediately cease doing business as a FCM until such time as the FCM is able to demonstrate compliance with the capital requirements. However, the FCM may trade for liquidation purposes only during this period unless prohibited from doing so by its DSRO or the CFTC. Moreover, the CFTC or DSRO, at its discretion, may provide the FCM with an additional 10 business days to achieve compliance without transferring accounts and ceasing business, if the FCM can demonstrate its ability to achieve compliance within this period.

CFTC regulation 1.17(e)(2) provides that the CFTC may, by written order, temporarily prohibit equity withdrawals by an FCM that would reduce excess adjusted net capital by 30 percent or more. Such orders would be based on the CFTC's determination that the withdrawal transactions could be detrimental to the financial integrity of FCMs or could adversely affect their ability to meet customer obligations.

(b) Is there evidence that the regulator exercises this authority?

Yes. CFTC regulation 1.10(b)(4) provides that upon receiving notice from any representative of the CFTC, an FCM or IB must provide more frequent Form 1-FR information, or such other financial information as may be requested by such representative. The CFTC and DSROs have in the past required FCMs to do daily instead of monthly capital reporting.

10. Does the prudential framework address risks from outside the regulated entity, for example, from unlicensed affiliates and off-balance sheet affiliates?

Affiliate risk generally is addressed through reporting and filing requirements under CFTC Regulations 1.14 and 1.15, which define material affiliates which may present risk to the FCM and requires certain reporting of the relationships and risks of such material affiliates. Under the net liquid assets capital approach for SDs, all direct and indirect affiliates for whom the SD guarantees liabilities would be required to be consolidated for capital purposes. This type of consolidation for capital purposes of any directly or indirectly guaranteed affiliates is also required for FCMs and IBs under CFTC regulation 1.17. Also, as discussed in the response to Principle 30, Question 2, certain off-balance sheet items must be reported as non-current

assets in the capital computations of FCMs and IBs.

| | |
|---|--|
| Principle 31 | Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters. |
| Key Questions (please answer with respect to market intermediaries that are direct participants in trading venues, providers of direct electronic access to such venues and/or first tier direct electronic access clients, and operators of trading venues) | |
| <i>Management and Supervision</i> | |
| 1. | With regards to a market intermediary's internal organization, does the regulatory framework require the following to be considered: |
| (a) | An appropriate management and organization structure, including in relation to activities that have been outsourced? |
| (b) | Adequate internal controls? |
| (c) | Management that is required to bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the whole firm? |
| <p>Yes, to all of the above. CFTC regulation 23.602 requires SDs and MSPs to establish and maintain a system to diligently supervise all activities relating to its business performed by its partners, members, officers, employees, and agents (or persons occupying a similar status or performing a similar function). Such system shall be reasonably designed to achieve compliance with the requirements of the CEA and CFTC regulations. The supervisory system shall provide for the designation of at least one person with the authority to carry out the supervisory responsibilities of the SD or MSP, and the use of reasonable efforts to determine that all supervisors are qualified and meet such standards of training, experience, competence, and other qualifications that the CFTC finds necessary or appropriate. In addition, CFTC regulation 23.600 requires SDs and MSPs to establish a risk management program of policies and procedures that identifies, and sets limits for, the risks of the entities' swaps activities, including, credit, market, liquidity, legal, and operational risk. The policies and procedures and risk limits must be approved by the firm's governing body annually.</p> <p>CFTC regulation 3.3(a) requires SDs, MSPs, and FCMs to designate an individual to serve as a CCO. Under CFTC regulation 3.3(d)(1), the CCO is responsible for developing and administering policies and procedures that fulfil certain duties of the SD, MSP, or FCM, and that are reasonably designed to ensure the registrant's compliance with the CEA and Commission regulations. CCOs must establish procedures, in consultation with the registrant's senior management, for the remediation of noncompliance issues he or she has identified, and must also establish procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues. Furthermore, CFTC regulation</p> | |

3.3(a)(1) requires the CCO of SDs, MSPs, and FCMs to report directly to the board of directors or the senior officer in order to ensure the proper independence of the compliance function. CFTC regulations 3.3(a)(1)-(2) stipulate that only the board of directors or senior officer may appoint the CCO, set their compensation, or remove the CCO.

To help ensure compliance by registrants with these operational conduct requirements, CFTC regulation 166.3 requires each registrant (except APs with no supervisory duties), to “diligently supervise” the handling by its partners, officers, employees and agents of all activities relating to its business as a CFTC registrant. Also, the review of FCM internal procedures falls within the scope of SRO audit and surveillance obligations under CFTC regulation 1.52. SRO obligations under this CFTC regulation include monitoring and auditing compliance by FCMs with their minimum financial and related reporting requirements, and also receiving the financial reports that all FCMs are required to file. In addition, CFTC regulation 1.11 imposes requirements for FCMs to have risk management policies and procedures in place.

2. Does the regulatory framework require market intermediaries: to provide all relevant information about the business in a timely, readily accessible way; and to regularly report to management? Is such information subject to procedures intended to maintain its security, availability, reliability and integrity?

Yes. CFTC regulation 23.600(c)(1) provides that the risk management program take into account market, credit, liquidity, foreign currency, legal, operational, settlement, and other risks, together with a description of the risk tolerance limits set by the SD or MSP and the underlying methodology in written policies and procedures. The risk tolerance limits shall be reviewed and approved quarterly by senior management and annually by the governing body.

CFTC regulation 23.600(c)(2) requires the risk management unit of each SD and MSP to provide to senior management and to its governing body quarterly written reports setting forth the market, credit, liquidity, foreign currency, legal, operational, settlement, and any other applicable risk exposures of the SD or MSP; any recommended or completed changes to the risk management program; the recommended time frame for implementing recommended changes; and the status of any incomplete implementation of previously recommended changes to the risk management program. The reports also shall be provided to the senior management and the governing body immediately upon detection of any material change in the risk exposure of the SD or MSP.

CFTC regulation 23.600(d)(7) requires all trade discrepancies to be documented and brought to the immediate attention of the management of the business trading unit. CFTC regulations 23.600(e)(1)-(2) requires SDs’ and MSPs’ risk management programs to be reviewed and tested annually, or upon any material change in the business of the SD or MSP that is reasonably likely to alter the risk profile of the SD or MSP. The results of these reviews shall be promptly reported to and reviewed

by the CCO, senior management, and governing body of the SD or MSP.

CFTC regulation 23.601 requires SDs and MSPs to establish and enforce written policies and procedures reasonably designed to monitor for and prevent violations of applicable CFTC, DCM, or SEF position limits and to monitor for and prevent improper reliance upon any exemptions or exclusions from such position limits. SDs and MSPs shall implement an early warning system to detect and alert senior management when position limits are in danger of being breached. Any detected violation of position limits shall be reported promptly to the firm's governing body. SDs and MSPs shall document compliance with position limits on a quarterly basis. The report shall be promptly reported and reviewed by the CCO, senior management and governing body of the SD and MSP.

CFTC regulation 23.603 requires SDs and MSPs to establish and maintain a written business continuity and disaster recovery plan that outlines the procedures to be followed in the event of an emergency or other disruption of its normal functions. A member of the senior management of the SD or MSP shall review the business continuity and disaster recovery plan annually or upon any material change to the business. Any deficiencies found or corrective action taken shall be documented.

CFTC regulation 1.11 contains the risk management program requirements for FCMs, which includes a supervisory system to ensure the program is followed, as well as review and testing by internal audit independent of the business unit, or a third-party audit service reporting to staff independent of the business unit. The annual review of the risk management program must be reported to the CCO, senior management and the governing body of the FCM. All records and reports including written policies and procedures and copies of all written approvals are subject to the CFTC's recordkeeping requirements under CFTC regulation 1.31, which covers availability, accessibility, and integrity.

CFTC regulation 3.3(e) requires CCOs of SDs, MSPs, and FCMs to annually prepare a written report (CCO Annual Report) on the state of the registrant's compliance to the registrant's senior management and audit committee, as well as to the CFTC. The CCO Annual Report must contain a description of: (1) the registrant's written policies and procedures, including the code of ethics and conflicts of interest policies; (2) the registrant's assessment of effectiveness of those policies and procedures; (3) any areas for improvement identified, and any recommended potential or prospective changes or improvements to the registrant's compliance program and resources devoted to compliance; (4) the financial, managerial, operational, and staffing resources devoted to compliance with CFTC regulations; (5) any material noncompliance issues identified and the corresponding action taken; and (6) any material changes to compliance policies and procedures during the coverage period for the report.

CFTC regulation 3.3(a)(1) requires the CCO to meet at least once a year with the board of directors or senior officer (but may also elect to meet with them at any time) to help ensure that the registrant's senior managers who are charged with the ultimate responsibility for ensuring compliance with applicable regulatory

requirements and internal controls are adequately informed as to the state of the registrant's compliance with those requirements.

The policies and procedures of the SD, FCM, or MSP, as well as the CCO Annual Report, are required to be readily available and maintained pursuant to CFTC regulation 1.31, which, as noted above, covers availability, accessibility and integrity.

3. Does the regulatory framework require a market intermediary to be subject to an objective, periodic evaluation of its internal controls and risk management processes?

Yes. CFTC regulation 23.600 requires each SD and MSP to establish, document, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with the swaps activities of the SD or MSP. The risk management program must identify risks and risk tolerance limits, provide senior management with periodic risk exposure reports, and identify and take into account the risks of new products prior to engaging in transactions on those products. CFTC regulation 23.600(e) requires risk management programs to be tested annually or upon any material change in the SD's or MSP's business that is reasonably likely to alter the risk profile of the SD or MSP. The annual reviews must include an analysis of adherence to, and the effectiveness of the risk management policies and procedures and any recommendations for modifications thereto. The annual testing must be performed by qualified internal audit staff that are independent of the business trading unit being audited or by a qualified third-party audit service reporting to staff that are independent of the business trading unit. The results of the quarterly reviews must be promptly reported to and reviewed by the CCO, senior management and the governing body of the SD or MSP. Each SD and MSP must document all internal and external reviews and testing of its risk management program and written risk management policies and procedures including the date of the review or test; the results; any deficiencies identified; the corrective action taken; and the date that corrective action was taken. Such documentation must be provided to CFTC staff upon request.

CFTC regulation 1.10 establishes a requirement for review of certain FCM operations by outside auditors, as a result of the requirement that FCMs file certified annual financial reports with the CFTC. CFTC regulation 1.16 provides that the term "certified" means that a financial report has been audited and reported upon with an opinion expressed by an independent certified public accountant.

In order to satisfy the requirements of CFTC regulation 1.16, the audit performed by the independent accountant must be conducted in accordance with the audit standards of the PCAOB. The procedures must include a review and appropriate tests of the accounting system of the FCM or IB, the FCM's or IB's internal accounting controls, and the procedures of the FCM or IB for safeguarding customer and firm assets. These procedures must be adequate to provide reasonable assurance that they will discover any material deficiencies in the

accounting system, in the internal accounting controls, and in the FCM's or IB's system for safeguarding customer and firm assets. Deficiencies in the FCM's or IB's procedures are considered to be material inadequacies if, in the absence of corrective steps, they could reasonably be expected to inhibit the FCM's or IB's ability to complete transactions promptly or to discharge responsibilities to customers or creditors; to result in material financial loss; to cause material misstatements in the FCM's or IB's financial statements and schedules; or to produce violations of the CFTC's segregation, secured amount, recordkeeping, or financial reporting requirements, which could reasonably be expected to result in impediments to meeting its obligations, material financial loss, or inaccurate financial reports.

An accountant who discovers any such material inadequacy in the course of an audit is required under CFTC regulation 1.16 to notify the FCM or IB, who, in turn, must notify the CFTC, NFA and the appropriate DSRO. A copy of the notice must also be given to the accountant within three business days after it is filed. The accountant is to advise the NFA, in the case of an applicant, or the CFTC and the DSRO, in the case of a registrant, within three business days if he or she does not receive a copy of the notice and must notify these regulatory bodies of any disagreement with the FCM's submission within three business days after receiving the copy of the FCM's notice.

CFTC regulation 1.11 prescribes the requirements for an FCM's risk management program, including the supervision, annual independent testing and review and reporting to the FCM's governing body, and recordkeeping of compliance with the requirements.

The CCO's duty in CFTC regulation 3.3(d)(1) to administer the registrant's policies and procedures is typically implemented through the CCO's daily, active engagement in processes involving reviewing, evaluating, and advising on policies and procedures and compliance matters. This daily, active engagement in monitoring and assessing the registrant's implementation and adherence to its internal controls is illustrated in the CCO Annual Report. As mentioned above, CFTC regulation 3.3(e)(2) requires the CCO to describe his or her assessment of the registrant's policies and procedure's effectiveness. This assessment of the registrant's internal compliance controls and procedures includes not only the CCO's own programmatic monitoring, but would also include other groups in the registrant responsible for auditing or monitoring internal processes, like internal audit, for example.

Organizational requirements

4. Does the regulatory framework include the assessment of a market intermediary's compliance function, taking into account the market intermediary's size and business? When the regulator becomes aware of deficiencies are steps taken to require market intermediaries to improve their compliance function?

Yes. CFTC regulation 1.52 governs the CFTC's DSRO examination program for

FCMs, and it includes consideration of high risk firms in scope setting. NFA conducts routine, on-site examinations of SDs on an on-going basis, as well as risk-based examinations utilizing similar standards. The Major Review Section of the Examinations Branch of DSIO conducts reviews of DSROs financial surveillance programs, including detailed evaluations of DSRO examinations of SDs, FCMs, and CPOs.

5. Does the regulatory framework require a market intermediary to establish and maintain appropriate systems of client protection, risk management and internal and operational controls, including policies, procedures, and controls relating to all aspects of its day-to-day business intended reasonably to ensure:

(a) The integrity of the firm's dealing practices, including the treatment of all clients in a fair, honest and professional manner?

(b) Appropriate segregation of key duties and functions, particularly those duties and functions which, when performed by the same individual, may result in undetected errors, or may be susceptible to abuses, which expose the firm, or its clients, to inappropriate risks?

Yes, to all of the above. CFTC regulations require intermediaries to establish and maintain appropriate systems of client protection. CFTC regulation 23.402(b) requires SDs to implement policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning each counterparty whose identity is known to the SD prior to the execution of the transaction that are necessary for conducting business. CFTC regulation 23.402(c) requires the SD or MSP to obtain a record showing the true name and address of each counterparty whose identity is known to the SD or MSP prior to the execution of the transaction, the principal occupation or business of such counterparty, and the name and address of any other person guaranteeing the performance of such counterparty and any person exercising any control with respect to the positions of the counterparty. CFTC regulation 23.430 requires an SD or MSP to verify that a counterparty meets the eligibility standards for an eligible contract participant, as that term is defined by the CEA, before offering to enter into a swap with that counterparty.

CFTC regulation 23.431(a)(1) requires an SD or MSP to disclose to non-dealer counterparties, material information concerning the swap in a manner reasonably designed to allow the counterparty to assess the material risks and characteristics of the swap and the incentives and conflicts of interest that the SD or MSP may have in connection with the swap. CFTC regulation 23.433 requires any communication between an SD or MSP and any counterparty to be conducted in a fair and balanced manner based on principles of fair dealing and good faith.

CFTC regulation 166.2 prohibits FCMs, RFEDs, and IBs from effecting a transaction in a commodity interest for the account of any customer unless the person designated by the customer to control the account specifies the precise commodity interest to be purchased and sold and the exact amount to be purchased or sold.

CFTC regulation 23.600 requires SDs and MSPs to establish, document, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with the swaps activities of the SD or MSP. The program must include policies and procedures necessary to monitor and manage market risk, credit risk, liquidity risk, foreign currency risk, legal risk, operational risk, and settlement risk. The risk management program must include, at a minimum, the identification of risks and risk tolerance limits; provide to senior management and to its governing body quarterly written reports setting forth the market, credit, liquidity, foreign currency, legal, operational, settlement and any other applicable risk exposures of the SD or MSP; and a new product policy designed to identify and take into account the risks of any new product prior to engaging in transactions involving the new product.

CEA Section 4s(j)(5)(A) requires the SD and MSP to implement conflict of interest systems and procedures that establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any commodity or swap acting in a role of providing clearing activities or making determinations as to accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure or oversight of persons whose involvement in pricing, trading or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards described in the CEA.

CFTC regulation 23.605(c) restricts SD and MSP non-research personnel from directing a research analyst's decision to publish a research report of the SD or MSP and non-research personnel must not direct the views and opinions expressed in a research report of the SD or MSP. Research analysts cannot be subject to the supervision or control of any employee of the SD's or MSP's business trading unit or clearing unit. Communications relating to derivatives to a current or prospective counterparty by a research analyst must not omit any material fact or qualification that would cause the communication to be misleading.

CFTC regulation 23.605(d) prohibits SDs or MSPs from interfering with or attempting to influence the decision of the clearing unit of any affiliate clearing member of a DCO to provide clearing services and activities to a particular customer. SDs and MSPs must create and maintain informational partitions between business trading units and clearing units of any affiliated clearing member of a DCO. At a minimum, such informational partitions must require that no employee of a business trading unit shall supervise, control or influence any employee of the clearing unit of any affiliated clearing member of a DCO.

CFTC regulation 23.605(e) requires the SD or MSP to adopt and implement written policies and procedures that mandate the disclosure to its counterparties of any material incentives and any material conflicts of interest regarding the decision of a counterparty of whether to execute a derivative on a SEF or a DCM or whether to

| |
|---|
| <p>clear on a DCO.</p> <p>To help ensure compliance by registrants with specific operational conduct requirements CFTC regulation 166.3 requires each registrant (except APs with no supervisory duties), to “diligently supervise” the handling by its partners, officers, employees and agents of all activities relating to its business as a CFTC registrant. CFTC regulation 1.71(c) prohibits non-research personnel from directing a research analyst’s decision to publish a research report of the FCM or IB, and non-research personnel must not direct the views and opinions expressed in a research report of the FCM or IB and must not review or approve a research report of the FCM or IB before its publication. Research analysts must not be subject to the supervision or control of any employee of the FCM’s or IB’s trading unit or clearing unit and no employee of the business trading unit or clearing unit may have any influence or control over the evaluation or compensation of a research analyst.</p> <p>CFTC regulation 1.11 requires FCMs which hold customer funds to have a comprehensive risk management program related to such funds, subject to supervision, independent testing and review, and reporting to the FCM’s governing body, and CFTC regulation 1.55 requires FCMs to make firm-specific disclosures publicly available.</p> |
| <p>6. With respect to DMIs specifically:</p> |
| <p>(a) Does the regulatory framework require DMIs to be subject to business conduct standards, tailored, as appropriate, for the OTC derivatives market?</p> |
| <p>Yes. Dealers in OTC derivatives are regulated by the CFTC as SDs. The CFTC’s regulatory regime for SDs is separate from that of market intermediaries and applies standards specific to the business of dealing in OTC derivatives. Part 23 of the CFTC’s regulations address business conduct requirements for SDs, including reporting and recordkeeping, counterparty eligibility, disclosures of material risks, incentives, and conflicts of interest, suitability, documentation, risk management, and diligent supervision.</p> |
| <p>(b) Does the regulatory framework require DMIs to have risk management systems and organization to properly identify and manage their OTC derivatives related business risks?</p> |
| <p>Yes. CFTC regulation 23.600 requires SDs and MSPs to establish, document, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with the swaps activities of the SD or MSP. The program must include policies and procedures necessary to monitor and manage market risk, credit risk, liquidity risk, foreign currency risk, legal risk, operational risk, and settlement risk. The risk management program must include, at a minimum, the identification of risks and risk tolerance limits; provide to senior management and to its governing body quarterly written reports</p> |

| | |
|------|--|
| | <p>setting forth the market, credit, liquidity, foreign currency, legal, operational, settlement, and any other applicable risk exposures of the SD or MSP; and a new product policy designed to identify and take into account the risks of any new product prior to engaging in transactions involving the new product.</p> |
| (c) | <p>Does the regulatory framework require DMIs to design supervisory policies and procedures to manage their OTC derivatives operations and the activities of their representatives?</p> |
| | <p>Yes. CFTC regulation 23.602 requires SDs and MSPs to establish and maintain a system to diligently supervise all activities relating to its business performed by its partners, members, officers, employees, and agents (or persons occupying a similar status or performing a similar function). Such system shall be reasonably designed to achieve compliance with the requirements of the CEA and CFTC regulations. The supervisory system shall provide for the designation of at least one person with the authority to carry out the supervisory responsibilities of the SD or MSP, and the use of reasonable efforts to determine that all supervisors are qualified and meet such standards of training, experience, competence, and other qualifications that the CFTC finds necessary or appropriate.</p> |
| (d) | <p>Does the regulatory framework require DMIs to retain OTC derivatives transaction records and be able to provide them in a timely, organized and readable manner? Does the record retention period for OTC derivatives transactions apply for a specified period after the transactions' termination, maturity or assignment?</p> |
| | <p>Yes. CFTC regulations 23.201, 23.202, 23.203, and 23.606 require SDs to keep comprehensive records of their OTC derivatives transactions, including daily trading records of pre-execution trade information (including recordings of phone calls), execution trade information necessary for accurate trade reconstruction, and post-execution trade information. All such records must be maintained and open to inspection by the CFTC or the DOJ for the duration of an OTC derivative transaction plus 5 years. In addition, SDs must have reliable internal data capture, processing, and storage systems capable of producing required information promptly.</p> |
| 7. | <p>Taking into account Principle 8, does the regulatory framework require a market intermediary:</p> |
| (a) | <p>To endeavour to address a conflict of interest arising between its interests and those of its clients, or between its clients?</p> |
| (b) | <p>Where the potential for conflicts arises:</p> |
| (i) | <p>to have mechanisms in place to manage conflicts of interests that seek to ensure an unbiased decision making process and fair treatment of all its clients; and</p> |
| (ii) | <p>consider further steps if the mechanisms identified in (a) prove inadequate,</p> |

| | |
|--|--|
| | <p>which may include disclosure of the conflict, internal rules of confidentiality, and declining to act where a conflict cannot be resolved?</p> <p>Yes, to all of the above. CFTC regulation 23.431(a)(3) requires SDs and MSPs to disclose to any counterparty to the swap, the material incentives and conflicts of interest that the SD or MSP may have in connection with a particular swap, including any compensation or other incentive from any source that the SD or MSP may receive in connection with the swap.</p> <p>Part 155 of the CFTC’s regulations requires FCMs and IBs to establish and enforce internal rules, procedures and controls to insure, to the extent possible, that orders received from customers are transmitted before any order in the same commodity for the benefit of a proprietary account. These CFTC regulations prevent FCMs and IBs and their affiliated persons from using their knowledge of customer orders to the customer’s disadvantage and have helped the CFTC to deter such practices as “front-running” and “trading ahead.” CFTC regulation 1.55 requires the FCM to make firm-specific disclosures, and also requires that policies and procedures be adopted to ensure that advertising and solicitation are not misleading.</p> |
| | <p>8. If DEA is allowed, does the regulatory framework require market intermediaries to use controls, including automated pre-trade controls, which can limit or prevent a DEA client from placing an order that exceeds the market intermediary’s existing position or credit limits?</p> |
| | <p>Yes. CFTC regulation 38.607 requires a DCM that permits direct electronic access by customers to have in place effective systems and controls reasonably designed to facilitate the FCM’s management of financial risk, such as automated pre-trade controls that enable member FCMs to implement appropriate financial risk limits. A DCM must implement and enforce rules requiring the member FCMs to use the provided systems and controls.</p> <p>CFTC regulation 37.202 requires a SEF to provide impartial access to markets and market services. This has been interpreted by DMO to mean that a SEF should allow participants to access its platform via intermediation or direct access. The controls surrounding this access include the SEF requiring the ECP to provide the SEF with written or electronic confirmation of its status as an ECP, as defined by the CEA and Commission regulations, prior to obtaining access to the SEF. In addition, prior to granting access to the ECP, the SEF must require that the ECP consent to its jurisdiction.</p> <p>CFTC regulation 48.7 requires an FBOT’s trading system to comply with the IOSCO Principles for the Oversight of Screen-Based Trading Systems for Derivative Products, which, among other things, provides that the relevant regulatory authorities and the exchange should consider risk management exposures pertinent to the system, including taking measures to reduce risk by permitting</p> |

credit controls or position limits to be programmed into the system. Additionally, as part of the CFTC's FBOT registration process, an applicant for registration is required to provide information about: risk management mechanisms for members allowing customers to place orders; any pre- and post-trade risk management controls made available to system users; the laws, rules, regulations, and policies that govern the supervision and oversight of market intermediaries who may deal with members and other participants located in the United States, including recordkeeping requirements, the protection of customer funds, and procedures for dealing with the failure of an intermediary; and rules determining access requirements with respect to the persons that may trade on the FBOT, and the means by which they connect to it. The CFTC evaluates this information as part of its determination of whether the FBOT is eligible to be registered, and whether the FBOT's home regulator supports and enforces regulatory objectives that are substantially equivalent to those supported and enforced by the CFTC in its oversight of DCMs, such as the regulatory objectives of CFTC regulation 38.607, described above.

Protection of clients

9. If a market intermediary has control of, or is otherwise responsible for, assets belonging to a client which it is required to safeguard, are there regulations that require proper protection for them (for example, segregation and identification of those assets) by the market intermediary? Do these measures facilitate the transfer of positions and assist in the orderly winding up in the event of financial insolvency and the return of client assets?

Yes. With respect to customer funds held by FCMs, Section 4d(a)(2) of the CEA and CFTC regulation 1.20 both state that FCMs must separately account for customer funds on their books and records, and segregate such customer funds from their own funds and funds of other persons. The FCM is permitted to pool all customer funds in a single account, which must be clearly identified as belonging to customers. Customer funds must be deposited by the FCM with a bank, trust company, DCO, or another FCM. The FCM is further obligated to obtain a letter from the depository acknowledging that the funds deposited represent customer assets under the CEA and that the depository may not offset any obligation that the depositing FCM may have with the depository by the funds maintained in a segregated account.

To be in compliance with the CFTC's segregation requirements, an FCM must always maintain in accounts segregated in accordance with Section 4d(a)(2) of the CEA, sufficient funds in order to satisfy the net liquidating value of every futures and options customer. Each FCM is required to compute a calculation demonstrating its compliance with the segregation obligations on a daily basis, and is required to provide the CFTC and its DSRO with immediate notification if it is not in compliance with its segregation obligation. Should an FCM be under its minimum capital requirements under CFTC regulation 1.17, it must cease doing business as an FCM and transfer customer accounts. In this instance, the segregation requirements make the quick transfer of customer funds and positions

between FCMs possible, and, in that circumstance, the process is directed and monitored by the DSRO and the CFTC.

Section 4d(f) of the CEA requires the segregation of cleared swaps pertaining to customers, as well as associated collateral. Part 22 of the CFTC regulations require cleared swaps customer collateral to be segregated from the FCM's own property, but permits the cleared swaps collateral of all FCM cleared swaps customers to be kept together pre-bankruptcy in one account. The value of the collateral attributable to each customer is tracked on a daily basis. This model is known as the Legally Segregated Operationally Commingled Model, or LSOC. Following an FCM's bankruptcy, where there is a shortfall in the cleared swaps customer account due to a cleared swaps customer loss that exceeds both the cleared swaps customer's collateral and the FCM's ability to pay, the DCO could only use the collateral value attributable to the cleared swaps customers whose portfolios of positions at the DCO suffered losses to meet each such customer's loss. Thus, all collateral attributable to cleared swaps customers whose portfolios of positions gained or were "flat" (neither gained nor lost), and the remaining collateral attributable to cleared swaps customers whose portfolios of positions lost, would be immediately available for transfer.

In addition, the CFTC has separate regulations regarding custodial arrangements for initial margin posted by a SD for which there is no prudential regulator pursuant to Section 4s(e) of the CEA that required the CFTC to promulgate margin requirements for uncleared swaps applicable to a SD for which there is no prudential regulator. The CFTC published final margin requirements in January 2016.¹²⁵

The Commission's requirements relating to segregation, CFTC regulation 23.157(a), requires that SDs that post initial margin with respect to an uncleared swap shall require that all funds or other property that the covered swap entity provide as initial margin be held by one or more custodians that are not the SD, the counterparty, or affiliates of the SD or the counterparty. Such requirements are also applicable under CFTC regulation 23.157(b) where the SD collects initial margin that is required to be collected pursuant to the Commission's uncleared margin regulations.

CFTC regulation 23.157(c) requires the custodian to act pursuant to a custodial agreement that is legal, valid, binding and enforceable under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or similar proceedings. Such a custodial agreement must prohibit the custodian from rehypothecating, repledging, reusing or otherwise transferring the funds or other property held by the custodian.

¹²⁵ See CFTC regulations 23.150-159, 161. (The applicable regulations also apply to major swap participants, but at this time there are no major swap participants registered with the CFTC.)

In addition, see response to Principle 31, Question 11, below, with respect to required SD disclosure of the right of the counterparty to require that any initial margin provided by the counterparty to a swap transaction be subject to segregation in situation where segregation is not mandatory pursuant to CFTC regulation 23.157.

10. Does the regulatory framework require market intermediaries to maintain accurate and up-to-date records and accounts of client assets that readily establish the precise nature, amount, location and ownership status of client assets and the clients for whom the client assets are held? Does the regulatory framework require that the records be maintained in such a way that they may be used as an audit trail?

Yes. CFTC regulations require daily reporting of the balances of futures customer assets under CFTC regulation 1.32 and cleared swaps customers assets under CFTC regulation 22.2(g). These reports must be filed with DSROs. Records of all the FCM's transactions and customer activity are also required to be maintained under CFTC regulations 1.32, 1.33, 1.34, and 1.31 which governs the registrant's maintenance of books and records. Also more detailed information about the depository accounts must be filed when such depository accounts are opened, and bi-monthly detailed reports of the investments of customer funds and the amounts held by specific depository must be reported under CFTC regulations 1.27 and 1.32.

In addition to the requirements of CFTC regulation 23.157 discussed above, the CFTC has also promulgated CFTC regulation 23.504 pertaining to swap trading relationship documentation. This regulation requires that the SD maintain written swap trading relationship documentation with its counterparties that governs all terms of the trading relationship. CFTC regulation 23.504(b)(3)(iv) expressly requires documentation of the custodial arrangements for margin assets. Finally, CFTC regulation 23.504(c) mandates that the SD conduct independent internal or external audits on a periodic basis to identify any material weakness in its documentation policies and procedures and maintain records of each audit.

11. Where client assets are to be held or placed in a foreign jurisdiction and will be subject to the client asset protection and/or insolvency regimes of that foreign jurisdiction and not the home jurisdiction, does the regulatory framework require the intermediary to inform the clients of that fact? Does the regulatory framework require market intermediaries to provide any required disclosures of the relevant client asset protection regime(s) and arrangements and the consequent risks involved in writing, which is prepared in clear, plain, concise and understandable language and that avoids the use of legal or financial jargon that is not commonly understood?

Yes. FCMs may not hold funds for cleared swaps or U.S. regulated futures outside of the U.S. customer funds protection regimes. With respect to foreign futures traded outside of the United States, U.S. FCMs must comply with CFTC regulation 30.7 with respect to holding funds. Customer risk disclosures are required under

CFTC regulation 1.55(b), and with respect to foreign futures, specifically disclose that no domestic organization regulates activities and no domestic regulator has the power to compel enforcement of rules and that the laws governing such transactions will vary and may not afford the protections which apply to domestic transactions.

The custodial requirements set forth in CFTC regulation 23.157 apply without regard to where the custodian is located. Moreover, CFTC regulation 23.157(c)(2) provides that the custodial agreement that each SD must enter into with a custodian holding initial margin pursuant to CFTC regulation 23.157 must provide that the agreement is a legal, valid, binding and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or similar proceeding.

Separate disclosures are required where initial margin is not mandated pursuant to CFTC regulation 23.157. In particular, CFTC regulation 23.701 mandates that at the beginning of the first swap transaction involving the execution of initial margin, a SD must notify the counterparty that the counterparty has the right to require that any initial margin the counterparty provides in connection with such transaction be segregated in accordance with requirements set forth in CFTC regulations 23.702 and 23.703, except in those circumstances where segregation is mandatory pursuant to CFTC regulation 23.157 or rules adopted by the prudential regulators.

In addition, CFTC regulation 23.704(a) requires that the chief compliance officer of each SD must report to each counterparty that does not choose to require segregation of initial margin pursuant to CFTC regulation 23.701(a) no later than the fifteenth business day of each calendar quarter, on whether or not the back office procedures of the SD relating to margin and collateral requirements were, at any point during the previous calendar quarter, not in compliance with the agreement of the counterparties.

12. With respect to DMIs specifically, for centrally cleared OTC derivatives transactions, does the regulatory framework require DMIs to segregate collateral belonging to clients from their own proprietary assets and employ an account structure that enables the efficient identification and segregation of positions and collateral belonging to DMI clients?

Yes. CFTC regulation 22.2 governs the segregation of cleared swaps collateral by FCMs and in most respects replicates the client protection regime for regulated futures. CFTC regulation 22.2 requires segregation from proprietary funds of the FCM but allows operational commingling so long as one customer's funds are not used to margin or guarantee the positions of another.

In addition, the CFTC has separate regulations regarding custodial arrangements for initial margin posted by a SD for which there is no prudential regulator pursuant to Section 4s(e) of the CEA, which requires the CFTC to promulgate margin requirements for uncleared swaps applicable to a SD for which there is no prudential regulator.

The Commission's requirements relating to segregation, CFTC regulation 23.157(a), requires that SDs that post initial margin with respect to an uncleared swap shall require that all funds or other property that the covered swap entity provide as initial margin be held by one or more custodians that are not the SD, the counterparty, or affiliates of the SD or the counterparty. Such requirements are also applicable under CFTC regulation 23.157(b) where the SD collects initial margin that is required to be collected pursuant to the Commission's uncleared margin regulations.

CFTC regulation 23.157(c) requires the custodian to act pursuant to a custodial agreement that is legal, valid, binding and enforceable under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or similar proceedings. Such a custodial agreement must prohibit the custodian from rehypothecating, repledging, reusing, or otherwise transferring the funds or other property held by the custodian.

13. Does the regulatory framework require market intermediaries to provide for an efficient and effective mechanism to address investor complaints?

Yes. CFTC regulation 166.5 sets forth the requirements that must be included in a customer account agreement with respect to dispute resolution procedures, including the use of arbitration procedures. Three fora exist for the resolution of disputes: civil court litigation, CFTC reparations proceedings, and arbitration conducted by an SRO or other private organization. An agreement to submit to arbitration must be voluntary and the intermediary must not require the customer to waive its right to seek reparations under Section 14 of the CEA and Part 12 of the CFTC's regulations.

CFTC regulation 23.504 requires SDs and MSPs to execute written trading relationship documentation with their counterparties, which must cover all terms governing the trading relationship, including dispute resolution. Additionally, CFTC regulation 23.201(b)(3) requires that SDs and MSPs retain records of any complaint received, including the disposition of the complaint and the date the complaint was resolved.

14. Does the regulatory framework require market intermediaries to identify, and verify, the client's identity using reliable, independent data, including persons who beneficially own or control securities?

Yes. CFTC regulation 23.402(b) requires each SD to implement policies and procedures to obtain and retain a record of the essential facts concerning each counterparty whose identity is known to the SD prior to the execution of a transaction that are necessary for conducting business with that counterparty, including facts required to comply with applicable laws and regulations; facts required to implement the SD's credit and operational risk management policies in

connection with transactions entered into with such counterparty; and information regarding the authority of any person acting for such counterparty. CFTC regulation 23.402(c) requires the SD or MSP to obtain a record showing the true name and address of each counterparty whose identify is known to the SD or MSP prior to the execution of the transaction, the principal occupation or business of such counterparty, and the name and address of any other person guaranteeing the performance of such counterparty and any person exercising any control with respect to the positions of the counterparty.

CFTC regulation 1.37 requires each FCM, RFED, IB, and member of a contract market to keep a record in permanent form which shall show for each commodity interest account carried or introduced by it the true name and address of the person for whom such account is carried or introduced, the principal occupation or business of such person, and the name of any other person guaranteeing such account or exercising any trading control with respect to such account. For each commodity option account, the records kept by the intermediary must also show the name of the person who has solicited and is responsible for each customer's account or assign account numbers in such a manner to identify that person.

15. Does the regulatory framework require market intermediaries to obtain and retain information from a client about their circumstances and investment objectives relevant to the services to be provided?

Yes. CFTC regulation 23.402(b) requires SDs to implement policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning each counterparty whose identify is known to the SD prior to the execution of the transaction that are necessary for conducting business. CFTC regulation 23.402(c) requires the SD or MSP to obtain a record showing the true name and address of each counterparty whose identify is known to the SD or MSP prior to the execution of the transaction, the principal occupation or business of such counterparty, and the name and address of any other person guaranteeing the performance of such counterparty and any person exercising any control with respect to the positions of the counterparty. CFTC regulation 23.430 requires an SD or MSP to verify that a counterparty meets the eligibility standards for an ECP, as that term is defined by the CEA, before offering to enter into a swap with that counterparty.

NFA Compliance Rule 2-30 requires the intermediary to know the customer's current estimated annual income and net worth and previous investment and futures trading experience.

16. Does the regulatory framework require a market intermediary to “know its customer” before providing specific advice to a client?

See responses to Principle 31, Questions 14 and 15, above.

17. Does the regulatory system require that intermediaries, as defined in IOSCO's Report on

| |
|--|
| <p>Suitability Requirements with respect to the Distribution of Complex Financial Products adopt and apply appropriate policies and procedures to distinguish between retail and non-retail customers when distributing complex financial products?</p> |
| <p>Yes. Pursuant to Section 2(e) of the CEA, it is unlawful for any person other than an ECP to enter into an OTC derivative transaction unless such transaction is entered into on a DCM. "ECP" is defined in Section 1a(18) of the CEA to exclude retail customers. Thus, in general, complex financial products in the form of OTC derivatives cannot be distributed to retail customers.</p> |
| <p>18. Does the regulatory framework require market intermediaries to keep records containing the above information for a reasonable number of years? Is the market intermediary required to maintain those books and records in such a way that allows the supervisor to be able to find all the relevant facts relating to a particular transaction?</p> |
| <p>Yes. Section 4s(g)(1) of the CEA requires SDs and MSPs to maintain daily trading records and all related records (including records of related cash and forward transactions) and recorded communications, including electronic mail, instant messages, and recordings of telephone calls. Section 4s(g)(3) of the CEA requires that daily trading records for swaps be identifiable by counterparty, and CEA Section 4s(g)(4) specifies that SDs and MSPs maintain a "complete audit trail for conducting comprehensive and accurate trade reconstructions." CFTC regulations in Part 23 require records to be maintained which include full and complete transaction and position information for all swap activities, including all documents on which trade information is originally recorded. Transaction records are required to be maintained in a manner that is identifiable and searchable by transaction and by counterparty. The CFTC regulations also require SDs and MSPs to keep basic business records, including, among other things, minutes from meetings of the entity's governing body, organizational charts, and audit documentation. Additionally, certain financial records, records of complaints against personnel, and marketing materials are required to be kept. Finally, SDs and MSPs are required to maintain records of information required to be submitted to an SDR and reported on a real-time public basis. All records are required to be maintained for a period of five years following the termination, expiration or maturity of a swap, with the exception of voice records which must be retained for one year.</p> <p>CFTC regulation 1.31 requires all books and records required by the CEA and CFTC regulations to be kept for a period of five years and records kept exclusively on paper to be readily accessible during the first 2 years of the 5-year period. All books and records must be open to inspection by any representative of the CFTC or DOJ. The relevant recordkeeping provisions of several CFTC regulations, which cover records pertaining to segregated funds, account activity, financial condition, customer protection, and other matters, are summarized below.</p> <p>CFTC regulation 1.18 requires FCMs and IBs to prepare and keep current ledgers which show each transaction affecting asset, liability, income, expense and capital</p> |

accounts consistent with the classifications specified on the Form 1-FR (or the FOCUS Report if a securities broker-dealer).

CFTC regulation 1.27 requires each FCM that invests customer funds to keep a record showing the details of the investment, including the size and type of investment, the date of the investment, and any disposition made of the investment.

CFTC regulation 1.32 requires an FCM to compute each day the customer funds in segregated accounts and the FCM's residual interest in those funds, and to keep a record of each such computation.

CFTC regulation 1.33(a) requires that FCMs prepare a statement for each futures or options on futures customer which shows the open contracts acquired or pertinent options transactions and their prices, the net unrealized prices in all open contracts marked to the market, any customer funds carried with the FCM and a detailed accounting of all credits and charges to the customer's account for the month. If there is no activity in an account, an account statement need only be prepared every three months. CFTC regulation 1.33 (b) requires that each FCM must furnish no later than the next business day: (1) a written confirmation of each futures transaction; or (2) a written confirmation of an options transaction containing the account identification number, a statement of the CFTC, premium or other applicable option charges, the strike price, the underlying futures contract or underlying physical, the final exercise date of the option and the date the transaction was executed.

CFTC regulation 1.34 requires each FCM to prepare a monthly balance of all open positions which brings to the closing or settlement price all open futures and option positions.

CFTC regulation 1.35(a) contains general recordkeeping requirements for FCMs and IBs with respect to futures, commodity options, and cash commodity transactions. FCMs and IBs must keep full, complete, and systematic records, together with all pertinent data and memoranda. Records to be kept include all orders (filled, unfilled, or cancelled), trading cards, signature cards, street books, journals, ledgers, cancelled checks, copies of confirmations, copies of statements of purchase and sale, and all other records, data and memoranda which have been prepared in the course of the firm's business.

CFTC regulation 1.35(d) requires that the FCM maintain a financial ledger record for each customer account showing credits, debits, deposits, withdrawals or transfers, and charges or credits resulting from losses or gains on closed positions, along with a central activity record or journal showing all transactions made each day by the FCM, with trade details and the identity of the trader.

CFTC regulation 1.36(a) requires FCMs to maintain records of all securities and property received from customers to margin, purchase, guarantee, or secure a futures or exchange-traded option transaction. The records must show where the

property is deposited and any other disposition of the property.

CFTC regulation 1.37(a) requires FCMs and IBs to keep a record of each account carried or introduced, the name and address of the person for whom such account is carried or introduced, and such person's principal occupation or business. The record must also show the name of any person guaranteeing the account or exercising any control over it.

CFTC regulation 1.37(b) requires each FCM carrying a futures or options omnibus account for another FCM, foreign broker, or other person to maintain a daily record of the positions in each such account.

CFTC regulation 1.40 imposes certain recordkeeping requirements relating to crop or market information or conditions that affect or tend to affect the price of any commodity.

19. Does the regulatory framework require market intermediaries to provide to the client a written contract of engagement or account agreement, or a written form of the general and specific conditions of doing business through the market intermediary?

Yes. CFTC regulations 23.402(a)-(e) require an SD or MSP to provide its counterparty with information regarding its policies and procedures to prevent evasion of CFTC regulations, facts regarding the identity of the counterparty, and the SD's or MSP's ability to reasonably rely on its counterparty's representations. Further, transactions must be specifically authorized; customer information as discussed above must be obtained; risk disclosure must be provided, signed and retained; and monthly account statements and confirmations must be provided.

CFTC regulation 23.504 requires each SD or MSP to execute written trading relationship documentation with each counterparty prior to entering into an OTC derivative transaction with such counterparty. Such documentation must include all terms governing the relationship between the SD or MSP and its counterparty, including terms addressing payment obligations, netting of payments, events of default, calculation and netting of obligations upon termination, governing law, valuation, and dispute resolution. In addition, such documentation must include credit support arrangements, where applicable.

CFTC regulation 1.55 requires customer risk disclosures as well as FCM-specific public disclosures of firm-specific information as well.

20. Does the regulatory framework require a market intermediary to disclose, or make available, information to its client so that the client can make an informed investment decision?

Yes. CFTC regulation 23.431 requires an SD or MSP to disclose to non-dealer counterparties, material information concerning the swap in a manner reasonably designed to allow the counterparty to assess the material risks and characteristics

of the swap and the incentives and conflicts of interest that the SD or MSP may have in connection with the swap. This CFTC regulation also requires SDs to notify its counterparty, prior to entering into a swap with a non-SD or MSP counterparty that is not made available for trading on a DCM or SEF, that the counterparty can request and consult on the design of a scenario analysis to allow the counterparty to assess its potential exposure in connection with the swap. Upon such request, the SD must provide a scenario analysis, which is designed in consultation with the counterparty and done over a range of assumptions, including severe downside stress scenarios that would result in a significant loss. The SD must also disclose all material assumptions and explain the calculation methodologies used to perform any requested scenario analysis. In designing any requested scenario analysis, the SD must consider any relevant analyses that the SD undertakes for its own risk management purposes.

CFTC regulation 33.7 requires FCMs and IBs, prior to opening a commodity option account, to furnish the customer with a written risk disclosure statement and to receive from the customer a signed acknowledgement that the risk disclosure statement has been received and understood.

CFTC regulation 1.55 requires FCMs to provide customers with a written statement disclosing the risks of trading, as well as disclosures of firm specific information and the protection of customer funds. The topics covered in the risk disclosure statement include the potential loss of the total amount of funds deposited and losses beyond those amounts, the possibility of margin calls and the liquidation of positions if such calls are not met, the possibility that a position cannot be liquidated when desired, the possibility that "stop-loss" orders may not be executable, the acknowledgement that spread transactions may not be less risky than long or short trades, and the notice that the leverage in futures trading can result in large losses as well as large gains. The statement also urges the customer to consider his or her own suitability for trading and to study futures trading carefully before committing funds.

21. Does the regulatory framework require market intermediaries to provide a client with statements of account (including details on the client assets held for or on behalf of such a client) on a regular basis (at least annually) and reasonably promptly upon request?

Yes. With respect to cleared swaps, CFTC regulation 23.431(d) requires SDs and MSPs to notify non-SD or MSP counterparties of the counterparty's right to receive the daily mark from the appropriate DCO. For uncleared swaps, the SD or MSP must provide the non-SD or MSP counterparty with a daily mark which shall be the mid-market mark of the swap. The mid-market mark of the swap must not include amounts for profit, credit reserve, hedging, funding, liquidity, or any other costs or adjustments. The daily mark must be provided to the counterparty during the term of the swap as of the close of business or such other time as the parties agree in writing.

CFTC regulation 1.32 requires FCMs to compute as of the close of each business day, on a currency-by-currency basis, the total amount of customer funds on deposit in segregated accounts; the amount of customer funds required by the CEA and CFTC regulations to be on deposit in segregated accounts on behalf of the customer; and the amount of the FCM's residual interest in such customer funds. CFTC regulation 1.33 requires FCMs to provide each customer with a monthly account statement regarding the details of transactions in its account, as well as charges and credits to the account. The FCM also must provide confirmation statements of each transaction by the next business day following the transaction.

22. Does the regulatory framework require market intermediaries to provide a client with information about any fees and commissions associated with the client's transactions?

Yes. CFTC regulation 23.431(a) requires an SD or MSP to make disclosures of material information concerning a swap to its counterparty in every swap transaction, including the pre-trade mid-market mark of the swap.¹²⁶ Such disclosures provide important pricing information about the spread between the quote and mid-market mark that facilitates negotiations and balances historical information asymmetry regarding swap pricing. Additionally, where an SD or MSP transacts with a Special Entity,¹²⁷ the SD or MSP must disclose all fees and compensation structures in a manner clearly understandable to the Special Entity.¹²⁸

NFA Compliance Rule 2-4 provides that "Members and Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business." NFA Compliance Rule 2-4 requires that each FCM member, or in the case of introduced accounts, the IB, to make available to its customers, prior to the commencement of trading, information concerning the costs associated with futures transactions.¹²⁹ If fees and charges associated with futures transactions are not determined on a per trade or round-turn trade basis, the member must provide the customer with a complete written explanation of such fees and charges. The NFA recognizes that FCM and IB

¹²⁶ The requirements of CFTC regulation 23.431(a) do not apply to swaps that are transacted anonymously on a DCM or SEF.

¹²⁷ "Special Entity" is defined by CFTC regulation 23.401(c) as a federal, state, city, county, municipality or other political subdivision of a state; an employee plan subject to Title I of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); any governmental plan, as defined in Section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); any endowment, including an endowment that is an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(c)(3)); or any employee benefit plan defined in Section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002), not otherwise defined as a Special Entity, that elects to be a Special Entity by notifying a swap dealer or major swap participant of its election prior to entering into a swap with the particular swap dealer or major swap participant.

¹²⁸ See *Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties*, 77 FR 9734, 9797 (Feb. 17, 2012).

¹²⁹ NFA Bylaws define "futures" to include exchange-traded options. See NFA Compliance Rule 1-1(l).

| | |
|-----|---|
| | members may employ various arrangements in assessing fees and charges associated with futures transactions to customers. Any such arrangement which is intended to or is likely to deceive customers is a violation of NFA Requirements and will subject the member to disciplinary action. |
| 23. | Does the regulatory regime require that disclosures of key information regarding collective investment schemes (CIS) to retail investors in their distribution prior to the point of sale be clear, accurate and not misleading to the target investor? |
| | Not applicable to the CFTC. |
| 24. | Does the regulatory framework require market intermediaries to act with due care and diligence in the best interests of its clients and their assets and in a way that helps preserve the integrity of the market? |
| | <p>Yes. Part 23 of the CFTC's regulations requires, among other things that SDs and MSPs communicate in a fair and balanced manner based on principles of fair dealing and good faith with respect to any communication between the SD or MSP and any counterparty,¹³⁰ and prohibit fraud, manipulation, and other abusive practices.¹³¹ An SD acting as an advisor to a Special Entity has a duty to make a reasonable determination that any swap or trading strategy involving a swap recommended by the SD is in the best interests of the Special Entity.¹³² The SD must also make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any swap or trading strategy involving a swap recommended by the SD is in the best interest of the Special Entity.¹³³</p> <p>NFA Compliance Rule 2-4 provides that "Members and Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business." NFA Compliance Rule 2-36(c) similarly provides that "Forex Dealer Members and their Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their forex business."</p> |
| 25. | Can the regulator demonstrate that it has in place a supervision program, including internal processes that seek to monitor compliance by market intermediaries with these requirements? |
| | To help ensure compliance by registrants with operational conduct requirements, CFTC regulation 166.3 requires each registrant, to "diligently supervise" the |

¹³⁰ CFTC regulation 23.433.

¹³¹ CFTC regulation 23.410.

¹³² See CFTC regulation 23.440(c)(1).

¹³³ See CFTC regulation 23.440(c)(2).

handling by its partners, officers, employees and agents of all activities relating to its business as a CFTC registrant. CFTC regulation 1.52 prescribes the requirements of the DSRO examination program for compliance. The CFTC's DSIO examinations staff works with the DSROs to monitor how they carry out CFTC regulation 1.52 examination functions, including performing desk reviews of FCM examination workpapers, as well as performing their own on-site FCM examinations for cause. DSRO examination cycles of FCMs must take place between nine and 15-month frequency.

The DSIO examinations staff today performs only high-level, limited-scope (thematic) reviews of the approximately 63 FCMs holding over \$260 billion in customer funds. Since 2015, this consisted of limited-scope reviews of 132 FCMs in the areas of liquidity, cyber-security, Volcker rule compliance (Part 75 of CFTC regulations), target residual interest in customer fund accounts, withdrawals of residual interest, investment of customer funds, and location of depositories. DSIO examinations staff also performed a number of "for-cause" reviews of FCMs during this period.

Please refer to NFA for information on NFAs periodic, for-cause, and thematic examinations of FCMs, IBs, CTAs, CPOs, SDs, and RFEDs (there are currently no registered MSPs).

Summary of CFTC Enforcement Actions: 2015-2019:

| | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 (Through 6/19/2019) |
|---|---------------|---------------|---------------|---------------|----------------------------------|
| Overview | | | | | |
| Number Of Enforcement Actions Charging Intermediaries* | 28 | 24 | 15 | 23 | 3 |
| Total Amount of Civil Monetary Penalties Imposed In Those Actions | \$1.7 Billion | \$537 Million | \$249 Million | \$1.5 Billion | \$12 Million |
| General Categorization of Primary Misconduct Charged | | | | | |
| Fraud | 4 | 5 | 2 | 2 | 2 |
| Manipulation, Attempted Manipulation, False Reporting, Disruptive Trading | 7 | 2 | 5 | 11 | 0 |
| Misappropriation of Material, Non Public, Confidential Information, Misconduct by Employees against their Employers | 0 | 1 | 0 | 1 | 0 |

UNITED STATES

U.S. COMMODITY FUTURES TRADING COMMISSION

| | | | | | |
|--|---|---|---|---|---|
| Other Trade Practice | 1 | 2 | 0 | 1 | 0 |
| Protection of Customer Funds, Supervision, and Financial Integrity | 7 | 7 | 4 | 4 | 1 |
| Reporting, Recordkeeping | 7 | 7 | 4 | 4 | 0 |
| Statutory Disqualification | 2 | 0 | 0 | 0 | 0 |
| *Intermediaries include the following entities that are registered with the CFTC: CPOs, CTAs, FCMs, IBs, RFEDs, and SDs. | | | | | |

Principle 32 **There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.**

Key Questions (please answer with respect to market intermediaries that are direct participants in trading venues, providers of direct electronic access to such venues and/or first tier direct electronic access clients, and operators of trading venues)

1. Does the regulator have clear plans for dealing with the eventuality of a firm's failure, including a combination of activities: to restrain conduct; to ensure assets are properly managed; and to provide information to the market, as necessary?

Yes. The CEA and CFTC regulations, in conjunction with the Bankruptcy Code, provide a clear framework for the CFTC and the insolvency officer (trustee) to follow in managing the failure of an FCM.

Early Warning Mechanisms. As described above, all FCMs are monitored by a DSRO¹³⁴ for compliance with the CEA and CFTC regulations, including CFTC

¹³⁴ As mentioned above, an SRO (*i.e.*, a DCM or RFA) has the responsibility for ensuring that an FCM complies with the CEA and the CFTC regulations. The term “DSRO” refers to the SRO that is primarily responsible for a specific FCM. If an FCM is a member of more than one SRO, all relevant SROs may decide among themselves which of them will be primarily responsible for that FCM, and that SRO will be appointed the DSRO for that FCM.

regulation 1.17 (e.g., minimum capital requirement), as well as CEA Section 4d(a)(2) and CFTC regulations 1.20-1.30 (e.g., treatment of customer property).

Additionally, if an FCM is executing transactions on a DCM, then such FCM is required to clear such transactions through a DCO.¹³⁵ In order to clear such transactions, the FCM generally must be a member of the DCO,¹³⁶ and must therefore comply with the rules of the DCO, especially those pertaining to

¹³⁵ See CEA Section 5(b)(5) (stating that, in order to become designated as a DCM, an entity must “establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into by or through the facilities of the contract market, including the clearance and settlement of the transactions with a derivatives clearing organization”).

A DCO is a central counterparty, and thus “interposes itself between counterparties” to commodity contracts, thereby “becoming the buyer to every seller and the seller to every buyer.” See Annex H (Glossary to CPSS-IOSCO *Principles for Financial Market Infrastructures*). A DCO guarantees that a member with net gains on its positions will receive related amounts, even if the DCO cannot collect such amounts from a member with net losses on its positions. Thus, a DCO is essential to managing systemic and counterparty risks in the event that a member fails.

To obtain and maintain its registration, a DCO must comply with 18 core principles established in Section 5b of the CEA and Part 39 of the CFTC regulations.

The CFTC evaluates compliance with the core principles when reviewing DCO applications, and for DCOs that are already registered, the CFTC performs periodic reviews to assess their compliance with the core principles on an ongoing basis. Such reviews may focus on one or two core principles and assess the compliance of multiple DCOs with those particular core principles (horizontal review), or it may focus on a particular DCO and the compliance of that DCO with multiple core principles (vertical review). In evaluating DCO applications and performing core principle reviews, CFTC staff members consider not only documentary information, but also conduct on-site visits and independent analysis and testing, if appropriate. CFTC staff members draft confidential memoranda summarizing their conclusions with respect to DCO applications and core principle reviews, and the CFTC bases its actions on such memoranda.

¹³⁶ Most large FCMs are members of a DCO. If an FCM is not a member of a particular DCO (Non-Clearing FCM), it may become a customer of, and thereby clear transactions through, an FCM that is a member of that DCO (Clearing FCM). The Clearing FCM monitors the compliance of the Non-Clearing FCM with payment obligations. Pursuant to CFTC regulation 1.12(f)(2), the Clearing FCM has an affirmative responsibility to notify the CFTC whenever it determines that it must immediately liquidate or transfer the positions of a Non-Clearing FCM, or limit the Non-Clearing FCM to trading for liquidation only, because the Non-Clearing FCM has failed to meet its payment obligations to the Clearing FCM.

payments and settlements. The FCM is monitored by the DCO for compliance with such rules.

Given the regulatory structure described above, the CFTC has a number of methods for ascertaining when an FCM may be experiencing financial distress. First, an FCM has affirmative responsibilities under CFTC regulations to notify the CFTC upon the occurrence of one of a number of events, any of which may indicate financial distress. For example, pursuant to CFTC regulation 1.12:

- an FCM must provide the CFTC with notice within 24 hours, if such FCM knows or should know that its capital exceeds its minimum capital requirement, but only by an amount that is less than a certain percentage specified in CFTC regulation 1.12;¹³⁷
- an FCM must provide the CFTC with immediate notice, if such FCM knows or should know that its capital is less than the amount specified in its minimum capital requirement;¹³⁸
- as mentioned above, an FCM must provide the CFTC with immediate notice, if such FCM determines that it has insufficient segregated property; and
- an FCM must provide the CFTC with immediate notice, if such FCM determines that a customer account is under margined by an amount that exceeds the adjusted net capital of such FCM.¹³⁹

Second, the CFTC may receive information from a DSRO or a DCO that an FCM is either currently not fulfilling its financial obligations, or has a risk profile indicating that it may shortly become unable to fulfill such obligations. Third, the RSG in DCR may identify such an FCM.¹⁴⁰

¹³⁷ Pursuant to CFTC regulation 1.10(b)(1)(i), the FCM must provide, on a monthly basis, certain financial information to the CFTC, in a Form 1-FR (or an equivalent SEC report, if the FCM is also a broker-dealer). However, the CFTC may require, pursuant to CFTC regulation 1.12, the FCM to provide interim financial information, to facilitate CFTC monitoring of such FCM.

¹³⁸ Pursuant to CFTC regulation 1.12, the FCM must provide, within twenty-four (24) hours of such notice, certain financial information to the CFTC, in a Form 1-FR (or an equivalent SEC report, if the FCM is also a broker-dealer).

¹³⁹ See CFTC regulation 1.12.

¹⁴⁰ The RSG, as described further below, endeavors on a daily basis: (i) to identify any significant financial risks posed by positions in products that (A) an FCM clears through a DCO, and (B) fall within the jurisdiction of the CFTC; and (ii) to confirm that such financial risks are being appropriately managed.

Management of Potential FCM Failure Pre-Bankruptcy. If the CFTC ascertains, from the mechanisms described above, that an FCM may be experiencing financial distress, the CFTC will attempt to determine whether there is a significant likelihood that the FCM will fail.¹⁴¹ The CFTC first gathers information from the DSRO, any other relevant SRO, and relevant DCOs on the financial resources available to the FCM (including the liquidity of such resources). The CFTC then gathers information, from the same sources, on the potential causes of financial distress at the FCM (*e.g.*, extreme market volatility, or concentration of proprietary or customer positions opposite to the direction of the market), and on losses that the FCM has already sustained, or will likely sustain, from such causes. The CFTC finally considers the extent to which the FCM will be able to cover its current or future losses using its available financial resources.

If the CFTC determines that an FCM is likely to fail, then it will attempt:

- to cause the transfer of customer accounts. For example, pursuant to CFTC regulation 1.17(a)(4), if an FCM holds less capital than the amount specified in its minimum capital requirement, then it generally must transfer all customer accounts and immediately cease conducting business as an FCM, until such time as the FCM is able to demonstrate compliance with its minimum capital requirement. The FCM itself or its DSRO would actually arrange the transfer of customer accounts. The role of the CFTC would be to facilitate such transfer as necessary (*e.g.*, grant relief from certain notice requirements applicable to such transfer under CFTC regulation 1.65);
- to determine the effects that such failure would have on the counterparties of the FCM, as well as on the futures markets. In most instances, if the FCM is clearing transactions through a DCO, the failure would cause minimal disruption to counterparties and the futures markets. See the section below entitled “Proper Management of Systemic and Counterparty Risks (Whether Pre-Bankruptcy or After Bankruptcy).”

If the CFTC determines that an FCM is not likely to fail, then it may permit the FCM to continue operations without transferring customer accounts, despite the financial distress experienced by the FCM. For example, even if the FCM violates its minimum capital requirement, the CFTC or the relevant DSRO has the discretion, pursuant to CFTC regulation 1.17(a)(4), to allow the FCM a maximum of ten days to achieve compliance with such requirement, without transferring customer accounts

¹⁴¹ In many cases, CFTC staff will receive notice from an FCM for less serious reasons, such as when a clerical error causes the capital of an FCM to temporarily fall below the percentage specified in CFTC regulation 1.12. Such notice will generally reveal that the error has been corrected.

and ceasing business, provided that the FCM immediately demonstrates to the CFTC or the DSRO its ability to achieve compliance within that time period. In determining whether the FCM has met its demonstration burden, the DSRO and the CFTC are in routine contact and work cooperatively.

Management of FCM Bankruptcy. If an FCM becomes the subject of bankruptcy proceedings, then Subchapter IV of Chapter 7 of the Bankruptcy Code (Subchapter IV), in conjunction with CFTC regulation Part 190 (Part 190), would govern such proceedings. As described below, Subchapter IV and Part 190 set forth a clear structure for the liquidation of a commodity broker, including an FCM.

This structure promotes the prompt and effective transfer of customer positions and associated collateral to a financially solvent transferee FCM, or the prompt return of customer property.

Restraints on Conduct. Pursuant to CFTC regulation 190.04(d)(2), the trustee appointed to administer the bankruptcy proceedings of an FCM is not permitted to purchase or sell new commodity contracts for the customers of such FCM, with the exceptions noted below. In general, CFTC regulation 190.04(d)(2) presumes that an FCM subject to bankruptcy proceedings is insolvent and, therefore, that such FCM does not have sufficient capital to operate its business, which business may include supporting the credit of its customers or performing on other obligations. Thus, in restricting the conduct of the trustee, CFTC regulation 190.04(d)(2) aims to minimize the risk of loss to customers of the FCM.

However, CFTC regulation 190.04(d)(2) recognizes that, even where an FCM is insolvent, certain purchases or sales of new commodity contracts may be risk-reducing, and thus may prevent material erosion in value of open commodity contracts constituting customer assets. Therefore, CFTC regulation 190.04(d)(2) permits the trustee to engage in such purchases or sales to achieve any of the following purposes: (i) to offset an open commodity contract; (ii) to transfer any transferable notice applicable to an open commodity contract; or (iii) to cover or partially cover, with the approval of the CFTC, inventory or commodity contracts of the FCM that cannot be immediately liquidated due to market conditions (including price limits).

Moreover, CFTC regulation 190.04(d)(3) provides an exception, permitting the trustee, with the written permission of the Commission, to operate the business of the debtor in the ordinary course, including the purchase or sale of new commodity contracts on behalf of the customers of the debtor under appropriate circumstances, such as where a transfer has been arranged but has not yet been approved or completed.

Proper Management of Assets.

Pre-Petition Transfers. If, pursuant to regulation 1.17(a)(4), the FCM had transferred customer accounts before becoming subject to bankruptcy proceedings, then Section 764(b) of the Bankruptcy Code, in conjunction with CFTC regulation 190.06(g)(1)(i), would protect such transfer from avoidance by the trustee. Specifically, Section 764(b) of the Bankruptcy Code prohibits a trustee from avoiding a transfer of customer positions in a commodity contract (and the collateral securing such positions), if the FCM made such transfer prior to seven calendar days after becoming subject to bankruptcy proceedings, and if the CFTC had approved such transfer by rule or order. In general, the CFTC has approved such transfer by promulgating CFTC regulation 190.06(g)(1)(i), which prohibits a trustee from avoiding a transfer of customer accounts pursuant to CFTC regulation 1.17(a)(4), unless the CFTC has specifically disapproved such transfer.

Post-Petition Transfer. An FCM may become subject to bankruptcy proceedings before it transfers customer accounts pursuant to CFTC regulation 1.17(a)(4). In that case, CFTC regulation 190.02(e) requires the trustee to immediately use its best efforts to transfer eligible customer accounts, as determined in accordance with CFTC regulation 190.06(e) and (f). If the trustee makes such transfer prior to seven calendar days after the FCM becomes subject to bankruptcy proceedings, then Section 764(b) of the Bankruptcy Code, in conjunction with CFTC regulation 190.06(g)(2), would protect such transfer from later attempts at avoidance.

Distribution of Assets in Customer Accounts. If the trustee determines, in accordance with CFTC regulation 190.06(e) and (f), that certain customer accounts are not eligible for transfer, then the trustee must liquidate, in accordance with CFTC regulation 190.02(f), the positions and accompanying collateral held in such accounts. As a practical matter, transfers of such accounts may be (and, in most cases have been) permitted, with the consent of the Commission.

With respect to customer collateral that is not transferred, the trustee must distribute the proceeds. Section 761(10) of the Bankruptcy Code characterizes such proceeds as "customer property." Section 766(h) of the Bankruptcy Code requires the trustee to distribute "customer property" to customers of the FCM, "in priority to all other claims," except claims attributed to the administration of such property. Therefore, under Section 766(h) of the Bankruptcy Code, "customer property" will be used to satisfy the claims held by customers of an FCM, until and unless this is fully accomplished. Accordingly, customer property is not available to satisfy the claims held by other creditors of such

FCM, with the exception of claims attributed to the cost of administration of “customer property.”

Section 766(h) of the Bankruptcy Code further requires the trustee to allocate “customer property” among customers of an FCM *pro rata*, on the basis of “allowed net equity claims.” CFTC regulation 190.08 specifies the manner in which the trustee must calculate such claims for each customer. *Pro rata* allocation provides a method for mutualizing any shortfalls in “customer property” in a fair and efficient manner that fosters prompt transfer of customer positions and associated collateral.

As described above, Section 4d(a)(2) of the CEA ensures the integrity of “customer property” by requiring that an FCM: (i) treat all collateral securing the positions of a customer, as well as all amounts accruing to such positions, as belonging to such customer; (ii) separately account for such collateral and amounts; and (iii) refrain from (A) commingling such collateral and amounts with proprietary funds, and (B) using the collateral and amounts belonging to one customer to margin or guarantee the transactions of, or to secure or extend credit to, another customer. As described above, the CFTC implemented Sections 4d(a)(2) and 4d(f) of the CEA by promulgating CFTC regulations 1.20 to 1.30, and, for swaps, Part 22, which address the treatment of customer property, including investments of such property by an FCM.

Provision of Information to the Market. CFTC regulation 190.02(a) requires: (i) an FCM filing a voluntary bankruptcy petition to notify the CFTC, as well as its DSRO, upon or before making such filing; and (ii) an FCM subject to an involuntary bankruptcy petition to notify the CFTC, as well as its DSRO, no later than one business day after the FCM receives information of such petition. Upon receiving such notification, both the CFTC and the DSRO will have the ability to provide information regarding such bankruptcy petition to the public, as necessary.

As a practical matter, FCM insolvencies receive prompt and widespread media coverage.

Proper Management of Systemic and Counterparty Risks (Whether Pre-Bankruptcy or After Bankruptcy). In general, if a DCO currently cannot collect payments from a member, or if a DCO believes that it will shortly be unable to collect such payments,¹⁴² the DCO will declare the member to be in default. The

¹⁴² In general, if a DCO suspects that a member will shortly be unable to make scheduled payments, a DCO would request that such member deposit additional performance bond. If the member is unable to make such deposit, then the DCO would declare such member to be in default.

| | |
|-----|--|
| | <p>rules of the DCO would govern the management of such default. Usually, such rules would permit: (i) the DCO to liquidate or transfer positions carried by the defaulting member; (ii) the DCO to access all property held in the proprietary accounts of the defaulting member; (iii) the DCO to access all property held in the customer account of the defaulting member, to the extent that the default of the member to the DCO resulted from the default of a customer to the member; and (iv) the DCO to access any amounts that the defaulting member had contributed to the guarantee fund. If the proceeds from (i) through (iv) do not cover all DCO losses, then the rules of the DCO may permit: (A) the DCO to access the amounts that non-defaulting members had contributed to the guarantee fund; (B) the DCO to look to its own capital; and (C) the DCO to levy an assessment on all members.</p> <p>The U.S. Bankruptcy code provides a variety of "safe harbor" provisions by preventing the avoidance of margin payments and protecting transfers of customer positions and associated collateral from reversal.¹⁴³</p> |
| 2. | <p>Are there early warning systems or other mechanisms in place to give the regulator notice of a potential default by a market intermediary, and time to address the problem and take corrective actions?</p> |
| | <p>Yes. See response to Principle 32, Question 1.</p> |
| 3. | <p>Does the regulator have the power to take appropriate actions: In particular, can it:</p> |
| (a) | <p>Restrict activities of the market intermediary with a view to minimizing damage and loss to investors?</p> |
| | <p>Yes. See response to Principle 32, Question 1.</p> |
| (b) | <p>Require the market intermediary to take specific actions, for example, moving client accounts to another market intermediary?</p> |
| | <p>Yes. See response to Principle 32, Question 1.</p> |
| (c) | <p>Request appointment of a monitor, receiver, curator or other administrator, or, in the absence of such power, can the regulator apply to the relevant authorities to take possession or control of the assets held by the market intermediary or by a third party on behalf of the intermediary?</p> |
| | <p>Yes. Pursuant to Section 6(c) of the CEA, the CFTC has the authority to request the appointment of a monitor, receiver, curator or other administrator, with respect to an FCM that the CFTC has reason to believe is violating or has violated any provision in the CEA and the CFTC regulations.</p> |

¹⁴³ See, e.g., 11 U.S.C. 362(b)(6), (7); 11 U.S.C. 556; 11 U.S.C. 764.

| |
|---|
| <p>(d) Apply other available measures intended to minimize client, counterparty and systemic risk in the event of intermediary failure, such as, client and settlement insurance schemes, or guarantee funds?</p> |
| <p>Yes. See response to Principle 32, Question 1. There is no insurance scheme or guarantee fund for customer recompense in the event of intermediary failure in the case of a shortfall in customer property, although there are significant regulatory requirements to keep customer property fully segregated to identify a shortfall quickly and transfer business, and provide priority claims to customer property under bankruptcy.</p> |
| <p>4. Can the regulator demonstrate that it has the power and practical ability to take these actions against a market intermediary?</p> |
| <p>To date, FCMs with customers trading exchange-traded futures and options on futures have been able to absorb some losses without causing any loss to their customers, and to wind down their business without disrupting the orderly functioning of markets. Even in a situation in which there appeared to be improper transfers of customer property resulting in a very significant deficiency in customer property developing over the course of a few days (MF Global), the FCM was immediately placed in Securities Investor Protection Corporation (SIPC) resolution when the deficiency in customer property was identified, which was the next business day. Customer accounts were transferred within hours and days, and market disruption was avoided. Although there was a shortfall in customer accounts, the bankruptcy process has enabled the satisfaction in full of all allowed net equity claims. Following the failure of MF Global, significant new enhancements have been made to the CFTC's customer protection regime, including new requirements for FCM policies and procedures, reporting, independent CFTC and DSRO verification of balances with depositories, daily segregation reporting, additional firm specific disclosure, and risk management program requirements.</p> |
| <p>5. Do the regulator's processes and procedures for addressing financial disruption include communication and cooperation with other regulators, both domestic and foreign, where appropriate, and is there evidence that contact arrangements are in place, and that such cooperation occurs?</p> |
| <p>Yes. As a routine matter, the CFTC communicates and cooperates with other regulators, both domestic and foreign, on areas of mutual interest. With respect to potential financial disruption, the CFTC communicates and cooperates with the appropriate domestic and/or foreign regulator. The CFTC also formally interacts with other financial regulatory agencies through its participation in FSOC and staff working groups thereunder. If the CFTC wishes to share non-public information with another regulator, it does so pursuant to an MOU or a less formal</p> |

arrangement in order to ensure that the requirements of Section 8(e) of the CEA are satisfied. *See also* responses to Principle 1, Question 2(d).

| | |
|---------------------|---|
| Principle 33 | The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight. |
|---------------------|---|

| |
|----------------------|
| Key Questions |
|----------------------|

| |
|---|
| <i>Exchanges or Trading Systems subject to Regulation</i> |
|---|

| |
|---|
| 1. Does the establishment of an exchange or trading system require authorization? |
|---|

Yes.

DCMs. Any market that seeks to provide a trading facility to trade futures, options on futures or options on commodities must apply to the CFTC to become a DCM, unless some exemption or exclusion would apply. Section 4(a) of the CEA establishes the basis for requiring DCMs to register. CEA Section 5 and Part 38 of the CFTC's regulations establish a comprehensive regulatory framework, including application for designation as a contract market, operation, and compliance requirements for DCMs. To be designated as a DCM, a DCM must comply with twenty-three core principles and the requirements of the Part 38 rules.

SEFs. Section 5h(a)(1) of the CEA requires that any multilateral trading facility that offers swaps must register with the CFTC as either a DCM or SEF. (SEF registration is only available for swaps trading facilities that limit participation to a sophisticated investor category known as ECPs). Both CEA Section 5h and Part 37 of the CFTC's regulations establish a comprehensive regulatory framework, including registration, operation, and compliance requirements for SEFs. To be registered and maintain registration, a SEF must comply with fifteen enumerated core principles and the regulations in the Part 37 rules.

FBOTs. Section 4(b)(1) of the CEA authorizes the CFTC to adopt rules and regulations requiring FBOTs that provide the members of the FBOT or other participants located in the U.S. with direct access to the electronic trading and order matching system of the FBOT to register with the Commission. CFTC regulation 48.3 makes it unlawful for an FBOT to permit direct access to its electronic trading and order matching system unless and until the CFTC has issued a valid and current Order of Registration to the FBOT. In order to become registered with the CFTC, an FBOT must demonstrate, among other things, that it

| | |
|-----|--|
| | and its clearing arrangements ¹⁴⁴ satisfy the requirements set forth in CFTC regulation 48.7. ¹⁴⁵ |
| 2. | Are there criteria for the authorization of exchange and trading system operators that: |
| (a) | Require analysis and authorization of the market by a competent authority? |
| | <p>Yes. The authorization of DCMs, SEFs and FBOTs requires analysis of their compliance with statutory and administrative requirements.</p> <p>DCMs. Statutory and administrative standards for DCM status. The procedures and requirements for designation as a DCM are set forth in Section 5 of the CEA and Part 38 of the CFTC's regulations. Appendix B to Part 38 provides guidance to applicants seeking to become designated as DCMs.</p> <p>Criteria for DCM Status and Ongoing DCM Requirements. To be designated and maintain designation as a contract market, a board of trade must comply with 23 core principles as set forth in Section 5(d) of the CEA and Part 38 of the CFTC's regulations. Those core principles are:</p> <ol style="list-style-type: none"> 1. Designation as contract market 2. Compliance with rules 3. Contracts not readily subject to manipulation 4. Monitoring of trading 5. Position limits or accountability 6. Emergency authority 7. Availability of general information 8. Daily publication of trading information 9. Execution of transactions 10. Trade information 11. Financial integrity of contracts 12. Protection of market participants 13. Disciplinary procedures 14. Dispute resolution 15. Governance fitness standards 16. Conflicts of interest |

¹⁴⁴ Transactions executed on an exchange may be cleared by a clearing organization that is part of the same corporate entity as the exchange (*e.g.*, CME Group); an affiliated entity of the exchange (*e.g.*, transactions executed on ICE Futures U.S. are cleared by ICE Clear U.S.); or an entity that is unaffiliated with the exchange (*e.g.*, Options Clearing Corporation).

¹⁴⁵ The FBOT must demonstrate, for example, that it satisfies certain requirements with respect to, among other things, its membership, its automated trading system, the terms and conditions of the contracts to be made available in the United States, clearing and settlement, its rules and enforcement thereof, and information sharing arrangements. CFTC regulation 48.7. The requirements applicable to the FBOT's clearing organization may alternatively be met by demonstrating that the clearing organization is registered and in good standing with the CFTC as a DCO. CFTC regulation 48.7. All contracts offered are required to be cleared and are subject to certain restrictions. *See e.g.*, CFTC regulation 48.7(c)(1)(ii).

17. Composition of governing boards of contract markets
18. Recordkeeping
19. Antitrust considerations
20. System safeguards
21. Financial resources
22. Diversity of board of directors
23. Securities and Exchange Commission

Application Process. Applicants for designation must submit Form DCM and follow the application procedures set forth in CFTC regulation 38.3. Form DCM is available in Appendix A to Part 38 of the CFTC's regulations. The application must include information sufficient to demonstrate compliance with the core principles specified in Section 5(d) of the CEA. An application will not be considered to be materially complete unless the application has submitted, at a minimum, the exhibits required in Form DCM. The CFTC reviews new applications for designation as a contract market pursuant to the 180-day time frame and procedures specified in Section 6(a) of the CEA. The CFTC may approve or deny the application or, if deemed appropriate, designate the applicant as a contract market subject to conditions.¹⁴⁶

SEFs. Statutory and administrative standards for SEF status. Criteria, procedures, and requirements for registration as a SEF are set forth in Section 5(h) of the CEA and Part 37 of the CFTC's regulations. Appendices A and B to Part 37 provide specific information on these requirements and guidance. Additional CFTC staff guidance on SEFs can be found on the CFTC's website.

Registration requirements and ongoing compliance with core principles. To be registered, and maintain registration as a SEF, a SEF must comply, on a continuing basis, with the following 15 core principles as set forth in Section 5h(f) of the CEA and Part 37 of the CFTC's regulations. Those core principles are:

1. Compliance with core principles
2. Compliance with rules
3. Swaps not readily subject to manipulation
4. Monitoring of trading and trade processing
5. Ability to obtain information
6. Position limits or accountability
7. Financial integrity of transactions
8. Emergency authority
9. Timely publication of trading information
10. Recordkeeping and reporting

¹⁴⁶ See *How to Become a Contract Market* available on the CFTC's website.

11. Antitrust considerations
12. Conflicts of interest
13. Financial resources
14. System safeguards
15. Designation of chief compliance officer

Application Process. CFTC regulation 37.3 sets forth the requirements and procedures for registration as a SEF. Form SEF is available in Appendix A to Part 37 of the CFTC's regulations. The application must include information sufficient to demonstrate compliance with the core principles specified in Section 5h of the CEA. An application will not be considered to be materially complete unless the application has submitted, at a minimum, the exhibits required in Form SEF. The CFTC will issue an order granting registration upon its determination that the applicant has demonstrated compliance with the CEA and regulations applicable to SEFs. If appropriate, the CFTC may issue an order granting registration subject to conditions.

FBOTs. Criteria, procedures, and requirements for registration as an FBOT are set forth in Section 4(b) of the CEA, and Part 48 of the CFTC's regulations. In determining whether to register an FBOT, the CFTC evaluates whether the FBOT's home regulatory authority oversees the FBOT in a comprehensive manner that is comparable to the CFTC's oversight of DCMs; specifically, whether the FBOT's regulator supports and enforces regulatory objectives that are substantially equivalent to those supported and enforced by the CFTC, such as prevention of market manipulation and customer and market abuse. The FBOT is subject to Commission oversight only with respect to trading by direct access from the United States.

- (b) Seek evidence of operational or other competence of the operator of an exchange or trading system?

Yes, for both DCMs and SEFs.

DCMs. The competency of facilities that apply for designation as a DCM are evaluated through the process whereby the operator demonstrates its capacity to operate in compliance with the core principles under CEA Section 5(d) and CFTC regulations in Part 38. Once an operator receives designation, DCM Core Principle 15, Governance Fitness Standards, requires the DCM to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other persons with direct access to the facility.

The guidance in Appendix B to Part 38 of the CFTC regulations provides, in part,

that the minimum standards of fitness for persons who have member voting privileges, governing obligations or responsibilities, or who exercise disciplinary authority are the bases for refusal to register a person under Section 8a(2) of the CEA. In addition, persons with governing obligations or responsibilities, or who exercise disciplinary authority, should not have a significant history of serious disciplinary offenses such as those that would be disqualifying under CFTC regulation 1.63.

SEFs. The competency of facilities that apply for registration as a SEF is demonstrated through a facility's capacity to operate in compliance with the core principles under CEA Section 5h and CFTC regulations in Part 37. In particular, SEF Core Principle 13 requires SEFs to have adequate "managerial resources" to discharge the SEF's responsibilities.

The CFTC collects relevant information about the operational or other competence as part of the SEF application process. Form SEF requires, among other information, a "[b]rief account of the business experience of each officer and director over the last five (5) years," "a description of the personnel qualifications for each category of professional employees employed by the Applicant or the division, subdivision, or other separate entity within the Applicant," and "an analysis of staffing requirements necessary to carry out the operations of the Applicant as a swap execution facility and the name and qualifications of each key staff person."¹⁴⁷ Further, Form SEF requires an exhibit setting forth the "fitness standards for the Board of Directors and its composition."

- (c) Require the operator of an exchange or trading system that assumes principal, settlement, guarantee or performance risk, to comply with prudential and other requirements designed to reduce the risk of non-completion of transactions (e.g., mandatory margin assessment and collection, capital or financial resources, member contributions, guaranty fund, credit or position limits)?

Yes. DCMs and SEFs are required to adopt and enforce rules for ensuring the financial integrity of transactions, which includes the clearance and settlement of transactions with a DCO that is registered with the Commission.

DCMs. DCM Core Principle 11 states that the DCM shall establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into on or through the facilities of the contract market (including the clearance and settlement of the transactions with a DCO that is registered with the Commission). The DCM is also required to establish and enforce rules to ensure the financial integrity of any FCM or IB, and the protection of customer funds. Specific

¹⁴⁷ Form SEF is available on the CFTC's website.

requirements implementing DCM Core Principle 11 are contained in subpart L of Part 38 of the CFTC regulations.

Each DCM must adopt rules prescribing minimum financial and related reporting requirements for member FCMs, IBs, and registered RFEDs. CFTC regulation 1.52. Each DCM must also establish and operate a supervisory program that includes written policies and procedures concerning the application of the supervisory program in the examination of its member FCMs, IBs, and RFEDs for the purpose of assessing whether each member registrant is in compliance with the applicable DCM and CFTC regulations governing minimum net capital and related financial requirements, the obligation to segregate customer funds, risk management requirements, financial reporting requirements, recordkeeping requirements, and sales practice and other compliance requirements. *Id.* The supervisory program must address each of the elements contained in CFTC regulation 1.52(c)(1). The DCM must also arrange for an examinations expert to evaluate the supervisory program at least every three years and report the results of the evaluation to the CFTC within 30 days of receiving the report.

DCMs are required to adopt rules that “provide for the exercise of emergency authority,” which includes, among other powers, the ability to suspend or curtail all trading in a contract under DCM Core Principle 6. This emergency authority is intended to allow DCMs to “intervene as necessary to maintain markets with fair and orderly trading and to prevent or address manipulation or disruptive trading practices.”

DCMs must notify the CFTC promptly after exercising emergency authority to explain the reasons for the actions taken and submit a rule certification under Part 40 of the Commission’s regulations to explain actions taken to address the emergency. A DCM must also have rules that allow it to take such market action as may be directed by the CFTC.

SEFs. SEF Core Principle 7 states that the SEF shall establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the SEF, including the clearances and settlement of the swaps subject to the swap clearing requirement of Section 2(h)(1) of the CEA.

CFTC regulation 37.701 requires transactions executed on or through the SEF that are required to be cleared under CEA Section 2(h)(1)(A) or that are voluntarily cleared by the counterparties to be cleared through a DCO. CFTC regulation 37.702 requires a SEF to establish minimum financial standards for its members, which shall at a minimum require that members qualify as an ECP as defined by CEA Section 1a(18). CFTC regulation 37.703 requires a SEF to monitor its members

| |
|---|
| <p>to ensure the members continue to qualify as ECPs.</p> |
| <p>(d) Permit the regulator to impose ongoing conditions (as appropriate) on the operator of an authorized exchange or regulated trading system, such as the obligation to establish: rules; policies; and procedures, to prevent fraudulent behaviour, treat all members or participants fairly, and have the capacity to carry out the market's and the competent authority's obligations?</p> |
| <p>Yes. DCM Core Principle 2 requires a DCM to establish, monitor and enforce compliance with the rules of the contract market, including (i) access requirements; (ii) the terms and conditions of any contracts to be traded on the contract market; and (iii) rules prohibiting abusive trade practices on the contract market. A DCM applicant must demonstrate its capacity to operate in compliance with the core principles and CFTC regulations on an ongoing basis under CEA Section 5(d). The CFTC may approve a DCM application with conditions under CFTC regulation 38.3.</p> <p>SEF Core Principle 2 requires a SEF to establish and enforce compliance with any rule of the swap execution facility, including (i) the terms and conditions of the swaps traded or processed on or through the swap execution facility; and (ii) any limitation on access to the swap execution facility. A SEF must also establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means: (i) to provide market participants with impartial access to the market; and (ii) to capture information that may be used in establishing whether rule violations have occurred. A facility applying for registration as a SEF must satisfactorily demonstrate its capacity to operate in compliance with the core principles and CFTC regulations pursuant to CEA Section 5h. The CFTC may approve a SEF application with conditions under CFTC regulation 37.3(b)(6).</p> <p>An applicant for FBOT registration must demonstrate that it meets the CFTC regulation 48.7 requirements for registration. The FBOT's registration is subject to continued compliance with CFTC regulation 48.7 and with the conditions included in CFTC regulation 48.8.</p> |
| <p><i>Supervision</i></p> |
| <p>3. Does regulation require an assessment of:</p> |
| <p>(a) The reliability of all arrangements made by the operator for the monitoring, surveillance and supervision of an exchange or trading system and its members or participants to ensure fairness, efficiency, transparency and investor protection, as well as compliance with securities legislation? The market's dispute resolution and appeal procedures or arrangements as appropriate, its technical systems standards and procedures related to operational failure, information on its recordkeeping system, reports of suspected breaches of law, arrangements for holding client funds and securities, if applicable, and information on how trades are cleared and settled?</p> |

Yes.

DCMs. The CFTC's review of the capacity of the applicant to continuously meet the obligations of CEA Section 5(d) requires a DCM to demonstrate that it can implement a trade practice monitoring system to monitor trading and supervise rule compliance by members; a market surveillance system to deter, detect and address manipulation; and a disciplinary process to address violations of exchange rules.

CFTC regulation 38.3 requires an applicant to demonstrate that it complies with all core principles, which include providing the CFTC with a copy of all rules, technical manuals, other guides or instructions for users of, or participants in, the market; a description of the trading system, algorithms, security and access limitation procedures; and copies of any agreements that enable or empower the applicant to comply with the core principles.

Note: The CEA imposes statutory continuing obligations on DCMs, and the CFTC supervises the implementation of the exchange's mechanisms and programs to meet those obligations.

DCM Core Principle 2 requires a DCM to establish, monitor and enforce compliance with rules prohibiting abusive trading practices and to have the capacity to, among other things, detect, investigate and apply sanctions to any person that violates the rule of the DCM. Under CFTC regulations 38.250 and 38.251, the applicant must demonstrate the means to monitor trading conduct, to supervise the system, and to address disorderly trading conditions.

DCM Core Principle 4 requires a DCM to have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures, including methods for conducting real-time monitoring of trading; and comprehensive and accurate trade reconstructions.

DCM Core Principle 10 requires the DCM to maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information to assist in the prevention of customer and market abuses and to provide evidence of any violations of the rules of the contract market.

DCM Core Principle 12 requires a DCM to establish and enforce rules to protect markets and market participants from abusive practices and to promote fair and equitable trading on the DCM. The CFTC's regulations require trade practice monitoring systems to monitor trading and supervise rule compliance by members; a market surveillance system to deter, detect and address manipulation; and a disciplinary process to address violations of exchange rules. CFTC regulation

38.155(a) requires that a DCM establish and maintain sufficient compliance staff and resources to conduct audit trail reviews, trade practice surveillance, market surveillance, real-time market monitoring, and the ability to address unusual market or trading events and to complete any investigations in a timely manner.

DCM Core Principle 13 requires the DCM to establish and enforce disciplinary procedures and discipline, suspend, or expel members or market participants that violate the rules of the DCM.

DCM Core Principle 14 requires the DCM to establish and enforce rules regarding dispute resolution and provide facilities for alternative dispute resolution as appropriate for market participants and any market intermediaries.

DCM Core Principle 18 requires the DCM to maintain records of all activities related to the business of the contract market in a form and manner acceptable to the CFTC for a period of 5 years

DCM Core Principle 20 requires the DCM to: (1) Establish and maintain a program of risk oversight to identify and minimize sources of operational risk through the development of appropriate controls and procedures and the development of automated systems that are reliable, secure, and have adequate scalable capacity; (2) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allows for the timely recovery and resumption of operations and the fulfillment of the responsibilities and obligations of the DCM; and (3) periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.

In addition, CFTC regulations 38.604-38.606 impose certain financial surveillance requirements on DCMs. CFTC regulation 38.604 requires a DCM to monitor its members' compliance with the DCM's minimum financial standards, routinely receive and promptly review financial and related information from its members and continuously monitor the positions of its members and their customers. It also requires a DCM to have rules that prescribe minimum capital requirements for member FCMs and IBs. Moreover, a DCM is required to continually survey the obligations of each FCM created by the positions of its customers; compare those obligations to the financial resources of the FCM, as appropriate; and take appropriate steps to use this information to protect customer funds. Under CFTC regulation 38.605, a DCM's financial surveillance program for FCMs, RFEDs, and IBs must comply with the requirements of CFTC regulation 1.52 to assess the compliance of such entities with applicable contract market rules and Commission regulations. Pursuant to CFTC regulation 38.606, a DCM may comply with the requirements of CFTC regulations 38.604 and 38.605 through the regulatory services of an RFA or a registered entity (Regulatory Service Provider), but must make sure that its Regulatory Service Provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and appropriate surveillance systems. Regulatory services must be provided

under a written agreement with the Regulatory Services Provider that specifically documents the services to be performed and the capacity and resources of the Regulatory Service Provider with respect to the services to be performed. However, at all times, the DCM remains responsible for compliance with its obligations under the CEA and CFTC regulations, and for the Regulatory Service Provider's performance on its behalf.

DMO's Compliance Branch conducts RERs of each DCM's ongoing compliance with the core principles and related regulations through the self-regulatory programs operated by the exchange or its third-party self-regulatory service provider. The RERs include review of an exchange's ability to enforce its rules, and prevent market manipulation and customer and market abuses. The Compliance Branch has established a risk-based determination of priorities for RERs so that key entities and subject areas receive the most attention. The Compliance Branch considers factors such as a DCM's market share; the time elapsed since the entity's last review; findings during the last review, including any need for follow-up in the short- to medium-term; concerns expressed by market participants and other Commission offices and divisions; new products, rules, or technology implemented by a DCM; significant organizational changes at the DCM, including changes in staffing, management, or ownership. In general, the large volume DCMs are subject to at least one RER annually, the medium volume DCMs are subject to one RER about every two years, and the smaller DCMs with little or no trading volume are reviewed occasionally. In all cases, the Compliance Branch holds calls with the DCMs throughout the year to discuss regulatory matters. For example, the calls allow the Compliance Branch to stay up-to-date on the DCMs' regulatory investigations and disciplinary cases of note.

The RERs normally examine "selected elements" of a DCM's trade practice surveillance, market surveillance, or disciplinary programs for compliance with the relevant core principles, which include DCM Core Principle 2, Compliance With Rules, and DCM Core Principle 12, Protection of Market Participants, with respect to trade practice surveillance; DCM Core Principle 4, Monitoring of Trading, DCM Core Principle 5, Position Limitations or Accountability, with respect to market surveillance; and DCM Core Principle 13, Disciplinary Procedures, with respect to disciplinary programs. Selected elements means the review includes a targeted sample of investigations/disciplinary cases and/or a subset of regulations for the core principles under review. The Compliance Branch also conducts examinations in emerging areas of self-regulation, where regulatory requirements and best practices may still be developing. In many instances, the Compliance Branch conducts examinations in a comparative fashion so that it can identify model regulatory practices more easily across DCMs.

In conducting an RER, the Compliance Branch examines trading and compliance activities at the exchange in question over an extended time period selected by

staff, typically the six months immediately preceding the start of the review. CFTC staff conducts an extensive review of documents and systems used by the exchange in carrying out its self-regulatory responsibilities, interviews compliance officials and staff of the exchange, and prepares a written report of its findings. DMO's 2019 examination priorities for DCMs and SEFs may be found on the CFTC's website.

DMO's Compliance Branch also conducts ongoing oversight, including regular, periodic SSEs of all DCMs and SEFs registered with the Commission. SSEs examine entity compliance with the system safeguards and cybersecurity requirements of the CEA and related Commission regulations. For a complete discussion of the SSEs, see response to Principle 9, Question 3(a).

With respect to clearing and settlement information, CFTC regulation 38.601 requires transactions executed on or through a DCM to be cleared through a DCO that is registered with the Commission in accordance with Part 39 of the Commission's regulations.

SEFs. SEF Core Principle 1 states that, to be registered and maintain registration as a SEF, the SEF must comply with the core principles and any other requirements the CFTC may impose. CFTC regulation 37.5(b) provides that, upon the CFTC's request, a SEF shall file with the CFTC a written demonstration, containing supporting data, information, and documents that it is in compliance with one or more core principles or with its other obligations under the CEA or the CFTC's regulations as the CFTC specifies in its request.

SEF Core Principle 2 requires SEFs to establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means to provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred. CFTC regulation 37.203 requires a SEF to establish a rule enforcement program for the monitoring, surveillance, and supervision of the SEF and its market participants. CFTC regulation 37.205 requires the SEF to establish procedures to capture and retain information that may be used in establishing whether rule violations have occurred. CFTC regulation 37.206 requires the SEF to have disciplinary procedures and sanctions in place to enforce trading, trade processing, and participation rules that will deter abuses.

SEF Core Principle 4 requires the SEF to monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive trade reconstructions. A SEF must also establish and enforce rules

governing trading procedures and trade processing. CFTC regulation 37.404(a) requires SEFs to have access to sufficient information to assess whether trading in swaps listed on its market, in the index or instrument used as a reference price, or in the underlying commodity for its listed swaps is being used to affect prices on its market.

SEF Core Principle 10 requires the SEF to maintain records of all activities relating to the business of the facility, including a complete audit trail in a form and manner acceptable to the CFTC for a period of 5 years.

SEF Core Principle 14 requires the SEF to establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems that are reliable and secure; have adequate scalable capacity; establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for the timely recovery and resumption of operations and the fulfillment of the responsibilities of the SEF; and periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.

In 2019, the Compliance Branch plans to initiate regulatory consultations with a number of SEFs and begin designing an examination program for SEFs. The regulatory consultations will serve as a preliminary step to help provide effective oversight while the Commission considers finalizing its new part 37 rules for SEFs. These regulatory consultations will seek, in part, to establish a baseline of information regarding each SEF's regulatory and business operations. In addition, the regulatory consultations will also help the Compliance Branch educate SEFs regarding the examination program and its other interactions with regulated entities to evaluate their compliance with the Act and Commission regulations.

With respect to clearing and settlement information, CFTC regulation 37.701 requires transactions executed on or through a SEF that are required to be cleared under Section 2(h)(1)(A) of the CEA or that are voluntarily cleared by the counterparties to be cleared through a DCO.

See also response to Principle 33, Questions 2(a-b).

- (b) Whether the trading venue has in place suitable trading control mechanisms (such as trading halts, volatility interruptions, limit-up/limit-down controls and other trading limitations) to deal with volatile market conditions?

Yes. DCM Core Principle 2 requires, among other things, a DCM to have rules

prohibiting abusive trade practices on the contract market. CFTC regulation 38.157 requires DCMs to conduct real-time market monitoring of all trading activity on their electronic trading platforms to identify disorderly trading and any market or system anomalies. Additionally, DCMs must have the authority to adjust trade prices or cancel trades when necessary to mitigate market disrupting events. SEF Core Principle 2 and CFTC regulation 37.203(e) have parallel requirements for SEFs. DCM Core Principle 4 requires a DCM to have, among other things, the capacity to prevent manipulation and price distortion. CFTC regulation 38.255 requires DCMs to establish and maintain risk control mechanisms to prevent and reduce potential risk of price distortion and market disruptions, including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the exchange. SEF Core Principle 2 and CFTC regulation 37.203(a) have parallel provisions for SEFs.

CFTC assesses DCM and SEF compliance with core principles and regulatory requirements both during the process of initial designation or registration of a DCM or SEF and during periodic oversight examinations thereafter.

DCMs and SEFs generally have in place suitable trading control mechanisms to deal with volatile market conditions. These mechanisms include risk and volatility mitigation tools such as price banding, protection points for market and stop orders, maximum order sizes, reserve periods activated by spikes in stop order triggering or extreme market moves, and credit controls. They also include exchange risk protection policies and rules addressing credit risk monitoring, trade cancellation and price adjustment, and price limits and circuit breakers.

(c) Assistance available to the regulator, in circumstances of potential trading disruption on the system?

Yes. With respect to assistance from the market on which the trading disruption may have occurred, CFTC regulations 37.1401(e) for SEFs and 38.1051(e) for DCMs require the entities to promptly notify Commission staff of all (1) electronic trading halts and material system malfunctions; (2) cyber security incidents or targeted threats that actually or potentially jeopardize automated system operation, reliability, security, or capacity; and (3) activations of the entity's business continuity-disaster recovery plan. With respect to assistance from other financial regulators, U.S. federal law enforcement agencies, or the intelligence community, CFTC is a member of FBIIC, the standing committee of the President's Working Group on Financial Markets which functions as the cybersecurity and critical infrastructure protection committee of all U.S. financial regulators and the coordination point for mutual assistance to financial regulators from other regulators, law enforcement agencies, and intelligence agencies, as appropriate, in the event of a trading disruption.

(d) Whether the relevant market authority (i.e., the regulator or relevant SRO), the outsourcing market, and its auditors, have: access to the books and records of service providers relating to an exchange’s outsourced activities; and the ability to obtain promptly, upon request, other information concerning activities that are relevant to regulatory oversight?

Yes. If a registered entity outsources a function, the CFTC has the authority to obtain relevant books and records from the registered entity, which would be required to obtain them from the service provider. A DCM or SEF is also required to provide the CFTC with copies of any service provider agreements as an application exhibit.

Certain third-party service arrangements are subject to additional Commission regulations. For example, although a DCM may comply with certain financial surveillance requirements through the regulatory services of an RFA or a registered entity, CFTC regulation 38.606 requires the DCM to ensure that the regulatory service provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and appropriate surveillance systems. The regulatory services must be provided under a written agreement with a regulatory services provider that specifically documents the services to be performed and the capacity and resources of the regulatory service provider with respect to the services to be performed. In any event, the DCM remains, at all times, responsible for compliance with its obligations under the CEA and Commission regulations, and for the regulatory service provider’s performance on its behalf.

Similarly, CFTC regulation 37.204 provides that a SEF shall ensure that such provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and automated surveillance systems. A SEF shall at all times remain responsible for the performance of any regulatory services received, for compliance with the SEF’s obligations under the CEA and CFTC regulations, and for the regulatory service provider’s performance on the SEF’s behalf. CFTC regulation 37.504 provides that a SEF shall share information with other regulatory organizations, data repositories, and third-party data reporting services as required by the Commission and that such information-sharing agreements can be established with such entities or the Commission can act in conjunction with the SEF to carry out such information sharing.

Securities and Commodity Derivatives and Market Participants

4. With respect to securities and commodity derivatives and market participants:

(a) Is the regulator informed of the types of financial products to be traded, and does it approve the rules governing the admission of the securities to trading or listing?

Yes. Under Section 5c of the CEA and Part 40 of the Commission’s regulations, DCMs and SEFs must inform the CFTC of the types of products to be traded on the

DCM or SEF through either of two methods: (1) self-certification (CFTC regulation 40.2); or (2) voluntary submission of new products for Commission review and approval (CFTC regulation 40.3). CFTC prior approval is required for certain enumerated agricultural commodities.

To meet its statutory mission of ensuring market integrity and customer protection with respect to products listed under self-certification procedures, the CFTC places greater reliance on its oversight authority, including market surveillance, RERs, reviews of contract terms, dialogue with the regulated entities, and enforcement actions. For contracts filed under self-certification procedures, the regulated entities are required to assume primary responsibility for ensuring that the contracts meet, on a continuing basis, the applicable statutory and regulatory requirements.

Listing of Products for Trading by Self-Certification

DCMs and SEFs must comply with the submission requirements of CFTC regulation 40.2 prior to listing a product for trading that has not been approved for trading under CFTC regulation 40.3 (the procedures for voluntary submission of new products for Commission review and approval).¹⁴⁸

The Commission must receive the submission no later than the opening of business on the business day preceding the business day of the initial listing (or re-listing in the case of dormant contracts) of the product.¹⁴⁹

The submission must include:

- A copy of the submission cover sheet, prepared in accordance with Appendix D of Part 40 of the Commission's regulations;
- A statement that the filing is made pursuant to CFTC regulation 40.2;
- The text of the product's rules, including those relating to terms and conditions;
- The product's intended listing date;
- A certification by the DCM or SEF that the product to be listed complies with the CEA and CFTC regulations;

¹⁴⁸ CFTC regulation 40.2(d) includes specific procedures pursuant to which a DCM or SEF may list or facilitate trading in a swap or a number of swaps based upon an "excluded commodity," as defined in CEA Section 1a(19)(i), subject to certain exceptions, or an excluded commodity, as defined in CEA Section 1a(19)(ii)-(iv), if the DCM or SEF makes the certifications set forth in CFTC regulation 40.2. However, the Commission may, in its discretion, require the DCM or SEF to withdraw such certification and submit each individual swap or certain individual swaps within the submission for Commission review pursuant to CFTC regulations 40.2 or 40.3. The listing of securities futures products is subject to additional requirements and procedures.

¹⁴⁹ CFTC regulation 40.1(a) defines "business day" as the period of time between 8:15 a.m. and 4:45 p.m. Eastern Standard Time or Eastern Daylight Savings Time, excluding Saturdays, Sundays, and Federal holidays in Washington, DC.

- A concise explanation and analysis of the product and its compliance with applicable provisions of the CEA, including core principles, and the CFTC's regulations. The explanation and analysis must either be accompanied by the documentation relied upon to establish the basis for compliance with applicable law, or incorporate information contained in such documentation, with appropriate citations to data sources.
- A certification by the DCM or SEF posted on its website that a notice of pending product certification is with the Commission.

If requested by CFTC staff, the DCM or SEF must provide additional information or data that demonstrates that the contract meets, initially or on a continuing basis, the requirements of the CEA or CFTC regulations.

The CFTC may stay the listing of a contract during the pendency of CFTC proceedings for filing a false certification or during the pendency of a petition to alter or amend the contract terms and conditions.

Voluntary Submission of New Products for CFTC Review and Approval

DCMs and SEFs may request that the CFTC approve a new or dormant product prior to listing the product for trading or, if a product was initially submitted under CFTC regulation 40.3, subsequent to listing the new product for trading. Approval requests for contracts filed under self-certification procedures may be submitted concurrently with a self-certification filing or at any time thereafter, including after initial listing of the product.

A product request for approval must include:

- A copy of the submission cover sheet prepared in accordance with the instructions in Appendix D to Part 40 of the CFTC regulations;
- A copy of the rules that set forth the contract's terms and conditions;
- An explanation and analysis of the product and its compliance with applicable provisions of the CEA, including core principles, and the CFTC's regulations. This explanation and analysis must be either accompanied by the documentation relied upon to establish the basis for compliance with applicable law, or incorporate information contained in such documentation, with appropriate citations to data sources;
- A description of any agreements or contracts entered into with other parties that enable the DCM or SEF to carry out its responsibilities; and
- A certification that the DCM or SEF posted a notice of its request for CFTC approval of the new product and a copy of the submission on its website.

If requested by Commission staff, the DCM or SEF must provide additional evidence, information or data demonstrating that the contract meets, initially or on

a continuing basis, the requirements of the CEA or other requirements for designation or registration under the CEA, Commission regulations or Commission policies. Such additional information must be submitted within the time frame set forth in the regulation.

All products submitted for CFTC approval are deemed approved by the CFTC 45 days after receipt by the CFTC or at the conclusion of an extended period,¹⁵⁰ unless the DCM or SEF is notified otherwise, if:

- The submission complies with the requirements of CFTC regulation 40.3(a);
- The DCM or SEF, during the review period, does not amend the terms or conditions of the product or supplement the request for approval, except as requested by the CFTC or for non-substantive revisions. However, the CFTC, at any time during its review, may notify the DCM or SEF that it will not, or is unable to, approve the product because the submission lacks sufficient information for a determination as to whether the product violates, appears to violate, or potentially violates the CEA or Commission regulations.

The procedures for listing products for trading are available on the CFTC's website.

Review of DCM and SEF Rules

Subject to certain exceptions, DCMs and SEFs, prior to implementing any new rule, must comply with the procedures for self-certification of rules set forth in CFTC regulation 40.6¹⁵¹ or the procedures for voluntary submission of new rules for CFTC review and approval set forth in CFTC regulation 40.5.

Self-Certification of Rules

CFTC regulation 40.6 requires that the DCM or SEF submit the following to the Commission no later than the open of business on the business day that is ten business days prior to the implementation of the rule:

- A copy of the submission cover sheet prepared in accordance with the instructions in Appendix D to part 40 of CFTC regulations;
- The text of the rule;
- A certification by the registered entity that the rule complies with the CEA

¹⁵⁰ The CFTC may extend the 45-day review period for an additional 45 days if the product raises novel or complex issues that require additional time for review or is of major economic significance, if the DCM or SEF agrees in writing.

¹⁵¹ The self-certification process is not available in certain instances.

and Commission regulations;

- The date of the intended implementation;
- A concise explanation and analysis of the operation, purpose, and effect of the proposed rule and its compliance with applicable provisions of the CEA, including core principles, and Commission regulations;
- A certification that the registered entity posted notice of pending certification and a copy of its submission on its website;
- A brief explanation of any substantive opposing views expressed to the registered entity by governing board or committee members, members of the entity or market participants that were not incorporated into the rule or a statement that no opposing views were expressed; and
- If requested by CFTC staff, any additional evidence, information or data that may be beneficial to the CFTC in conducting a due diligence assessment of the filing and the registered entity's compliance with the CEA or Commission regulations.

The CFTC has ten business days to review the new rule before the new rule is deemed certified and can be effective, unless the CFTC notifies the DCM and SEF during the ten business day review period that it intends to stay the certification on the grounds that the rule presents novel or complex issues that require additional time to analyze, is accompanied by an inadequate explanation, or is potentially inconsistent with the CEA or CFTC regulations. The CFTC has an additional 90 days to conduct its extended review during which period it provides a 30-day public comment period. A stayed rule becomes effective after an additional 90 days, unless the CFTC withdraws the stay prior to that time or the CFTC notifies the registered entity that it objects to the proposed certification on the grounds that the rule is inconsistent with the CEA or Commission regulations.

Voluntary Submission of Rules for CFTC Review and Approval

Under CFTC regulation 40.5, a DCM or SEF may request that the CFTC approve a new rule prior to implementation thereof or, if the rule was initially submitted under CFTC regulations 40.2 or 40.6, subsequent to the implementation of the rule. A request for approval must include all of the materials required for self-certification of rules, as well as:

- A description of any action taken or anticipated to be taken by the DCM or SEF or its respective governing board or by any committee thereof and citations to the rules of the registered entity that authorize the adoption of the proposed rule;
- A description of the anticipated benefits to market participants or others, any potential anti-competitive effects on market participants or others, and how the rule fits into the registered entity's framework of self-regulation;

- Any additional information that may be beneficial to the CFTC in analyzing the new rule and, if the proposed rule affects the application of any other rule of the DCM or SEF the text of any such rule and a description of the anticipated effect; and
- Identification of any CFTC regulation that the Commission may need to amend or sections of the CEA or Commission regulations that the CFTC may need to interpret, in order to approve the new rule and a reasoned analysis supporting the amendment or interpretation.

At any time during the Commission's review of the proposed rule, the Commission may notify the DCM or SEF that it will not, or is unable to, approve the new rule. Otherwise, all rules submitted for CFTC approval are deemed approved by the Commission 45 days after receipt or at the conclusion of any extended period,¹⁵² if the rule complies with the submission requirements, and the DCM or SEF does not amend the proposed rule or supplement its submission (except as requested by the Commission and other than for non-substantive revisions) during the pendency of the review period.

Made Available to Trade Determinations

Section 2(h)(8) of the CEA requires swaps subject to the clearing requirement to be traded on a DCM or SEF, unless no DCM or SEF "makes the swap available to trade." CFTC regulations 37.10 and 38.12 specify the process for a SEF and DCM, respectively, to make a swap available to trade. The SEF or DCM must demonstrate that it lists or offers that swap for trading on its trading system or platform. In considering whether to make a swap available to trade, the SEF or DCM must consider one or more of the following factors: whether there are ready and willing buyers and sellers; the frequency or size of transactions; trading volume; number and types of market participants; the bid/ask spread; or the usual number of resting form or indicative bids and offers. Upon a determination that a swap is available to trade on any SEF or DCM, that swap is subject to the Section 2(h)(8) trade execution requirement, which means that the swap may only be traded on a DCM or SEF in accordance with certain execution methods.

Rules of Enumerated Agricultural Commodities¹⁵³ required to be submitted

¹⁵² The CFTC may extend the review period for an additional 45 days, if the proposed rule raises novel or complex issues that requires additional time for review or is of major economic significance, the submission is incomplete, or the requestor does not respond completely to Commission questions in a timely manner.

¹⁵³ The agricultural commodities listed here are commonly referred to as the enumerated commodities of the CEA: wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain, sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed, cottonseed meal, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice.

for prior CFTC Approval

Registered entities must submit to the CFTC, and receive CFTC approval prior to implementation, all new rules and rule amendments that materially change the terms and conditions of contracts on commodities enumerated in CEA Section 1a(9) and that will apply to contracts with open interest.

CFTC regulation 40.4 provides that such new rules and rule amendments cannot be implemented pursuant to the certification procedures of CFTC regulation 40.6, but must be submitted to the CFTC for approval under CFTC regulation 40.5.

If the CFTC determines that a new rule or rule amendment is consistent with the requirements of the CEA and CFTC regulations, the new rule or rule amendment is deemed approved 45 days after CFTC receipt of the approval request, or at the conclusion of any extended review period, as provided under CFTC regulations 40.5(b) and (c). If the CFTC determines that it will not, or is unable to, approve the new rule or rule amendment, it will provide a Notice of Non-Approval to the registered entity, as provided under CFTC regulation 40.5(e). In this Notice of Non-Approval, the CFTC will briefly specify the nature of the issues identified and the specific provision of the CEA or CFTC regulations that the new rules or rule amendments violate.

A registered entity receiving a Notice of Non-Approval may not certify the same, or substantially the same, new rules or rule amendments under the certification procedures of CFTC regulation 40.6. However, the registered entity may submit revised new rules or rule amendments for approval under the procedures in CFTC regulations 40.4 and 40.5.

(b) Where applicable, does the regulator, or the market, take product design and trading conditions into account in order to admit a product for trading?

Yes. Express authorization prior to trading is required only for contracts based on enumerated agricultural commodities. *See also* response to Principle 33, Question 4(a).

(c) Does the regulatory framework provide for fair access to the exchange, or trading system, through oversight of the related rules for participation?

Yes, for DCMs and SEFs.

DCMs. DCM Core Principle 2 requires DCMs to establish, monitor, and enforce compliance with the rules of the DCM including access requirements. CFTC regulation 38.151(b) requires DCMs to provide its members, persons with trading privileges, and independent software vendors (ISVs) with impartial access to its

markets and services, including access criteria that are impartial, transparent, and applied in a non-discriminatory manner. CFTC regulation 38.151(b)(2) requires that the DCM provide comparable fee structures for members, persons with trading privileges, and ISVs receiving equal access to, or services from, the DCM. CFTC regulation 38.151(c) requires a DCM to establish and impartially enforce rules governing any decision by the DCM to deny, suspend, or permanently bar a member's or a person with trading privileges access to the contract market. Accordingly, any decision by a DCM to deny, suspend, or permanently bar a member's or person with trading privileges access to the DCM must be impartial and applied in a non-discriminatory manner.

SEFs. SEF Core Principle 2 requires SEFs to provide market participants with impartial access to the SEF. CFTC regulation 37.202 requires SEFs to provide any ECP and any ISV with impartial access to its market(s) and market services, including any indicative quote screens or any similar pricing data displays. The SEF has to have impartial criteria governing access, comparable fee structures and impartial enforcement of rules for limiting access.

Fairness of Order Execution Procedures

5. With respect to order execution procedures:

- (a) Are order routing procedures clearly disclosed to regulators and to market participants, applied fairly, and not inconsistent with relevant securities regulation (e.g., requirements with respect to precedence of client orders and prohibition of front running or trading ahead of customers)?

Yes, for DCMs and SEFs.

DCMs. The statutory duties and CFTC regulations regarding the requirement to offer fair and impartial access are discussed in the response to Principle 33, Question 5(c), below, and the requirement to apply execution rules fairly to all participants is discussed in response to Principle 33, Question 5(b), below. These requirements operate to ensure that a system's order routing procedures are clearly disclosed to the regulator and to market participants, are applied fairly and are not inconsistent with relevant derivatives regulations. DCM Core Principle 2 also specifically prohibits front-running, wash trading, some forms of pre-arranged trading, fraudulent trading, money passes, and any other trading practices that a DCM deems to be abusive. Further, DCM Core Principle 12 requires DCMs to promote fair and equitable trading on the contract market. CFTC regulation 38.650(b) requires DCMs to establish and enforce rules to promote fair and equitable trading on the contract market. DCM applicants must attach as Exhibit L to Form DCM a description of the manner in which the applicant is able to comply with each core principle.

SEFs. The statutory duties and CFTC regulations regarding the requirement to offer impartial access are discussed in the response to Principle 33, Question 5(c) below, and the requirement to apply execution rules fairly to all participants is discussed in response to Principle 33, Question 5(b) below. These requirements operate to ensure that a system's order routing procedures are clearly disclosed to the regulator and to market participants, are applied fairly and are not inconsistent with relevant derivatives regulations. SEF Core Principle 2 requires a SEF to establish rules governing the operation of the SEF including rules specifying trading procedures to be followed by members and market participants when entering and executing orders traded or posted on the SEF. CFTC regulation 37.201 requires SEFs to establish and impartially enforce compliance with the rules of the SEF, including, the terms and conditions of any swaps traded or processed on or through the SEF; access to the SEF; trade practice rules; audit trail requirements; disciplinary rules; and mandatory trading requirements. SEF applicants must attach as Exhibit L to Form SEF a description of the manner in which the applicant is able to comply with each core principle.

(b) Are execution rules disclosed to the regulator and to market participants, and consistently applied to all participants?

Yes, for DCMs and SEFs.

DCMs. Applicants for designation as a DCM must meet statutory requirements that execution rules are disclosed to the regulator and to market participants, and are fairly applied to all participants. DCM Core Principle 7 requires a DCM to make available to market authorities, market participants, and the public information on the rules, regulations, and mechanisms for executing transactions on or through the DCM. DCM Core Principle 9 requires DCMs to provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the DCM. CFTC regulation 1.38, which applies to commodity futures and options requires competitive execution. Note: CFTC regulation 1.38 permits certain noncompetitive trades that are executed pursuant to rules that have been approved by the CFTC. Exhibit L to Form DCM requires DCM applicants to describe the manner in which the applicant is able to comply with each core principle. DCM rulebooks are also required to be publicly available.

SEFs. CFTC regulation 37.201 requires a SEF to establish and impartially enforce compliance with the rules of the swap execution facility, including, but not limited to execution rules. All rules are disclosed to the regulator when the entity applies for registration as a SEF under CFTC regulation 37.3 or after the SEF has been registered under Part 40 of the Commission's regulations. SEF rulebooks are required to be publicly available. A SEF applicant must also explain the operation

| | |
|-----|--|
| | <p>of its trading system or platform and the manner by which the trade functionality requirement of CFTC regulation 37.3(a)(2) is satisfied.</p> |
| (c) | <p>Where applicable, does the regulator review the trade matching or execution algorithm of automated trading systems for fairness?</p> |
| | <p>Yes, for DCMs and SEFs.</p> <p>DCMs. Applicants for designation as a DCM must meet statutory requirements that trade matching or execution algorithms are disclosed to the regulator and to market participants, and are fairly applied to all participants. The DCM applicant must attach Exhibit Q to its application on Form DCM, which requires a description of the applicant’s trading system and trade matching algorithm and examples of how that algorithm works in various trading scenarios involving various types of orders.</p> <p>SEFs. Applicants for registration as a SEF must meet statutory requirements that trade matching or execution algorithms are disclosed to the regulator and to market participants, and are fairly applied to all participants. For trading systems or platforms that enable market participants to engage in transactions through an order book, the SEF applicant must attach as Exhibit Q to its Form SEF an explanation of the trade matching algorithm, if applicable, and examples of how that algorithm works in various trading scenarios involving various types of orders. For trading systems or platforms that enable market participants to engage in transactions through a request for quote system, the SEF applicant must attach as Exhibit Q to Form SEF an explanation of how a requester may transact on resting bids or offers along with the responsive orders.</p> |
| (d) | <p>Do all system users have equal opportunity to connect, and maintain the connection to, the electronic trading system and are differences in order execution response times disclosed by the system operator?</p> |
| | <p>Yes. See response to Principle 33, Question 4(c).</p> |
| (e) | <p>Are there in place effective systems and controls reasonably designed to enable the management of risk with regard to fair and orderly trading including, in particular, automated pre-trade controls that enable intermediaries to implement appropriate risk limits?</p> |
| | <p>Yes, for DCMs and SEFs.</p> <p>DCMs. CFTC regulation 38.255 requires DCMs to establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions</p> |

and market disruptions, including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the DCM. CFTC regulation 38.607 requires DCMs that permit direct electronic access by customers¹⁵⁴ to have in place effective systems and controls reasonably designed to facilitate the FCM's management of financial risk, such as automated pre-trade controls that enable member FCMs to implement appropriate financial risk limits. A DCM must implement and enforce rules requiring the member FCMs to use the provided systems and controls.

SEFs. SEF Core Principle 4 and CFTC regulation 37.405 require SEFs to establish and maintain risk control mechanisms to prevent and reduce the potential risk of market disruptions, including, but not limited to, market restrictions that pause or halt trading under market conditions prescribed by the SEF.

Operational Information

6. With respect to trading information:

(a) Do similarly situated market participants have equitable access to market rules and operating procedures?

Yes, for DCMs and SEFs.

DCMs. Section 5(d) of the CEA ensures that all market rules and operating procedures are available to market participants. DCM Core Principle 7 requires DCMs to make available to market authorities, market participants, and the public information concerning the mechanisms for executing transactions on or through the facilities of the contract market. CFTC regulation 38.400 requires DCMs to make available to market authorities, market participants and the public accurate information concerning the rules, regulations, and mechanisms for executing transactions on or through the facilities of the DCM. The DCM must also make available to market authorities, market participants, and the public accurate information concerning the rules and specifications describing the operation of the DCM's electronic matching platform or trade execution facility.

SEFs. Section 5h of the CEA ensures that that all market rules and operating procedures are available to market participants. Under CFTC regulation 37.202, a SEF is required to provide any ECP and any ISV with impartial access to its markets and market services, including any indicative quote screens or any similar pricing data displays, and the facility must have criteria governing such access that are impartial, transparent and applied in a non-discriminatory manner. The SEF must

¹⁵⁴ CFTC regulation 38.607 describes "direct electronic access by customers" as being situations where customers of FCMs are permitted to enter orders directly into a DCM's trade matching system for execution.

| | |
|-----|--|
| | <p>have comparable fee structures for ECPs and ISVs receiving comparable access to, or services from, the SEF.</p> |
| (b) | <p>Are adequate records (i.e., audit trails) available to reconstruct trading activity within a reasonable time?</p> |
| | <p>Yes.</p> <p>DCMs. DCM Core Principle 10 requires DCMs to maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information: (a) to assist in the prevention of customer and market abuses; and (b) to provide evidence of any violations of the rules of the contract market.</p> <p>CFTC regulation 38.551 requires DCMs to capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses. Such data must be sufficient to reconstruct all transactions within a reasonable period of time and to provide evidence of any violations of the rules of the DCM. An acceptable audit trail must also permit the DCM to track a customer order from the time of receipt through fill, allocation, or other disposition, and must include both order and trade data. CFTC regulation 38.256 requires DCMs to have the ability to comprehensively and accurately reconstruct all trading on its trading facility.</p> <p>SEFs. SEF Core Principle 10 requires SEFs to maintain records of all activities relating to the business of the facility, including a complete audit trail in a form and manner acceptable to the CFTC for a period of 5 years. CFTC regulation 37.406 requires SEFs to have the ability to comprehensively and accurately reconstruct all trading on its facility.</p> |
| (c) | <p>Is the system capable of disclosing the types of information that it is designed to make available, and, conversely, of providing safeguards to preserve the confidentiality of other information, the disclosure of which is not intended?</p> |
| | <p>Yes. CFTC regulation 16.01 requires SEFs and DCMs to publish market data on futures, swaps, and options regarding trading volume, open contracts, prices, and critical dates to the public either through the news media or through the SEF or DCM's rulebook. CFTC regulation 16.02 requires SEFs and DCMs to report to the CFTC on a daily basis transaction-level trade data and related order information for each futures or options contract. Upon request, such information shall be accompanied by data that identifies or facilitates the identification of each trader for each transaction or order included in a submitted trade and supporting data report if the reporting market maintains such data.</p> |

DCMs and SEFs must report swap transaction data to a SDR as soon as technologically practicable after execution of a transaction under CFTC regulations in Parts 43 and 45. The SDR must publicly disseminate certain swap transaction and pricing data reported pursuant to CFTC regulation in Part 43 as soon as technologically practicable after it is received from the DCM or SEF. The CFTC has direct access to the full scope of swap data reported to SDRs pursuant to Parts 43 and 45 of the CFTC regulations and, subject to compliance with CFTC regulations in Part 49, certain other US and foreign regulators have access to a partial or the full scope of swap data reported to SDRs. While Part 43 transaction and pricing data is publicly disseminated, Part 45 swap data is not made publicly available.

DCMs. Fair and equitable trading on a DCM, among other things, includes providing to market participants, on a fair, equitable and timely basis, information regarding prices, bids and offers, as applicable to the market. A DCM applicant must satisfactorily demonstrate its capacity to operate in compliance with CFTC regulation 38.401 and DCM Core Principles 7, 8, and 10. CFTC regulation 38.401 requires the DCM to provide the public with access to the rule, regulations, and contract specifications of the DCM. DCM Core Principle 7 ensures disclosure of general information to market authorities, market participants, and the public. DCM Core Principle 8 requires the daily publication of trade information. DCM Core Principle 10 requires the creation of an audit trail. An acceptable audit trail will include a safe storage capability providing for the storing of data included in the transaction history in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss.

CFTC regulation 38.401(c)(2) states that to the extent that a DCM requests confidential treatment of any information filed with the Secretary of the CFTC, the DCM must post on its website the public version of such filing or submission.

In addition, CFTC regulation 38.7 prohibits a DCM from using for business or marketing purposes proprietary or personal information that it collects from market participants unless the market participant clearly consents to the use of its information in such a manner. The CFTC notes that the requirements of CFTC regulation 38.7 are in line with similar rules intended to provide privacy protections to certain consumer information under the Fair Credit Reporting Act. See CFTC regulations in Part 162.

DCM Core Principle 10 requires a DCM to maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information: (a) to assist in the prevention of customer and market abuses; and (b) to provide evidence of any violations of the rules of the contract market. CFTC regulation 38.552(d) requires safe storage capability. A DCM's audit trail program must include the

capability to safely store all audit trail data retained in its transaction history database. Such safe storage capability must include the capability to store all data in the database in a manner that protects it from unauthorized alteration, as well as from accidental erasure or other loss. Data must be retained in accordance with the recordkeeping requirements of Core Principle 18.

SEFs. Fair and equitable trading on a SEF, among other things, includes providing to market participants, on a fair, equitable, and timely basis, information regarding prices, bids and offers, as applicable to the market. A SEF applicant must satisfactorily demonstrate its capacity to operate in compliance with SEF Core Principle 9 and CFTC regulation 37.901. SEF Core Principle 9 requires the SEF to make public timely information on the price, trading volume, and other trading data on swaps. The SEF must have the capacity to electronically capture and transmit trade information with respect to transactions executed on the SEF.

As noted above, CFTC regulation 37.901 requires SEFs to report the data required under CFTC regulations in Part 43 (real-time public reporting) and Part 45 (swap data recordkeeping and reporting requirements).

CFTC regulation 37.7 prohibits a SEF from using for business or marketing purposes any proprietary data or personal information the SEF collects or receives, from or on behalf of any person, for the purpose of fulfilling its regulatory obligations; provided, however, that a SEF may use such data or information for business or marketing purposes if the person from whom it collects or receives such data or information clearly consents to the SEF's use of such data or information in such manner. A SEF may not condition access to its market(s) or market services on a person's consent to the SEF's use of proprietary data or personal information for business or marketing purposes. A SEF, where necessary for regulatory purposes, may share such data or information with one or more swap execution facilities or designated contract markets registered with the CFTC.

(d) Does the market provide member intermediaries with access to relevant pre-and post-trade information (on a real-time basis) to enable these intermediaries to implement appropriate monitoring and risk management controls?

See response to Principle 35, Questions 1(a) and (b).

Principle 34 There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.

Key Questions

- | | |
|-------|---|
| 1. | Does the regulatory system: |
| (a) | Include a program whereby the regulator or an SRO, which is subject to oversight by the regulator: |
| (i) | monitors day-to-day trading activity on the exchange or trading system (through a market surveillance program); |
| (ii) | monitors conduct of market intermediaries (through examinations of business operations); and |
| (iii) | collects and analyzes the information gathered through these activities? |

Yes, to all. The CFTC, DCMs, DCOs, and SEFs conduct market surveillance.¹⁵⁵

The CFTC conducts a comprehensive market integrity program that includes a system of collecting information on market participants as part of its market surveillance and financial risk surveillance programs. The CFTC's oversight programs are supported by the CFTC's enforcement program as necessary. The market surveillance program is intended to preserve the economic functions of the U.S. derivatives markets under its jurisdiction by monitoring trading activity, to detect and prevent manipulation or abusive practices, to keep the CFTC informed of significant market developments, to enforce CFTC and exchange speculative position limits, and to ensure compliance with CFTC reporting requirements. In conducting market surveillance, CFTC staff has a close working relationship with the exchanges' market surveillance staff.

The Commission monitors trading and positions of market participants on an ongoing basis. Commission staff screen for potential market manipulations and disruptive trading practices, as well as trade practice violations. The staff also monitors exchange transactional data routinely to detect violations such as wash trading, prearranged trading, accommodation trading, customer fraud, fictitious sales, price distortion and manipulation, and trading ahead. Such market surveillance is dependent on the ability to acquire large volumes of data and the development of sophisticated analytics to identify trends and/or outlying events that warrant further investigation. The combination of analysis of available data

¹⁵⁵ The discussion in this section does not discuss the market surveillance conducted by DCOs.

sets and Special Call authority leads to an understanding of benign market activities and possible violations of the CEA. In addition, the Commission conducts risk and financial surveillance of DCOs, FCMs, and other market participants such as SDs, MSPs, and large traders that may pose a risk to the markets. The Commission and U.S. futures exchanges employ a comprehensive large-trader reporting system where clearing members, FCMs, and foreign brokers (collectively called Reporting Firms) file daily reports with the Commission.

As discussed below in response to Question 1(b) of this Principle and in response to Principle 33, Question 3(a) above, RERs are formal, structured assessments of regulated entities' operations or oversight programs to assess ongoing compliance with statutory and regulatory mandates. Regular RERs are an effective method of ensuring that the entities' are complying with the core principles established in the CEA and Commission's regulations. In general, the large volume DCMs are subject to at least one RER annually, the medium volume DCMs are subject to at one RER about every two years, and the smaller DCMs with little or no trading volume are reviewed occasionally.

- (b) Include regulatory oversight mechanisms to verify compliance by the exchange, or trading system, with its statutory or administrative responsibilities, particularly as they relate to the integrity of the markets, market surveillance, the monitoring of risks and the ability to respond to such risks?

Yes. The Compliance Branch of CFTC's Division of Market Oversight reviews the ability of applicants for designation and registration as DCMs and SEFs to comply with the requirements of the CEA and Commission regulations relating to market integrity, market surveillance, monitoring of market disruption risks and the ability to respond to such risks prior to their designation. Once a market is designated as a DCM or SEF, the Compliance Branch conducts regular and periodic RERs and SSEs to verify the entity's continuing compliance with these requirements.

See also response to Principle 33, Question 3(a) above regarding RERs and SSEs.

- (c) Provide the regulator with adequate access to all pre-trade and post-trade information available to market participants?

Yes.

DCMs. DCM Core Principle 7 requires each DCM to make available to market authorities, market participants, and the public accurate information concerning the terms and conditions of the contract market; the rules, regulations and mechanisms for executing transactions on or through the facilities of the contract market; and the rules and specifications describing the operation of the contract

market's electronic matching platform or trade execution facility.

DCM Core Principle 8 requires each DCM to make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market.

DCM Core Principle 18 requires each DCM to maintain records of all activities relating to the business of the DCM in a form and manner that is acceptable to the CFTC for a period of at least 5 years. CFTC regulation 38.951 provides that these records include trade records and investigatory and disciplinary files pursuant to CFTC regulation 1.31 and Part 45 of the CFTC's regulations.

A DCM must also report swap transaction data to the public and to the CFTC as prescribed in Parts 16, 43, and 45 of the CFTC's regulations.

SEFs. SEF Core Principle 5 requires each SEF to establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions under the core principles and to provide the information to the Commission on request.

SEF Core Principle 9 requires each SEF to make public timely information on price, trading volume, and other trading data on swaps as prescribed by the Commission. Specifically, each SEF must report swap data as required in Parts 16, 43, and 45 of the Commission's regulations.

SEF Core Principle 10 requires each SEF to maintain records of all activities relating to the SEF's business, including a complete audit trail, in a form and manner acceptable to the CFTC for a period of at least 5 years and to provide such information to the CFTC on request. *See also* CFTC regulations 37.1000 and 37.1001.

2. Does the regulatory framework require that amendments to the rules or requirements of the exchange, or trading system, must be provided to, or approved by, the regulator?

Yes. As discussed above in response to Principle 33, Question 4(a), DCMs and SEFs generally may implement new rules or rule amendments by either voluntarily submitting a rule change to the CFTC for review and approval under CFTC regulation 40.5 or by filing with the Commission a certification that the new rule or rule amendment complies with the CEA and CFTC regulation 40.6.

3. When the regulator determines that the exchange, or trading system, is unable to comply with the conditions of its approval, or with securities law or regulation, is there a mechanism that permits the regulator to:

(a) Re-examine the exchange, or trading system, and impose a range of actions, such

| | |
|-----|--|
| | as restrictions or conditions on the market operator? |
| | |
| (b) | Withdraw the exchange, or trading system, authorization? |
| | <p>Yes, to (a) and (b). The CFTC has the power to direct DCMs and SEFs to alter or supplement their rules and to take such action as it deems to be necessary to maintain or restore orderly trading. See Sections 8a(7) and (9) of the CEA, respectively.</p> <p>CEA Sections 5e and 6(b) authorize the CFTC to suspend or revoke registration based on a failure or refusal to comply with any of the provisions of the CEA, CFTC regulations, or CFTC orders.</p> |

| | |
|---|--|
| Principle 35 Regulation should promote transparency of trading. | |
| Key Questions | |
| 1. | Does the regulatory framework include: |
| (a) | Requirements or arrangements for providing pre-trade (e.g., posting of orders) information to market participants? |
| <p>Yes.</p> <p>DCMs. DCM Core Principle 9 requires a DCM to “provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade.” See also CFTC regulation 38.500. The CFTC has regulations in place for the competitive execution of transactions, such that the purchase and sale of commodity futures and options that are traded on or subject to DCM rules “shall be executed openly and competitively by open outcry or posting of bids and offers or by other equally open and competitive methods, in the trading pit or ring or similar place provided by the contract market, during the regular hours prescribed by the contract market for trading in such commodity or commodity option.” CFTC regulation 1.38.</p> <p>Consistent with the open and competitive execution requirements discussed above, all DCMs utilize central limit order books in which bids and offers are shown, and post price quote information on their public websites. DCMs are required to provide impartial access to their markets to ISVs, who are free to collect, aggregate, and disseminate pre- and post- trade information to the public. DCMs must also make public the information regarding “rules, regulations, and mechanisms for executing transactions on or through the facilities of the contract” as well as rules and specifications describing the operation of the DCM’s electronic matching platform and/or trade execution facility under Core Principle 7. See CFTC regulations 38.400 and 38.401.</p> <p>SEFs. Section 5h(e) of the CEA provides a rule of construction that states that the goal of SEF registration is to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market. The Commission interprets this mandate as follows:</p> <p>Pre-trade transparency with respect to the swaps market refers to making information about a swap available to the market, including bid (offers to buy) and offer (offers to sell) prices, quantity available at those prices, and other relevant information before the execution of a transaction. Such transparency lowers costs for investors, consumers, and businesses, and enhances market integrity to protect market participants and the public. By requiring the trading of swaps on SEFs and DCMs, all market participants will benefit from viewing the prices of available bids and offers and from having access to transparent and competitive trading systems or platforms.¹⁵⁶</p> | |

¹⁵⁶ *Core Principles and Other Requirements for Swap Execution Facilities*, 78 FR 33477 (June 4, 2013).

CEA Section 2(h)(8) requires that certain swap transactions be executed on a SEF or DCM. When such contracts are executed on a SEF, they must be executed on the SEF's order book or via a request-for-quote to three unaffiliated recipients. Participants may pre-arrange trades of such contracts; however, CFTC regulation 37.9(b) requires that the SEF post one side of the trade on its order book for at least 15 seconds in order to disclose the trade to other market participants and allow other market participants time to execute against the trade.

(b) Requirements or arrangements for providing post-trade information (e.g., last sale price and volume of transaction) to market participants on a timely basis?

DCMs. DCMs facilitate post-trade transparency by reporting the details of swap transactions on the DCM to a Commission-registered SDR. The DCM must transmit all swap transaction and pricing data for transactions executed on or pursuant to the rule of the DCM to the SDR as soon as technologically practicable after execution, unless the transaction qualifies for a reporting delay. The SDR must then, as soon as technologically practicable, disseminate the swap transaction and pricing data to the public in real-time. SDRs make the swap transaction and pricing data freely available to the public in a non-discriminatory manner through their websites.

Trade details made public through DCMs and SDRs include, but are not limited to: the trading date and time (execution timestamp), the unique product identifier, the price, price notation, notional amount, venue identification, and amendments to previously disseminated information (by amendment or correction). See CFTC regulations included in Part 43.

DCMs have further daily obligations to make futures and swap transaction information available to the public under CFTC regulations 16.01 and 38.450. These include daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts. All DCMs post price quote information on their public websites. In addition, DCMs are required to provide impartial access to their markets to ISVs, who collect, aggregate and disseminate pre- and post- trade information to the public.

SEFs. For SEFs, post-trade transparency includes "the public and timely transmission of information on past trades, including execution time, volume and price:"

The Dodd-Frank Act also ensures that a broader universe of market participants receive pricing and volume information by providing such information upon the completion of every swap transaction (*i.e.*, post-trade transparency). By requiring the trading of swaps on SEFs and [DCMs], all market participants will benefit from viewing the prices of available bids and offers and from having access to

transparent and competitive trading systems or platforms.¹⁵⁷

SEF Core Principle 9 requires each SEF to make public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission.

The Commission's rules for SEFs also require real-time reporting of all swap transaction terms "as soon as technologically practicable" in order to meet the statutory mandate of post-trade price transparency. See CFTC regulations 43.3(b) and 45.3(a).

CFTC regulation 16.01, applicable for both DCMs and SEFS, requires the reporting of transactions as follows:

(a) Trading volume and open contracts.

(1) Each reporting market, as defined in part 15 of this chapter, must separately record for each business day the information prescribed in paragraphs (a)(2)(i) through (vi) of this section for each of the following contract categories:

(i) For futures, by commodity and by futures expiration date;

(ii) For options, by underlying futures contracts for options on futures contracts or by underlying commodity for options on commodities, and by put, by call, by expiration date and by strike price;

(iii) For swaps or class of swaps, by product type and by term life of the swap; and

(iv) For options on swaps or classes of options on swaps, by underlying swap contracts for options on swap contracts or by underlying commodity for options on swaps on commodities, and by put, by call, by expiration date and by strike price.

(2) Each reporting market must record for each trading session the following trading volume and open interest summary data:

(i) The option delta, where a delta system is used;

¹⁵⁷ *Core Principles and Other Requirements for Swap Execution Facilities*, 78 FR at 33554.

(ii) The total gross open contracts for futures, excluding those contracts against which delivery notices have been stopped;

(iii) For futures products that specify delivery, open contracts against which delivery notices have been issued on that business day;

(iv) The total volume of trading, excluding transfer trades or office trades:

(A) For swaps and options on swaps, trading volume shall be reported in terms of the number of contracts traded for standard-sized contracts (*i.e.*, contracts with a set contract size for all transactions) or in terms of notional value for non-standard-sized contracts (*i.e.*, contracts whose contract size is not set and can vary for each transaction).

(B) [Reserved]

(v) The total volume of futures/options/swaps/swaptions exchanged for commodities or for derivatives positions that are included in the total volume of trading; and

(vi) The total volume of block trades included in the total volume of trading.

(b) Prices.

(1) Each reporting market must record the following contract types separately

(i) For futures, by commodity and by futures expiration;

(ii) For options, by underlying futures contracts for options on futures contracts or by underlying commodity for options on commodities, and by put, by call, by expiration date and by strike price;

(iii) For swaps, by product type and contract month or term life of the swap; and

(iv) For options on swaps or classes of options on swaps, by underlying swap contracts for options on swap contracts or by

underlying commodity for options on swaps on commodities, and by put, by call, by expiration date and by strike price.

(2) Each reporting market must record for the trading session and for the opening and closing periods of trading as determined by each reporting market:

(i) The opening and closing prices of each futures, option, swap or swaption;

(ii) The price that is used for settlement purposes, if different from the closing price; and

(iii) The lowest price of a sale or offer, whichever is lower, and the highest price of a sale or bid, whichever is higher, that the reporting market reasonably determines accurately reflects market conditions. Bids and offers vacated or withdrawn shall not be used in making this determination. A bid is vacated if followed by a higher bid or price and an offer is vacated if followed by a lower offer or price.

(3) If there are no transactions, bids, or offers during the opening or closing periods, the reporting market may record as appropriate:

(i) The first price (in lieu of opening price data) or the last price (in lieu of closing price data) occurring during the trading session, clearly indicating that such prices are the first and last prices; or

(ii) Nominal opening or nominal closing prices that the reporting market reasonably determines to accurately reflect market conditions, clearly indicating that such prices are nominal.

(4) Additional information. Each reporting market must record the following information with respect to transactions in commodity futures, commodity options, swaps or options on swaps on that reporting market:

(i) The method used by the reporting market in determining nominal prices and settlement prices; and

(ii) If discretion is used by the reporting market in determining the opening and/or closing ranges or the settlement prices, an explanation that certain discretion may be employed by the

reporting market and a description of the manner in which that discretion may be employed. Discretionary authority must be noted explicitly in each case in which it is applied (for example, by use of an asterisk or footnote).

(c) Critical dates. Each reporting market must report to the Commission, for each futures contract, the first notice date and the last trading date, and for each option contract, the expiration date in accordance with paragraph (d) of this section.

(d) Form, manner and time of filing reports. Unless otherwise approved by the Commission or its designee, reporting markets must submit to the Commission the information specified in paragraphs (a), (b), and (c) of this section as follows:

(1) Using the format, coding structure and electronic data transmission procedures approved in writing by the Commission or its designee; provided however, that the information must be made available to the Commission or its designee in hard copy upon request;

(2) When each such form of the data is first available, but not later than 7:00 a.m. on the business day following the day to which the information pertains for the delta factor and settlement price and not later than 12:00 p.m. for the remainder of the information. Unless otherwise specified by the Commission or its designee, the stated time is U.S. eastern standard time for information concerning markets located in that time zone, and U.S. central time for information concerning all other markets; and

(3) For information on reports to the Commission for swap or options on swap contracts, refer to part 20 of this chapter.

(e) Publication of recorded information.

(1) Reporting markets must make the information in paragraph (a) of this section readily available to the news media and the general public without charge, in a format that readily enables the consideration of such data, no later than the business day following the day to which the information pertains. The information in paragraphs (a)(2)(iv) through (vi) of this section shall be made readily available in a format that presents the information together.

(2) Reporting markets must make the information in paragraphs (b)(2)

and (3) of this section readily available to the news media and the general public, and the information in paragraph (b)(4)(ii) of this section readily available to the general public, in a format that readily enables the consideration of such data, no later than the business day following the day to which the information pertains. Information in paragraph (b)(4)(i) of this section must be made available in the registered entity's rulebook, which is publicly accessible on its website.

Entity-Netted Notionals Report. SDRs have greatly enhanced the Commission's ability to monitor derivatives markets. Using this data source, as discussed in response to Principle 6, Question 2, on a quarterly basis, the CFTC computes ENNs for interest rate swaps, credit default swaps on corporates and sovereigns, and foreign exchange swaps.

Weekly Swaps Report. The CFTC publishes a weekly report which provides aggregate notional metrics for swap market transactions and positions reported to three SDRs by swap market participants. In aggregate, this report provides a summary of around \$350tn of reported swap position notional. The report is published every Wednesday at 3:30 p.m. and provides aggregate summaries for trades and positions as of two weeks prior.

The report is structured as a set of tables and supporting documentation. The report provides three views of the swaps market: measures of the gross notional outstanding value, the weekly transactions measured by dollar volume, and the weekly transactions measured by ticket volume (in all three views, only "market-facing" swaps are included so, for example, inter-affiliate trades are omitted). For each asset class, the report provides detailed breakdowns of the swaps market by product type, currency, tenor, participant type, as well as whether swap trades/positions are cleared or uncleared. Since October 2018, the report has included positions and transactions in CFTC-regulated FX markets, to supplement the earlier interest rate and credit asset classes, introduced at the end of 2013. The weekly reports provide information not only on the prevalence of certain swap activities, such as clearing or swap dealer vs non-swap dealer volumes, but also how these relative measures have changed across time. The Weekly Swaps Report is available on the CFTC's website.

(c) Requirements or arrangements that information on completed transactions be provided on an equitable basis to all market participants?

Yes. DCM Core Principle 8, Daily Publication of Trading Information, requires that a DCM make available to the public accurate information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market. See CFTC regulation 38.450. Additionally, DCM Core

Principle 7, Availability Of General Information, requires a DCM to make publicly available accurate information regarding the contract market's terms and conditions of the contracts; the rules, regulations and mechanisms for executing transactions on or through the contract market; and the rules and specifications describing the operation of the contract market's electronic matching platform or trade execution facility. See CFTC regulations 38.400 and 38.401. DCM Core Principle 7 requires making public the rules and specifications describing the operation of the DCM's electronic matching platform or trade execution facility. DCMs are required to "ensure that authorities, market participants, and the public have available all material information pertaining to new product listings, new or amended governance, trading and product rules, or other changes to information previously disclosed by the DCM." See CFTC regulation 38.401.

Similarly, CFTC regulation 37.500 requires that SEFs make certain swap data, including end of day pricing data and trading volume, publicly available each day.

CFTC regulation 16.01 provides that reporting markets, both DCMs and SEFs, shall make readily available data pertaining to trading volume, open contracts, and price to the news media and general public without charge, in a format that readily enables the consideration of such data, for each business day following for each of the following contract categories:

- (i) For futures, by commodity and by futures expiration date;
- (ii) For options, by underlying futures contracts for options on futures contracts or by underlying commodity for options on commodities, and by put, by call, by expiration date and by strike price;
- (iii) For swaps or class of swaps, by product type and by term life of the swap; and
- (iv) For options on swaps or classes of options on swaps, by underlying swap contracts for options on swap contracts or by underlying commodity for options on swaps on commodities, and by put, by call, by expiration date and by strike price.

Section 21 of the CEA covers reporting by SDRs and addresses the provision of direct electronic access to the Commission as well as the establishment of "systems for monitoring, screening, and analyzing swap data, including compliance and frequency of end user clearing exemption claims by individual and affiliated entities." This section also refers to Section 2(a)(13) of the CEA on the "Public Availability of Swap Transaction Data." Section 2(a)(13) states: "[t]he purpose of this section is to authorize the Commission to make swap transaction and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery." Such real-time reporting is done "as soon as technologically practicable after the time at which the swap transaction has been executed." CFTC regulation 49.15 requires SDRs to establish electronic systems to accept and publicly disseminate real-time swap transaction

| | |
|-----|---|
| | and pricing data as required by Part 43 of the CFTC regulations. CFTC regulation 43.3 contains the requirements for real-time public reporting, including the CFTC regulation 43.3(d) requirement for SDRs to publicly disseminate swap transaction and pricing data in a consistent, usable, and machine-readable electronic format and to make the data freely available and readily accessible to the public through the Internet. |
| 2. | Where derogation from the objective of real-time transparency is permitted: |
| (a) | Are the conditions clearly defined? |
| | <p>Yes. Post-trade public dissemination of transaction data is waived for swap transactions that are large in scale and qualify as a “block trade” or “large notional off-facility swap transaction” under Part 43 of the Commission’s regulations. A block trade in a swap occurs away from a DCM or SEF, but pursuant to the DCM’s or SEF’s rules, and has a notional or principle amount at or above the minimum block threshold. A large notional off-facility swap is an off-facility swap that does not meet the definition of a “block trade,” but is for a notional or principle amount in excess of the minimum block threshold. Post-trade public dissemination of transaction data is deferred for large transactions that qualify as a “block trade” or “large notional off-facility swap transaction” under Part 43 of the Commission’s regulations.</p> |
| (b) | Does the market authority (being either, or both, the exchange operator and the regulator) have access to the complete information to be able to assess the need for derogation and, if necessary, to prescribe alternatives? |
| | <p>Yes. As discussed in response to Principle 35, Question 1(c), DCMs must comply with: DCM Core Principle 7 (Availability of General Information), DCM Core Principle 8 (Daily Publication of Trading Information), CFTC regulation 16.01 (Publication of Market Data on Futures, Swaps and Options Thereon: Trading Volume, Open Contracts, Prices, and Critical Dates), CFTC regulation 16.02 (Daily Trade and Supporting Data Reports), Part 43 (Real-Time Public Reporting), and Part 45 (Swap Data Recordkeeping and Reporting Requirements).</p> <p>DCM Core Principle 7 specifically states that market authorities must have access to certain information regarding the DCM, its operations and its products. Furthermore, DCMs must have procedures, arrangements and resources for disclosing to the Commission, market participants and the public accurate information pertaining to:</p> <ul style="list-style-type: none"> (i) Contract terms and conditions; (ii) Rules and regulations pertaining to the trading mechanisms; and (iii) Rules and specifications pertaining to operation of the electronic matching platform or trade execution facility. (CFTC regulations 38.400 and 38.401). |

| | |
|------------|--|
| | <p>DCM Core Principle 8 states that daily information “on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market” must be made publicly available as contemplated in Commission regulations (CFTC regulation 38.450; <i>see also</i> CFTC regulation 16.01).</p> <p>DCM Core Principle 18 states that the DCM must maintain records of all activities relating to the business of the DCM for a period of at least five years.</p> <p>The CFTC’s SEF regulations establish a similar set of requirements for SEFs, including CFTC regulation 37.500 (Ability to obtain information), CFTC regulation 37.502 (Collection of information), CFTC regulation 37.503 (Provide information to the Commission), CFTC regulation 37.900 (Timely publication of trading information) and CFTC regulation 37.1000 (Recordkeeping and reporting).</p> <p>Data for swaps that are block trades under Part 43 of the CFTC’s regulations must also be reported to SDRs without any derogation under Part 45 of the CFTC’s regulations. This more robust and un-delayed data is then made available to the CFTC pursuant to CFTC regulations in Part 49.</p> |
| <p>(c)</p> | <p>Does the regulator have access to adequate information to monitor the development of dark trading and dark orders?</p> |
| | <p>Futures must be traded on DCMs so there is no dark trading in this area that the Commission could monitor or have access to.</p> <p>With respect to swaps, there exist both Required Transactions and Permitted Transactions. The former refers to transactions subject to the trade execution mandate under Section 2(h)(8) of the CEA and while the latter refers to transactions that are not subject to the clearing and trade execution mandates, such as illiquid or bespoke swaps, or block trades. Permitted Transactions are not subject to the trade execution mandate and could, therefore, be traded off-market.</p> <p>All swaps, regardless of where they are executed and the methods of execution, must be reported to SDRs under Part 43 and/or Part 45 of the CFTC regulations. The data related to all swaps is available to the CFTC pursuant to Part 49 of the CFTC regulations.</p> |
| <p>(d)</p> | <p>Do transparent orders have priority over dark orders?</p> |
| | <p><i>See response to Principle 35, Question 2(c), above.</i></p> |
| <p>(e)</p> | <p>Do dark pools, and transparent markets that offer dark orders, provide market participants with sufficient information so that they are able to understand the manner in which their orders are handled and executed?</p> |
| | |

DCMs and SEFs are regulated markets that do not allow dark orders.

| | |
|---|---|
| Principle 36 | Regulation should be designed to detect and deter manipulation and other unfair trading practices. |
| Key Questions | |
| 1. | Does the regulatory system prohibit the following with respect to products admitted to trading on authorized exchanges and regulated trading systems: |
| (a) | Market or price manipulation (or attempts at market or price manipulation)? |
| (b) | Misleading information? |
| (c) | Insider trading? |
| (d) | Front running? |
| (e) | Other fraudulent or deceptive conduct and market abuses? |
| <p>Yes, to all of the above.</p> <p>The CEA has multiple enforcement provisions related to items 1(a) through (e) above.</p> <p>CFTC regulations 33.10, 180.1, and 180.2 (which apply to DCMs pursuant to CFTC regulation 38.2) prohibit manipulation and other unfair trading practices. CFTC regulation 33.10 makes it unlawful for any person to cheat, defraud or attempt to cheat or defraud any other person; to make or cause to be made to any other person any false report or statement or record; or to deceive or attempt to deceive any other person by any means whatsoever in connection with commodity option transactions. CFTC regulation 180.1 prohibits the employment, or attempted employment, of manipulative and deceptive devices, which include: (1) any manipulative device, scheme, or artifice to defraud; (2) untrue or misleading statements of a material fact; (3) engaging or attempting to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person; and (4) false or misleading or inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of a commodity. CFTC regulation 180.2 prohibits price manipulation.</p> <p>CFTC regulation 1.59 prohibits any DCM or SEF employee, governing board member, committee member, or consultant from improperly disclosing material, non-public information obtained through special access related to the performance of such person's official duties and from trading on such person's own account, or for or on behalf of any other account, in any commodity interest, on the basis of such information. CFTC regulation 1.59 also prohibits any person from trading for such person's own account, or for or on behalf of any other account, in any commodity interest, on the basis of any material, non-public information that such person knows was obtained in violation of applicable</p> | |

regulations from an employee, governing board member, committee member, or consultant. Additionally, CFTC regulation 1.59 requires a SEF or a DCM to have rules that prohibit employees from trading in any commodity interest traded on the SEF or DCM and that prohibit employees from trading in commodity interests on other exchanges based on material non-public information.

DCM Core Principle 2 requires DCMs to have rules prohibiting abusive trading practices on the exchange.¹⁵⁸ CFTC regulations 38.156 and 38.157, respectively require DCMs to have an automated trade surveillance system to detect trade practice violations and to engage in real-time monitoring to identify disorderly trading and any market or system anomalies.

DCM Core Principle 3 requires DCMs to list only contracts that are not readily susceptible to manipulation.¹⁵⁹ In order to demonstrate compliance with the requirement that contracts not be readily susceptible to manipulation, DCMs listing new futures contracts should provide the Commission with certain information, including, among other things, data and information to support the contract's terms and conditions and a detailed cash market description for physical and cash-settled contracts.¹⁶⁰ When designing futures contracts, DCMs should conduct market research so that the product meets the risk management needs of users and promotes price discovery.¹⁶¹ For futures contracts settled by physical delivery, the terms and conditions should be designed to avoid impediments to delivery so as to promote convergence between the price of the futures contract and the cash-market value of the commodity.¹⁶² The specified terms and conditions should result in a deliverable supply that is sufficient to ensure that the contract is not susceptible to price manipulation or distortion.¹⁶³ For cash-settled futures contracts, contract specifications should fully describe the essential economic characteristics of the underlying commodity, as well as how the final settlement price is calculated.¹⁶⁴ In evaluating susceptibility to manipulation, DCMs should

¹⁵⁸ See also CFTC regulations 38.150 and 38.152.

¹⁵⁹ See also CFTC regulation 38.200.

¹⁶⁰ Appendix C to Part 38 at (a)(2).

¹⁶¹ *Id.* at (a)(1).

¹⁶² CFTC regulation 38.252.

¹⁶³ Appendix C to Part 38 at (b)(1)(i)(A).

¹⁶⁴ *Id.* at(c)(1).

consider the size and liquidity of the underlying cash market.¹⁶⁵ Each DCM must also demonstrate that it: monitors the pricing of the index to which the cash-settled contract will be settled; monitors the continued appropriateness of the methodology deriving the index; and makes a good faith effort to resolve conditions where there is a threat of market manipulation, disruptions, or distortions.¹⁶⁶ A DCM should determine that the reference price indices used for swap contracts are not readily susceptible to manipulation, giving careful consideration to the potential for manipulation or distortion of the cash settlement price, as well as the reliability of that price as an indicator of cash market value.¹⁶⁷

DCM Core Principle 4 requires DCMs to have the capacity and responsibility to prevent manipulation, price distortion and disruptions of the delivery or cash-settlement process through market surveillance, compliance and enforcement practices and procedures, including (a) methods for conducting real-time monitoring of trading and (b) comprehensive and accurate trade reconstructions.¹⁶⁸ CFTC regulation 38.255 requires DCMs to “establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions, including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the designated contract market.”

Finally, to reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), DCMs must, for each contract, as is necessary and appropriate, adopt position limitations or position accountability for speculators. For any contract that is subject to a position limitation established by the Commission, the DCM must set the position limitation at a level not higher than the position limitation established by the Commission.¹⁶⁹

The CEA and CFTC regulations also require SEFs to prevent and monitor market or price manipulation, misleading information, insider trading, front running, and other fraudulent or deceptive conduct or market abuses. CFTC regulations 33.10, 180.1 and 180.2, which are discussed above, also apply to SEFs pursuant to CFTC regulation 37.2.

SEF Core Principle 2 requires SEFs to have rules prohibiting abusive trading

¹⁶⁵ *Id.* at (a)(1).

¹⁶⁶ CFTC regulation 38.253.

¹⁶⁷ Appendix C to Part 38 at (g)(1).

¹⁶⁸ CFTC regulations 38.250-258.

¹⁶⁹ DCM Core Principle 5; CFTC regulation 38.300.

practices on the exchange.¹⁷⁰ CFTC regulation 37.203 requires SEFs to engage in real-time monitoring for trading and have an automated trade surveillance system to detect trade practice violations.

SEF Core Principle 3 provides that SEFs may only permit trading in contracts that are not readily susceptible to manipulation.¹⁷¹ Like DCMs, in order to demonstrate compliance with the requirement that contracts are not readily susceptible to manipulation, SEFs listing new contracts should provide the Commission with certain information including, among other things, data and information to support the contract's terms and conditions and a detailed cash market description for physical and cash-settled contracts.¹⁷² When designing contracts, SEFs should conduct market research so that the product meets the risk management needs of users and promotes price discovery.¹⁷³ For contracts settled by physical delivery, the terms and conditions should be designed to avoid impediments to delivery so as to promote convergence between the price of the contract and the cash-market value of the commodity at the expiration of the contract.¹⁷⁴ The specified terms and conditions should result in a deliverable supply that is sufficient to ensure that the contract is not susceptible to price manipulation or distortion.¹⁷⁵ For cash-settled contracts, contract specifications should fully describe the essential economic characteristics of the underlying commodity, as well as how the final settlement price is calculated.¹⁷⁶ In evaluating susceptibility to manipulation, SEFs should consider the size and liquidity of the underlying cash market.¹⁷⁷

SEFs must monitor trading on their facility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures.¹⁷⁸ CFTC regulation 37.401 requires SEFs to monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, disciplinary practices and procedures, and risk control mechanisms. In addition, CFTC regulation 37.405 requires SEFs to

¹⁷⁰ See also CFTC regulation 37.200.

¹⁷¹ See also CFTC regulation 37.300.

¹⁷² Appendix C to Part 38 at (a)(2) (which applies to SEFs pursuant to CFTC regulation 37.201).

¹⁷³ *Id.* at (a)(1).

¹⁷⁴ *Id.* at (b)(1).

¹⁷⁵ *Id.* at (b)(1)(i)(A).

¹⁷⁶ *Id.* at (c)(1).

¹⁷⁷ *Id.* at (c)(2).

¹⁷⁸ SEF Core Principle 4 and CFTC regulation 37.400.

establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the designated contract market. Finally, to reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), SEFs must, for each contract, as is necessary and appropriate, adopt position limitations or position accountability for speculators. For any contract that is subject to a position limitation established by the Commission, SEFs must set the position limitation at a level no higher than the position limitation established by the Commission.¹⁷⁹

In addition, DOE is empowered to investigate violations of core principles relating to registered entities.

For a broad overview of the CFTC's Enforcement Program, please refer to the CFTC DOE, *Enforcement Manual* (May 8, 2019), available on the CFTC's website. (Note that this is the first public manual setting out the Division's operations, policies, and procedures issued by the CFTC's DOE.)

Market or price manipulation. The exchanges are obliged to detect and deter unlawful conduct and use a combination of direct surveillance, inspection, reporting, product design requirements, position limits, settlement price rules, or market halts complemented by vigorous enforcement of their rules. The CFTC conducts oversight of the exchanges' programs to ensure effectiveness. In addition to the exchange surveillance program, the CFTC independently conducts a market surveillance program. DOE also aggressively pursues leads to detect and deter violations, including manipulation.

With respect to a specific inquiry, the CFTC has power to investigate possible violations of the CEA.

The CFTC has comprehensive investigative and enforcement powers under the CEA. The CFTC enforces compliance with the laws and regulations relating to futures, options on futures, and swaps by conducting investigations and bringing enforcement actions where appropriate. The CFTC has broad authority to investigate actual or potential violations of the CEA and Commission regulations and to determine the scope of its investigations and the persons and entities subject to investigation.

Section 8(a)(1) of the CEA authorizes the Commission to make such investigations as it deems necessary to ascertain the facts regarding the operations of boards of

¹⁷⁹ SEF Core Principle 6 and CFTC regulation 37.600.

trade and other persons subject to the provisions of this chapter. Further, Section 6(c) of the CEA provides:

For the purpose of securing effective enforcement of the provisions of this chapter, for the purpose of any investigation or proceeding under this chapter, ... any member of the Commission or any Administrative Law Judge or other officer designated by the Commission ... may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records that the Commission deems relevant or material to the inquiry.

Finally, Part 11 of the Commission's regulations, Relating to Investigations, sets forth the rules applicable to investigatory proceedings conducted by the Commission to determine whether there have been violations of the CEA or the Commission's regulations. CFTC regulation 11.2 sets out the authority of the DOE to carry out Section 6(c) of the CEA and conduct the investigations, which includes obtaining evidence through voluntary statements and submissions, through exercise of inspection powers over registrants, and through the issuance of subpoenas. In addition, Part 11 of the Commission's regulations provides witnesses certain procedural protections, such as the right to have a lawyer present when testifying and to review the Commission's order of investigation. A witness can also assert his or her Fifth Amendment protection against self-incrimination. CFTC investigations are non-public.

In particular, DOE employs its full panoply of investigative powers to examine conduct that affects the integrity of the commodity futures and swaps markets, including price manipulation, cornering, and communication of false information that tends to affect commodity prices;¹⁸⁰ position limit violations;¹⁸¹ enumerated trade practice violations, such as wash trades, accommodation trades, and fictitious sales;¹⁸² and disruptive practices, such as violating bids or offers, spoofing, and disregard for the orderly execution of transactions during the closing period¹⁸³; and prohibits the use or attempted use of any manipulative device, scheme, or artifice to defraud, untrue or misleading statement, false report, or any act that operates or would operate as a fraud.¹⁸⁴

¹⁸⁰ CEA Sections 6(c)(1)(A), 6(c)(3), and 9(a)(2); CFTC regulation 180.2.

¹⁸¹ CEA Section 4a(e).

¹⁸² CEA Section 4c(a).

¹⁸³ CEA Section 4c(a).

¹⁸⁴ CEA Section 6(c)(1) and CFTC regulation 180.1.

To the extent the investigation indicates a violation of the CEA or Commission regulations; the Commission takes appropriate enforcement action. Under Sections 6(c), 6(d) and 6c of the CEA, the CFTC has the authority to file a civil enforcement action in Federal district court or an administrative enforcement proceeding in an administrative tribunal to ensure compliance with the CEA and Commission regulations.

The relief available in Federal district court is composed of the remedies that Congress expressly authorized Federal courts to grant under Section 6c of the CEA and the Federal courts' general equitable powers. Thus, the Commission's Federal court enforcement actions may seek any or all of the following types of relief when appropriate:

- Preliminary and permanent injunctions barring future violations of the CEA and CFTC regulations and enforcing compliance with the CEA and regulations;
- An ex parte order (i) prohibiting any person from destroying, altering or disposing of, or refusing to permit authorized representatives of the Commission to inspect, when and as requested, any books and records or other documents, (ii) prohibiting any person from withdrawing, transferring, removing, dissipating, or disposing of any funds, assets, or other property, or (iii) appointing a temporary receiver to administer such restraining order;
- Imposition of civil monetary penalties;
- Appointment of a receiver to administer a defendant's estate;
- An order directing that a defendant disgorge ill-gotten gains;
- An order directing that a defendant make restitution to persons who have sustained losses proximately caused by such violations in the amount of such losses;
- An order rescinding all contracts entered into by a defendant with any customer;
- An order directing that the defendant make an accounting (in a form and by an individual or firm approved by the Commission and the court) of the defendant's estate; and
- An award of pre-judgment interest on any sums to be disgorged or paid in restitution.

All complaints initiating an administrative action pursuant to Sections 6(c) and 6(d) of

the CEA are conducted under the Commission's Rules of Practice contained in Part 10 of the Commission's regulations. The following sanctions are available in administrative actions and all administrative complaints notify respondents of these possible sanctions that can be imposed if liability is found:

- An order prohibiting a respondent from trading on or subject to the rules of any contract market and requiring all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order;
- An order suspending (for a period of not more than six months), revoking or restricting a respondent's registration with the Commission;
- An order assessing civil monetary penalties against a respondent, not to exceed \$140,000 per violation (\$1 million for manipulation);
- An order directing that a respondent make restitution to customers of damages proximately caused by the respondent's violations; and
- An order directing a respondent to cease and desist from violating the CEA or CFTC regulations in an administrative action brought pursuant to Section 6(d) of the CEA.

As set forth above, the Commission has a myriad of tools at its disposal to deter and remediate violations of the CEA. The interplay of many factors influences the particular mix of sanctions imposed in any given matter. The Commission bases its analysis of an appropriate sanction in a matter on the gravity of the offense, the specific circumstances of each violation and violator, the deterrent and remedial effect of each package of sanctions and penalties imposed in analogous cases. The Commission has identified a variety of factors relevant to ascertaining the gravity of an offense, including whether the violation involves core provisions of the CEA, like fraud and manipulation, and whether the violator acted willfully. The Commission may also consider the impact of the case on Commission resources as a result of cooperation or settlement. These factors provide guidance for all parties in the Commission's adjudicatory process.

In addition to other substantive violations of the CEA, as set forth in Section 6(c), if an individual or firm named in a subpoena refuses to comply with its terms, the Commission may apply to a Federal district court to enforce the subpoena. The Commission has delegated its authority to file a subpoena enforcement action to the Director of DOE. In pertinent part, Section 6(c) of the CEA provides as follows:

In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction in which the investigation . . . is conducted, or where such person resides or transacts business, in requiring the

attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. Such court may issue an order requiring such person to appear before the . . . officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question.

If the subpoenaed party refuses to comply with the district court's order enforcing the subpoena, the court can punish the party for contempt.

The CFTC has the power to refer matters for criminal prosecution to DOJ, but cannot independently initiate such actions. Alleged criminal violations of the CEA pursuant to Section 9 of the CEA or violations of other Federal laws that involve commodity futures trading are frequently referred to DOJ for prosecution.

The CFTC also works closely with criminal and civil state agencies, particularly members of the North American Securities Administrators Association, Inc. and offices of State attorney generals. Pursuant to statutory authority under the CEA, States can join as co-plaintiffs in CFTC Federal court injunctive enforcement actions and have done so in over 80 matters since afforded that authority

Misleading information. One mainstay of the CFTC's enforcement program is the detection, investigation, and prosecution of fraudulent and manipulative practices. To that end, the Commission has the power to investigate possible violations of the CEA and employ its full panoply of investigative powers to examine the conduct at issue. To the extent an investigation indicates a violation of the CEA, the Commission takes appropriate enforcement action as described above.

In general, Section 4b(a) of the CEA makes it unlawful for any person, in or in connection with any order, or the making of, any contract of sale of any commodity in interstate commerce or for future delivery on or subject to the rules of a DCM, for or on behalf of any other person:

- To cheat or defraud or attempt to cheat or defraud another person;
- Willfully to make or cause to be made to another person any false report or statement or willfully to enter or cause to be entered for the other person any false record;
- Willfully to deceive or attempt to deceive another person;
- Bucket such order (if such order is represented as an order to be executed); or
- Fill such order by offset against the order of any other person, or willfully or knowingly and without prior consent of the other person to become the buyer

in respect to any selling orders or become the seller in respect to any buying order of such person.

CEA Section 4c prohibits “enter[ing] into a swap knowing, or acting in reckless disregard of the fact, that [a] counterparty will use the swap as part of a device, scheme, or artifice to defraud any third party.”

CEA Section 4o makes it unlawful for a CTA, associated person of a CTA, CPO, or associated person of a CPO, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly (A) to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or (B) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant. Section 4o further makes it unlawful for any CTA, associated person of a CTA, CPO, or associated person of a CPO registered under this Act to represent or imply in any manner whatsoever that such person has been sponsored, recommended, or approved, or that such person's abilities or qualifications have in any respect been passed upon, by the United States or any agency or officer thereof.

CFTC regulation 33.10 (which applies to DCMs pursuant to CFTC regulation 38.2) makes it unlawful for any person to cheat, defraud, or attempt to cheat or defraud any other person; to make or cause to be made to any other person any false report or statement or record; or to deceive or attempt to deceive any other person by any means whatsoever in connection with commodity option transactions.

Section 6(c)(1) of the CEA and CFTC regulation 180.1(a) prohibit the intentional or reckless use of any “manipulative or deceptive device or contrivance” in connection with any swap or contract of sale of any commodity in interstate commerce or for future deliver on or subject to the rules of any registered entity and includes a special provision for manipulation by false or misleading or inaccurate reporting.¹⁸⁵

Section 6(c)(2) of the CEA makes it unlawful to make any false or misleading statement of a material fact to the Commission. CEA Section 9(a)(3) makes it a felony knowingly to make or cause to be made any false or misleading statement, or knowing omission of a material fact, in a document required to be filed under the CEA or CFTC regulations or any undertaking contained in any registration statement required under the CEA or by any SRO. CEA Section 9(a)(4) makes it a felony willfully to make a false statement to or conceal a material fact from an SRO.

Insider Trading and Front Running. Section 9(e) of the CEA provides an explicit

¹⁸⁵ See also CFTC regulation 180.1(a).

prohibition against insider trading by employees of the CFTC and registered entities, making it a felony:

- (1) for any person who is an employee, member of the governing board, or member of any committee of a board of trade, registered entity, or registered futures association, in violation of a regulation issued by the Commission, willfully and knowingly to trade for such person's own account, or for or on behalf of any other account, in contracts for future delivery or options thereon on the basis of, or willfully and knowingly disclose for any purpose inconsistent with the performance of such person's official duties as an employee or member, any material non-public information obtained through special access related to the performance of such duties; and
- (2) willfully and knowingly to trade for such person's own account, or for or on behalf of any other account, in contracts for future delivery or options thereon on the basis of material, non-public information that such person knows was obtained in violation of paragraph (1) from an employee, member of the governing board, or member of any committee of a board of trade, registered entity, or registered futures association.

It should be noted that the CEA's prohibitions of insider trading in Sections 9(c) and (d) apply to Commission employees and employees of SROs, as well as the SRO's board and committee members.¹⁸⁶

Section 4c(a)(4) of the CEA prohibits insider trading on the basis of information emanating from Federal government departments and agencies that may affect or tend to affect the price of any commodity in interstate commerce or swap and persons who receive and trade in this information. This prohibition applies to employees or agents of a Federal government department or agency or any person who receives information imparted by such an employee or agent and who knowingly uses the information to trade.

Insider trading by others in the derivatives markets (*e.g.*, a broker trading ahead of an executable customer order) may also be actionable under the CEA's anti-fraud provisions, including CEA Sections 4b and 6(c)(1). This is generally articulated under a theory of misappropriation of material, non-public information. The CFTC has brought several cases on this theory since the last FSAP update. *See, e.g., In re Ruggles*, CFTC No. 16-34, 2016 WL 5682206 (Sept. 29, 2016) (consent order) (finding that a futures and options trader misused his employer's material, non-public information to trade for his own personal benefit in personal trading accounts, including by engaging in front-running); *In re Motazed*, CFTC No. 16-02,

¹⁸⁶ See CEA Section 9(e); CFTC regulation 1.59.

2015 WL 7880066 (Dec. 2, 2015) (consent order) (finding that a gasoline futures trader misused his employer’s material, non-public information to trade for his own personal benefit in his personal trading accounts, including by engaging in front-running); *see also* Complaint, *CFTC v. EOX Holdings LLC*, No. 18-cv-8890 (S.D.N.Y. Sept. 28, 2018), ECF No. 1 (alleging that block trader broker engaged in insider trading by disclosing material, non-public information to a large, favored customer, including information about other customers’ identifies, trading activity, and positions).

Other Fraudulent or Deceptive Conduct and Market Abuses. CEA Section 4c(a) makes it unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that:

- violates bids or offers;
- demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
- is of the character of, or is commonly known to the trade as, “spoofing” (bidding or offering with the intent to cancel the bid or offer before execution).

The CFTC has brought a number of cases under CEA Section 4c(a), including a large number of cases alleging spoofing, some in combination with parallel criminal action. *See, e.g.*, Release No. 7681-18, *CFTC Files Eight Anti-Spoofing Enforcement Actions against Three Banks (Deutsche Bank, HSBC & UBS) & Six Individuals* (Jan. 29, 2018), <https://www.cftc.gov/PressRoom/PressReleases/pr7681-18>; DOJ, Press Release: Acting Assistant Attorney General John P. Cronan Announces Futures Markets Spoofing Takedown (Jan. 29, 2018), <https://www.justice.gov/opa/speech/acting-assistant-attorney-general-john-p-cronan-announces-futures-markets-spoofing>.

2. Does the regulatory approach to detect and deter such conduct include an effective and appropriate combination of mechanisms drawn from the following:

(a) Direct surveillance, inspection, reporting, such as, for example:

(i) securities listing, or product design requirements (where applicable);

Futures exchanges can self-certify new products or amendments to existing products that are listed for trading. Exchanges provide product-related information to the Commission as appropriate. The DMO Product Review branch reviews such filings.

(ii) position limits;

The Commission has established federal speculative position limits for nine agricultural commodities for the spot month, single month and all months

| | |
|--|---|
| | <p>combined. The Commission receives data from reporting firms such as FCMs that can be used to determine a trader’s reportable position at the end of the day. Transaction data submitted to the Commission by the futures exchanges can be used to detect potential intraday speculative position limit violations. Bona fide hedge exemptions may need to be accounted for in such analyses. Data related to bona fide hedged exemptions is collected by the Commission.</p> |
| | <p>(iii) audit trail requirements;</p> |
| | <p>The Commission can obtain order and message related data from a DCM or SEF. DOE staff, including the Surveillance Branch, can examine such data in order to determine whether market integrity may have been harmed. <i>See also</i> CFTC regulation 1.35.</p> |
| | <p>(iv) quotation display rules;</p> |
| | <p><i>See above.</i> In addition, DOE staff has obtained and examined order and message data from DCMs to detect abusive trading practices such as spoofing.</p> |
| | <p>(v) order handling rules;</p> |
| | <p>DOE staff may use futures transaction and order and message data to determine whether a trader may have engaged in insider trading or front running. Information submitted by FCMs and other reporting firms may also be used to help identify trading accounts.</p> |
| | <p>(vi) settlement price rules;</p> |
| | <p>As part of its market integrity program, DOE Surveillance Branch staff monitor settlements for certain futures contracts. Forensic practices for conducting settlement surveillance include the examination futures and swap positions and transactions in order to determine whether a trader may have attempted to manipulate the settlement price of a futures contract.</p> |
| | <p>(vii) market halts, complemented by enforcement of the law and trading rules; or</p> |
| | <p>The Commission receives information concerning any applicable market halt, pause or other types of trading restriction on a daily basis from DCMs. Such alerts may stem from circuit breakers, stop logic procedures, velocity logic, and limit up/downs. Commission staff may examine transactions executed during such events and order and message data.</p> |
| | <p>(viii) power to obtain information on a market participant’s positions in related OTC commodity derivatives and the underlying physical commodity</p> |

| |
|---|
| markets. |
| <p>CFTC regulation 18.05 pertains to the maintenance of books and records. It provides the Commission with the authority to obtain all positions and transactions in the commodity or swap executed on all reporting markets (including DCMs and SEFs), OTC or on foreign boards of trade. In particular, traders that have a reportable position are required to keep books and records showing all details concerning all such positions and transactions.</p> |
| <p>(b) Effective, proportionate and dissuasive sanctions for violations? In the case of exchange-traded commodity derivatives markets, does the relevant market authority have and use effective sanctioning powers to discipline its members or other authorized market participants and does it have powers to take action against non-members of the market or other market participants?</p> |
| <p>Yes, to all of the above. DCMs have the primary obligation to detect and deter unlawful conduct and use a combination of direct surveillance, inspection, reporting, product design requirements, position limits, settlement price rules or market halts complemented by vigorous enforcement of the law and trading rules.</p> <p>Audit trail requirements. DCM Core Principle 10 requires the DCM to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market. <i>See also</i> CFTC regulation 38.550.</p> <p>DCM Core Principle 18 requires the DCM to maintain records of all activities related to the business of the contract market in a form and manner acceptable to the Commission for a period of at least five years. <i>See also</i> CFTC regulation 38.950.</p> <p>Pursuant to CFTC regulation 38.551, a DCM must capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses. Such data must be to reconstruct all transactions within a reasonable period of time. An acceptable audit trail also must permit the DCM to track a customer order from time of receipt through fill, allocation or other disposition, and must include both order and trade data. Further, the audit trail must include original source documents, a transaction history database, electronic analysis capability, and safe storage capability.</p> <p>CFTC regulation 38.552 requires original source documents to include unalterable, sequentially identified records on which trade execution information is originally recorded, whether manually or electronically. A transaction history database includes a history of all trades executed via open outcry or via entry into an electronic trading system, including all orders entered into an electronic system,</p> |

including all order modifications and cancellations. A transaction history database also includes all data that are input into the trade entry or matching system for the transaction to match and clear the customer type indicator code, timing and sequencing data adequate to reconstruct trading, and identification of each account to which fills are allocated. An electronic analysis capability must include electronic analysis capability with respect to all audit trail data in the transaction history database. Such electronic analysis capability must ensure that the DCM has the ability to reconstruct trading and identify possible trading violations with respect to both customer and market abuse. The safe storage capability of the DCM must include the capability to safely store all audit trail data retained in its transaction history database. Such safe storage must include the capability to store all data in the database in a manner that protects it from unauthorized alternation, as well as from accidental erasure or other loss.

With respect to SEFs, SEF Core Principle 2 requires a SEF to establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means to provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred. *See also* CFTC regulation 37.200.

SEF Core Principle 10 requires the SEF to maintain records of all activities relating to the business of the facility in a form and manner acceptable to the Commission for a period of five years. *See also* CFTC regulation 37.1000.

CFTC regulation 37.205 requires a SEF to capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses. Such data shall be sufficient to reconstruct all indications of interest, requests for quotes, orders, and trades within a reasonable period of time and to provide evidence of any violations of the rules of the SEF. An acceptable audit trail shall also permit the swap execution facility to track a customer order from the time of receipt through fill, allocation, or other disposition, and shall include both order and trade data. The audit trail must also include original source documents, a transaction history database, electronic analysis capability, and safe storage capability.

CFTC regulation 1.31 governs the manner in which an exchange is required to maintain trade-related records. The regulation mandates that all records required to be kept under the CEA or CFTC regulations be maintained for five years and be readily accessible during the first two years. However, trading cards, documents on which trade information is originally recorded in writing, and order tickets must be retained in hard copy for five years.

The CFTC has robust sanctioning powers in cases of manipulation and other

unfair trading practices which serve the twin purposes of punishing the wrongdoer and deterring misconduct by others, all in an effort to protect the integrity of the markets regulated by the CFTC. The sanctions apply across all markets within the CFTC's jurisdiction and to registrants and non-registrants alike. These sanctions include:

1. Trading ban – An order prohibiting a violator from trading on or subject to the rules of any (or all) contract market(s) and requiring contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order, including a lifetime prohibition. This trading ban could be imposed on customers who trade, as well as registered intermediaries. Registration sanctions - an order suspending (for a period not more than six months), revoking or restricting a respondent's registration with the Commission.
2. Restitution – An order directing that a wrongdoer make restitution to customers of damages or losses caused by the respondent's violations. It is a remedy designed to make victims whole.
3. Disgorgement – An order directing that a respondent disgorge ill-gotten gains. It is a remedy that is designed to deprive a wrongdoer of the amount by which he profited from his wrongdoing, which in some cases differs from the amount of victim loss.
4. Civil penalties – An order assessing civil monetary penalties against a wrongdoer in an amount up to \$1,000,000 per manipulation violation or triple the monetary gain to the respondent for each such violation. Thus, a penalty is not limited to the amount of the gain to the wrongdoer.
5. Preliminary and permanent injunctions or cease and desist – Orders barring future violations of the CEA and CFTC regulations and enforcing compliance with the Act and regulations.

In addition to the civil remedies and penalties available to the CFTC, CEA Section 9(a) provides that manipulation, conversion, false statements to a registered entity or to the Commission, and other willful violations of the Act or CFTC regulations are also felonies that may be prosecuted by the DOJ and are punishable by a fine of up to \$1 million or imprisonment for up to ten years or both. The Commission is able to, and does, refer appropriate matters to the DOJ, and may bring enforcement actions in parallel to criminal prosecutions.

It is important to note that the Commission and the courts can mix and match the appropriate sanctions to the facts of the case in order to establish the appropriate relationship and proportion to the wrongdoing.

Several recent cases illustrate this principle. For example, in *CFTC v. Southern Trust*

Metals, Inc., No. 14-cv-22739-KING (S.D. Fla. Apr. 7, 2016), ECF No. 166, a U.S. District Court found the defendants liable after a bench trial for fraud in connection with the off-exchange, leveraged sale of precious metals, as well as for unregistered futures transactions. As the Court found, the defendants' precious metals fraud scheme lured retail investors to purchase physical precious metals that allegedly were held in depositories in London or Hong Kong. The Court found that customers were told that they could purchase additional metals by utilizing loans arranged by defendants, when, in reality, defendants did not purchase or sell physical metals, nor did defendants make any loans. Instead, defendants transferred customer funds through Defendant Loreley, a British Virgin Islands company, and then to trading accounts at firms based in the United Kingdom where customer funds were used to engage in margined derivatives trading. According to the Court, seventy-eight leveraged metals customers suffered losses totaling \$1,543,892. The Court's order describes Defendants' actions as "egregious" and found that they warranted a slew of sanctions, including full restitution, a permanent ban on commodity trading, and a substantial civil penalty.

Subsequent to this order, the Court, on motion by the CFTC, found Defendant Escobio in contempt for failing to pay more than \$1.5 million in previously-ordered restitution to defrauded customers. The evidence showed that Escobio had significant assets, but had paid only \$3,525, which the Court held did not constitute good faith compliance with the final judgment. Not only that, the evidence showed that Escobio did not intend to comply with the Court's restitution order and had deliberately and contemptuously refused to do so. Escobio was incarcerated for several weeks until paying an initial \$350,000 as ordered by the Court, and remains subject to a requirement that he pay an additional \$10,000 per month until his restitution obligation has been satisfied.

Another case demonstrates the benefits of self-reporting and cooperation with the CFTC. In *In re The Bank of Nova Scotia*, CFTC No. 18-50, 2018 WL 4828376 (Sept. 28, 2018), the Bank of Nova Scotia (BNS) entered into a settlement with the CFTC in which it agreed to the issuance of an order by the CFTC finding that it had engaged in spoofing in violation of CEA Section 4c(a)(5)(C). The misconduct consisted of traders on BNS's precious metals trading desk placing numerous orders for gold and silver futures on CME with the intent to cancel those orders before execution. Generally, the spoofing strategy involved three steps. First, a trader placed a small order on one side of the market at or near the best price (the Genuine Order). Second, that trader placed a larger order on the opposite side of the market away from the best price (the Spoof Order). The trader placed these Spoof Orders to create—or sometimes exacerbate—an imbalance in the order book. This created the impression of greater buying or selling interest than would have existed absent the Spoof Orders and, in turn, induced other market participants to fill the trader's smaller resting Genuine Orders. Third, within seconds of the Genuine Order being filled, the trader cancelled the Spoof Order before it was filled.

As a result of BNS's self-reporting of this misconduct, its cooperation with the CFTC's investigation, and its remediation of its surveillance systems and controls designed to prevent future incidents of spoofing, the civil monetary penalty imposed by the CFTC (\$800,000) was substantially reduced from what it otherwise would have been.

In a final case, *CFTC v. Bourne*, CFTC No. 18-51, 2018 WL 4862368 (Sept. 28, 2018), the CFTC filed and settled charges against Jacob Bourne, a former managing director of Deutsche Bank Securities Inc., for fraudulently mismarking swap valuations to conceal significant trading losses. The CFTC Order against Bourne found that Bourne mismarked the valuations for inflation swap instruments in an attempt to hide from his employer estimated trading losses of more than \$16 million. In doing so, Bourne ignored a policy dictating the method for entering end-of-day marks into an internal spreadsheet used for internal asset valuations. The Order also finds that after Bourne's employer confronted him about the discrepancies, Bourne attempted to conceal his misconduct by altering historical versions of the internal spreadsheet to create the appearance that he had complied with the policy. The mismarked swaps were ultimately reported to swap counterparties and to the CFTC. The Order finds that this conduct constituted fraud under the federal commodities laws. The CFTC Order requires Bourne to pay a \$350,000 civil penalty and permanently bans Bourne from trading on exchange and seeking registration with the CFTC, among other prohibitions.

In connection with this action, the DOE also issued its first public declination letter to Deutsche Bank AG and Deutsche Bank Securities Inc. (Deutsche Bank) stating that it closed its related investigation into Deutsche Bank. In its declination letter, the Division notes that its decision to close the investigation was based on a number of factors, including: Deutsche Bank's (1) timely, voluntary self-disclosure of the matters described above, which Deutsche Bank discovered itself as part of its compliance program; (2) full cooperation (including its provision of all known relevant facts about the individuals involved in or responsible for the misconduct); and (3) proactive remediation efforts directed at strengthening and enhancing Deutsche Bank's swap valuation process.

The CFTC DOE's cooperation program, as illustrated by the *BNS* order and the declination letter issued to Deutsche Bank, is set forth in several Enforcement Advisories. The DOE updated its Enforcement Advisory as to cooperation by companies and issued its first Enforcement Advisory with respect to cooperation by individuals in January 2017. See Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Companies and Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Individuals, both are available on the CFTC's website. The DOE subsequently issued an Enforcement Advisory regarding the benefits of self-reporting and full cooperation in September 2017, and recently issued an Enforcement Advisory regarding self-reporting and cooperation in the context of cases involving foreign corrupt practices. See Enforcement Advisory: Self-

Reporting and Full Cooperation and Enforcement Advisory: Self Reporting and Cooperation for CEA Violations Involving Foreign Corrupt Practices, both available on the CFTC's website.

As noted above, the DOJ can bring a criminal prosecution in parallel to (or independent of) a Commission enforcement action in appropriate cases. For example, the Commission and the DOJ resolved parallel investigations of Société Générale S.A. for manipulation, attempted manipulation, and false reporting of LIBOR in settlements announced on June 4 and 5, 2018. *See CFTC v. Société Générale S.A.*, CFTC No. 18-14, 2018 WL 2761752 (June 4, 2018) (entering settlement order for violations of CEA Section 9(a)(2), among others, relating to false reports regarding, and manipulation and attempted manipulation of, LIBOR and Euribor); *United States v. Société Générale S.A.*, No. 18-CR-253 (DLI) (E.D.N.Y. June 5, 2018), ECF No. 8 (reflecting agreement to a deferred prosecution agreement (DPA)); DPA Between Société Générale S.A. and the United States (June 5, 2018), <https://www.justice.gov/opa/press-release/file/1068521/download> (memorializing DPA in connection with conspiracy to manipulate USD LIBOR and JPY LIBOR, in violation of CEA Section 9(a)(2)). (The criminal resolution also included unrelated charges arising out of a multi-year scheme to pay bribes to officials in Libya.)

Under its emergency powers, when it has reason to believe an emergency exists, the Commission is authorized to direct a registered entity such as a DCM to take such action as in the Commission's judgment is necessary to maintain or restore orderly trading in or liquidation of any futures contract. The term "emergency" includes threatened or actual market manipulation or corners, any act of the United States or a foreign government affecting a commodity, or any other major market disturbance which prevents the market from accurately reflecting the forces of supply and demand.¹⁸⁷ DCMs are required to adopt rules that "provide for the exercise of emergency authority," which includes, among other powers, the ability to suspend or curtail all trading in a contract under DCM Core Principle 6. This emergency authority is intended to allow DCMs to intervene as necessary to maintain markets with fair and orderly trading and to prevent or address manipulation or disruptive trading practices.¹⁸⁸

DCMs, DCOs, and SEFs have the ability to discipline their members and other market participants. *See, e.g.*, DCM Core Principle 13, DCO Core Principle H, SEF Core Principle 2; *see also* CFTC regulation 38.700, CFTC regulation 37.200, and CFTC regulation 39.17; response to Principle 9, Question 2(c).

¹⁸⁷ *See* CEA Section 8a(9).

¹⁸⁸ *See* Appendix B to Part 38 (Core Principle 6).

| | |
|-----|--|
| | |
| 3. | Are there arrangements in place for: |
| (a) | The continuous collection and analysis of information concerning trading activities? |
| (b) | Providing the results of such analysis to market and regulatory officials in a position to take remedial action if necessary? |
| (c) | Monitoring the conduct of market intermediaries participating in the market(s)? |
| (d) | Triggering further inquiry as to suspicious transactions or patterns of trading? |
| | <p>Yes, to all of the above. Both the CFTC and DCMs conduct market surveillance. See response to Principle 34, Question 1(a), regarding the CFTC's market surveillance program.</p> |
| 4. | If there is potential for domestic cross-market trading, are there: |
| (a) | inspection; |
| (b) | assistance; and |
| (c) | information-sharing, requirements or arrangements in place to monitor and/or address domestic cross-market trading abuses? |
| | <p>Yes, to all of the above. The CFTC's market surveillance program, previously described in the response to Principle 34, Question 1(a), enables the CFTC to monitor and address domestic cross-market trading abuses. In addition, the CFTC has entered into Arrangements that, among other things, provide for enforcement and investigative assistance to address domestic cross-market trading abuses. In addition, individual markets have entered into arrangements of their own.</p> <p>MOUs. See response to Principle 2, Question 2(a) for a list of MOUs.</p> <p>Intermarket Surveillance Group. The purpose of the Intermarket Surveillance Group (ISG) is to provide a framework for the sharing of information and the coordination of regulatory efforts among exchanges trading securities and related products to address potential intermarket manipulations and trading abuses. The ISG plays a crucial role in information sharing among markets that trade securities, options on securities, security futures products, and futures and options on broad-based security indexes. The ISG also provides a forum for discussing common regulatory concerns, thus enhancing members' ability to fulfill efficiently their regulatory responsibilities. In effect, the ISG is an information-sharing cooperative governed by a written agreement. The ISG is not subject to regulatory oversight, nor does it file rule changes with the CFTC or the SEC, or seek approval when it</p> |

considers requests from securities or futures exchanges to become a member.

Membership in the ISG carries with it a commitment to share information required for regulatory purposes with other members. ISG agreements provide that information that is shared must be kept strictly confidential and used only for regulatory purposes. Such information is shared on an as-needed basis and only upon request. In addition, U.S. securities participants, via the facilities of the Securities Industry Automation Corporation (SIAC), routinely share trading information electronically.

In connection with the routine sharing of information, the ISG has defined certain types of violations which can occur across markets, and has allocated responsibility for surveillance for such activity to the appropriate member. This enables participants to avoid duplicative efforts while continuing to ensure effective intermarket surveillance.

Generally, the full ISG meets two times per year. Meetings are open only to representatives of members, prospective members, SIAC representatives, and appropriate governmental authorities such as the CFTC, SEC, the UK Financial Conduct Authority, and, on occasion, international organizations such as IOSCO. Senior market surveillance or market regulation personnel represent member organizations.

From time to time, and at the discretion of the Chairman of the ISG, subgroups may be formed to address specific issues of importance to the group. Such subgroups may be permanent or have a limited time depending on the subject. Subgroups are headed by a representative of a member or affiliate and are appointed by the Chairman. Meetings of subgroup members are generally independent of regular ISG meetings and may take place either at a location directed by the subgroup chairperson or telephonically during the interval between ISG meetings. Ordinarily, standing subgroups meet on the day preceding a full ISG meeting. Affiliate membership in the ISG is open to all recognized market centers that trade products that have rules and regulations designed to detect and deter possible abuses in their marketplaces. Participants in the ISG must have the ability to share regulatory information and otherwise cooperate with other ISG participants in connection with regulatory matters affecting their markets.

Intermarket Financial Surveillance Group. The Intermarket Financial Surveillance Group was formed in 1988 to provide a coordinating body to address financial surveillance issues relevant to both futures and securities markets. The IFSG includes most of the principal commodity and securities exchanges as well as the NFA and FINRA. The members of the IFSG have agreed to share financial information with respect to "high risk" member firms as commonly defined by the

group. The agreement also provides for the exchange of information upon request regarding capital, segregation of customer funds, margins, liquidity problems, omnibus accounts carried and/or carrying brokers, and pay/collect data with respect to such high risk firms.

Joint Audit Committee (JAC). The JAC, which consists of representatives of the financial compliance departments of each of the futures industry SROs, was established in 1979 to coordinate the SROs' audit and financial surveillance programs, including information-sharing, disciplinary actions, audit procedures, and assignment of audit responsibility for dual-membership firms, and to review current financial reporting issues and interpretations. CFTC staff frequently attends JAC meetings to discuss financial compliance issues.

Joint Compliance Committee. To foster improvements and uniformity in their systems and procedures used for trade practice compliance, the futures exchanges, at the CFTC's urging, formed the Joint Compliance Committee (JCC). The JCC has developed uniform definitions of trade practice offenses and routinely meets to share information on automated compliance systems and other surveillance matters with a view to improving exchange compliance programs.

International Exchange MOU (Exchange MOU). In 1995, numerous derivatives exchanges developed an Exchange MOU that was created to address the problem of accessing information about large exposures where exchange member firms and market participants typically trade on multiple exchanges and no one regulator or market authority will have all of the information necessary to evaluate the risks in its markets. Under the Exchange MOU, the occurrence of agreed triggering events affecting an exchange member's financial resources, positions, price movements or price relationships will prompt the sharing of information.

5. If there are foreign linkages, substantial foreign participation, or cross listings, are there cooperation arrangements with relevant foreign regulators, and/or markets, that address manipulation, or other abusive trading practices?

Yes. Pursuant to CFTC regulation 48.7(c)(3), FBOTs that wish to register with the Commission in order to provide to members and other participants located in the United States with direct access to their respective trade matching systems are required to specifically identify any contract that the FBOT will make available in the United States that is linked to a contract listed for trading on a registered entity or has any other relationship with a contract listed for trading on a registered entity.

Once registered, the FBOT must comply with specific conditions for registration, including the ongoing obligations regarding linked contracts set forth in CFTC regulation 48.8(c)(2).¹⁸⁹ Specifically, the FBOT must: (1) report to the Commission on a quarterly basis, any member that had positions in a linked contract above the applicable FBOT trade position limit, whether a hedge exemption was granted and, if not, whether disciplinary action was taken; (2) for all linked contracts, provide to the Commission trade execution and audit trail data for the Commission’s Trade Surveillance System on a trade-date plus one basis; (3) provide to the Commission, at least one day prior to the effective date thereof (except in the event of an emergency market situation) copies of or hyperlinks to all rules, rule amendments, circulars and other notices published by the FBOT with respect to all linked contracts; (4) provide to the Commission copies of all reports of disciplinary action involving the FBOT’s linked contracts upon closure of the action; and (5) in the event that the Commission, pursuant to its emergency powers and authority, directs the registered entity that lists the contract to which the FBOT’s contract is linked to take emergency action with respect to the contract, the FBOT, subject to information sharing arrangements between the Commission and its regulatory authority, must promptly take similar action.

With respect to cooperation with foreign regulators, CFTC regulations 48.7(g)(1) and (2) require foreign regulators of FBOTs (and their clearing organizations) to be signatories to the IOSCO MMOU or enter into substitute information sharing arrangements and to be signatories to the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations (Declaration) or agree in writing to share similar information with the CFTC.

6. Regarding market authorities responsible for the supervision of commodity derivatives markets only:

(a) Does the market authority have authority to access information on a routine and non-routine basis for regulated commodity derivatives markets as well as the power to obtain information on a market participant’s positions in related OTC commodity derivatives and the underlying physical commodity markets?

The Commission collects information on a daily basis on all futures transactions executed on a DCM (CFTC regulation 16.02) as well as all reportable large trader positions (Part 17). The Commission uses Form 40 information supplied by traders to aggregate end-of-day futures positions filed by reporting firms. Prior to filing such reports with the Commission, reporting firms aggregate positions in special accounts. The Surveillance Branch can readily access the entire portfolio of a

¹⁸⁹ A linked contract is defined in CFTC regulation 48.2(d) as a futures, option or swap contract that is made available for trading by direct access by a registered FBOT that settles against any price (including the daily or final settlement price) of one or more contracts listed for trading on a registered entity, as defined in Section 1(a)(4) of the CEA.

market participant's physical and financial holdings as well as transactions on a non-routine basis through Special Calls. The Branch regularly issues Special Calls to audit compliance with bona fide hedge use, form filings, and trading during derivative settling periods in order to detect and refer potentially violative conduct.

DCMs. CFTC regulation 38.5(a) requires the DCM to provide the Commission with information related to the business of the DCM, including information relating to data entry and trade details in the form and manner specified by the Commission. Additionally, upon request, the DCM must provide the Commission with a written demonstration that the DCM is in compliance with one or more core principles or a demonstration to show that the DCM satisfies its obligations under the Act.¹⁹⁰

DCM Core Principle 18 requires the DCM to maintain records of all activities related to the business of the contract market in a form and manner acceptable to the CFTC for a period of 5 years.

SEFs. CFTC regulation 37.5(a) requires the SEF to provide the Commission with information related to the business of the SEF in the form and manner specified by the Commission. Additionally, upon request, the SEF must provide the Commission with a written demonstration that the SEF is in compliance with one or more core principles or with its other obligations under the Act or the Commission's regulations.¹⁹¹

SEF Core Principle 10 requires the SEF to maintain records of all activities relating to the business of the facility, including a complete audit trail in a form and manner acceptable to the CFTC for a period of 5 years.

(b) Does the market authority collect information on a routine and regular basis on relevant on-exchange commodity derivatives transactions and does it have the capability to aggregate position holder information promptly in order to identify positions under common ownership and control? Reference should be made to the commodity derivatives principles for the type of information required

Yes, the Commission also has the ability to aggregate certain Ownership and Control Records in order to identify positions under common ownership. The Commission's ability is better developed for futures markets than cash market positions, swap and other derivative positions.

(c) In respect of OTC commodity derivatives transactions and positions, has the market authority considered what information it should collect on a routine basis and what it should collect on an "as needed" basis

¹⁹⁰ See CFTC regulation 38.5(b).

¹⁹¹ See CFTC regulation 37.5(b).

As previously described, the Surveillance Branch has the ability to collect OTC physical and derivative transactions and positions directly from market participants. Data that is routinely collected from the exchanges includes all futures transactions, related order handling information and account details. Data that is routinely collected from the SDRs includes open swap details, related primary economic terms information details. In addition, the Commission regularly collects:

Form 102A: This is an updated version of current Form 102. Form 102A collects information with respect to position-based special accounts in the futures market. Special accounts, defined in part 15 of the Commission's regulations, refer to any commodity futures or option account with a reportable position. Form 102A also requires clearing members to identify the individual trading accounts underlying these special accounts. FCMs, clearing members, foreign brokers, and certain reporting markets may have reporting obligations on Form 102A.

Form 102B: This is a new form. Form 102B requires the transaction-based reporting of trading accounts that have daily trading volume that exceeds a specified level on a DCM or SEF in a single trading day (defined as "volume threshold accounts"), regardless of whether the accounts maintain positions at the end of the day. Form 102B also requires identifying information with respect to the owners and controllers of these volume threshold accounts. Clearing members and certain reporting markets may have reporting obligations on Form 102B.

Form 102S: This is an updated version of the 102S filing required under part 20.5 of the Commission's regulations. Form 102S collects information regarding position-based counterparty consolidated accounts with respect to 47 categories of non-financial, paired swaps listed in part 20. Swap dealers and clearing members may have reporting obligations on Form 102S.

Form 71: This is a new form, to be used in conjunction with Form 102B, that will be sent by the Commission in its discretion via a special call. The Commission will send Form 71 to request information on volume threshold accounts that are omnibus accounts, for purposes of identifying the ultimate owner and controller of these accounts.

Form 40/40S: This is an updated version of current Form 40, which will be sent by the Commission in its discretion via a special call. The Commission will send Form 40 in order to collect information on reporting traders that are identified on other reporting forms.

Form 204 and Form 304: these are statements of cash positions related to federal commodities and hedge exemptions.

Surveillance Branch information collections through Special Calls are essentially ad hoc interests which are issue specific, commodity futures trade or position specific, swap specific and participant specific.

Certain cash data or underlying physical commodity transaction information collected by a third party administrator (which is then referenced in a settling derivative) does not generally fall within regulatory recordkeeping requirements. Obtaining and analyzing these data sets could enhance the Surveillance program's ability to protect market integrity through identification of potentially inappropriate conduct.

7. Does the market authority have the organizational and technical capabilities to monitor effectively the trading venues it supervises, including the ability to identify market abuse and activities that may impact the fairness and orderliness of trading on such venues?

Yes. As discussed in more detail in response to Question 3(a) of Principle 33 and Question 1(b) of Principle 34, DMO's Compliance Branch conducts rule enforcement reviews (RER). RERs are formal, structured assessments of regulated entities' operations or oversight programs to assess ongoing compliance with statutory and regulatory mandates. Regular RERs are an effective method of ensuring that the entities' are complying with the core principles established in the CEA and Commission's regulations. The operational integrity of DCMs is addressed through the RERs that broadly address market surveillance, trade practice surveillance, and disciplinary programs.

The CFTC has the necessary organizational and technical capabilities to conduct such monitoring, depending upon resource allocation determination. DOE's Market Surveillance Branch uses Commission data resources to evaluate potential position limit violations, swap market abuses, futures trading compliance and potential violations with a focus on detecting manipulation. The Branch may examine the settlement period for certain futures contracts and trade related concerns when appropriate. Data resources routinely accessed by staff include the futures transactions and positions for large traders as well as swaps transactions and positions. Staff developed computer code to examine trader conduct during futures settlements and other periods of interest. OTC physical and financial transactions and positions for a particular trader can be assessed using the Commission's authority to issue a Special Call under CFTC regulation 18.05.

Principle 37 Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.

Key Questions

Monitoring of Large Exposures

1. Does the market authority have a mechanism in place that is intended to monitor and evaluate continuously the risk of open positions, or credit exposures, that are sufficiently large to expose a risk to the market, or to a clearing firm, that includes:

- (a) Qualitative or quantitative, trigger levels appropriate to the market for the purpose of identifying large exposures (as defined by the market authority), continuous monitoring, and an evaluative process?

Yes. Section 3(b) of the CEA states that one of the purposes of the CEA is “to ensure the financial integrity of all transactions subject to [the CEA] and the avoidance of systemic risk.” DCR’s Examination Branch examines DCOs that are registered with the Commission for compliance with 18 DCO core principles set forth in the CEA as well as all relevant CFTC regulations. These examinations encompass all aspects of clearing process and involve a sophisticated analysis of a broad range of topics including, but not limited to, financial resources, risk management, systems safeguards including cyber security, and default management including recovery plans and wind-down plans. The selection of DCOs for an examination is based upon a risk assessment. Among the factors considered in the assessment is the data submitted through event-specific reporting, financial resource reporting, and certified financial statements, areas of concern identified during previous examinations and the DCO’s remediation plans to address the issues, major changes that have occurred at the DCO, if the DCO has started clearing new business lines, changes in lines of credit, issues identified in the press, and whether there have been notifications of hardware or software malfunctions, cybersecurity breaches, or threats. Once the DCO is selected for an examination, a second risk assessment occurs to identify those items that will be included in the scope of the examination. The Examinations Branch examines DCOs as frequently as practicable.

Title VIII of the Dodd-Frank Act requires annual examinations of all SIDCOs. For SIDCO examinations, Title VIII requires the CFTC to consult with the Federal Reserve Board on the scope and methodology. Title VIII also requires the CFTC to measure compliance using heightened risk management processes and procedures and prudential standards concerning payment, clearing, and settlement supervision, and the resources and capabilities of the SIDCO to monitor and control such risks. The Examinations Branch examines each SIDCO to determine: (1) the nature of the operations of, and the risks borne by, the SIDCO; (2) the financial and operational risks presented by the SIDCO to financial institutions, critical markets, or the broader financial system; (3) the resources and capabilities of the SIDCO to monitor and control such risks; (4) the safety and soundness of the SIDCO; and (5) the SIDCO’s compliance with (A) Title VIII of the Dodd-Frank Act, and (B) the rules and orders prescribed under Title VIII of the Dodd-Frank Act. SIDCOs also are examined for compliance with the CEA and CFTC regulations including, *inter alia*,

regulations that are consistent with the PFMI.

DCR's Examinations Branch also performs the following tasks: (i) reviews all monthly and quarterly submissions from DCOs to evaluate compliance with the CFTC's financial resource requirements; (ii) reviews certified financial statements of each DCO; (iii) analyses notice filings from all DCOs to determine the severity of the issue being reported and to assess the DCO's remediation plan; (iv) assists with DCO applications by reviewing information supporting the DCO applicant's compliance with certain core principles; (v) develops tools to help in the evaluation of compliance with core principles; and (vi) assists in the review of SIDCO material rule change filings.

In addition, DCR's Risk Surveillance Group (RSG) aids the Commission in fulfilling the objective of the CEA to ensure the financial integrity of all transactions subject to the CEA and to avoid systemic risk. RSG has developed a comprehensive data-driven risk analytics program.

RSG defines risk as the potential that a market participant might not fulfill its financial obligations on a contract subject to the Commission's jurisdiction under the CEA. All futures and options must be cleared through a DCO. A substantially large portion of swap transactions in rates, credit, and certain FX contracts are being cleared either voluntarily or to comply with the swap clearing requirements. Some traders are members of a DCO and clear for themselves while others use FCMs to clear for them. If a trader is unable to meet its obligations on a cleared contract, the obligations become those of the trader's clearing member. If the clearing member is unable to cover its obligations, the obligations become those of the DCO.

RSG evaluates the financial resources and risk management practices of traders, clearing members, and DCOs in relation to those risks. RSG's daily risk surveillance program attempts to identify positions in cleared products subject to the Commission's jurisdiction that pose significant financial risk and to confirm that these risks are being appropriately managed. The RSG undertakes these tasks at the trader level, the clearing member level, and the DCO level. That is, it identifies both traders that pose risks to clearing members and clearing members that pose risks to the DCO. The program for futures and options and for cleared swaps is well-established, and is being extended to cover uncleared swaps.

The margin model team is tasked with ensuring that DCOs' margin models are being implemented adequately to capture the different risk factors of particular products and portfolios.

RSG has also established a supervisory stress test program to assess the ability of the clearinghouse to absorb shocks, and to probe for vulnerabilities in the clearing

eco-system.

RISK ASSESSMENT TECHNIQUES

A. Overview

The risk surveillance program contains four primary components: 1) identifying traders, clearing members, and DCOs at risk; 2) estimating the magnitude of the risk; 3) comparing the risk to the available financial resources; and 4) assessing the risk management practices of the DCO, clearing members, and their clients.

B. Identifying Traders, Clearing Members, and DCOs at Risk

1. Analysis Based on Account Characteristics

RSG attempts to be proactive rather than reactive. Accordingly, staff attempts to identify traders and clearing members who might pose extraordinary risk before a market becomes volatile not just after the volatility appears. A number of different characteristics may trigger further scrutiny.

a. Absolute size

Simple size (as measured by initial margin (IM) requirements), of course, can be an indicator of risk. The composition of the position is also relevant. Assigning responsibility to the staff on a market-by-market basis permits analysts to develop familiarity over time with the identity and trading patterns of the largest participants in their respective markets. Additional design and development work is focused on aggregating exposures across futures (outrights and spreads) and related swap markets.

b. Short option size

Unlike futures, the risk of options is non-linear. That is, a price change that would cause a \$1,000 change in the value of a futures position might cause a \$20,000 change in the value of an option on that futures position. Accordingly, RSG pays particular attention to large net-short option positions, particularly those that are deeply out-of-the-money. RSG has developed a dedicated set of analytical risk surveillance tools to monitor relevant clients and their clearing firms. The data driven analysis is supplemented with visits to both the trading firms and their clearing firms.

c. Size relative to the market

A position that is not large in absolute terms but is large relative to the market may pose additional risk. Such a concentrated position may be

difficult to liquidate quickly without moving the market.

d. Size relative to the initial margin on deposit

Initial Margin (IM) is the first layer of financial protection at both the FCM and DCO level. A trader or clearing firm that is currently subject to a margin call poses greater risk than a trader or clearing firm with an identical position that has excess IM on deposit.

e. Size relative to the trader's assets

A large position held by a trader that is well-capitalized would be of less concern than the same position held by a trader who did not have such "deep pockets." As discussed below, this is an area where follow-up may be more difficult because RSG does not have the same ready access to financial information about traders or self-clearing firms that it has for FCMs and DCOs.

f. Size relative to the clearing member's capital

A position that is not large in absolute terms but is large relative to the clearing firm may pose significant risk. As discussed further below, the resources of the clearing firm are always a factor in assessing financial risk.

g. Size relative to the DCO's resources

In evaluating a DCO's financial resources, RSG measures a DCO's ability to cover a default by the clearing member carrying the riskiest position. Greater concern would arise if positions on one side of a market were concentrated among a few firms than if they were dispersed over many firms.

h. Cumulative size across multiple DCOs

RSG has developed procedures to monitor changes in variation margin (VM) payments and IM deposits across DCOs. RSG identifies clearing firms that have, (1) increasing IM requirements, (2) VM payments that are a high percentage of the IM requirement, (3) VM payments that are larger than usual, and/or (4) a streak of losses on consecutive days. RSG analyzes which asset classes or products are driving the IM or VM movements and whether the movements are correlated across DCOs. RSG has developed capability to systematically aggregate positions by specific firms across multiple DCOs.

i. News about a particular trader or FCM

RSG may decide to perform additional analysis of a particular trader or FCM based on information staff learns from public sources, industry participants, or other Commission staff. For example, a large trader might be experiencing financial difficulties because of losses in a cash market or the securities markets.

2. Analysis Based on Current Market Conditions

RSG risk analysts routinely monitor conditions in their assigned markets throughout the day. Because of the work done in identifying accounts of interest, analysts are able to focus their efforts on those traders whose positions warrant heightened scrutiny under current conditions.

C. Estimating the Magnitude of the Risk**1. Daily Stress Testing**

After identifying traders or clearing members at risk, RSG estimates the magnitude of the risk. An essential technique in evaluating risk is the use of stress testing. Stress testing is the practice of determining the potential loss (gain) to a position or portfolio based on a hypothetical price change or a hypothetical change in a price input such as option volatility. For instance, a stress test will calculate the change in value of a portfolio of crude oil futures and option positions if the price of crude oil increases \$10 a barrel.

RSG conducts a wide array of stress tests. Some stress tests are based on the greatest price move over a specified period of time such as the last five years or the greatest historical price change. Another stress testing technique is the use of "event based" stress testing that replicates the price changes on a particular date in history such as September 11, 2001 or the day of Hurricane Katrina. Price changes can be measured as a dollar amount or a percentage change. This flexibility can be helpful when price levels have changed by a large amount over time. For example, the actual price changes in equity indices in October 1987 are not particularly large at today's market levels but the percentage changes are meaningful.

The standard used in developing stress tests is "extreme but plausible" market moves.

2. Supervisory Stress Testing

In addition to the stress test tools for the daily, real time risk surveillance, the

team also conducts annual stress test exercises to study and assess systemic, cross-CCP vulnerabilities in the clearing ecosystem. These exercises are also a tool to assess the resiliency of the CCPs and their clearing members – in other words to absorb shocks. RSG has completed three such exercises to date.

D. Comparing Risks to Available Assets

1. Initial Margin

After identifying accounts at risk and estimating the size of the risk, the third step is to compare that risk to the assets available to cover it. The first layer of protection is IM. Traders post IM to clearing members and clearing members post IM to DCOs. Pursuant to CFTC Regulation 39.13(g), in setting IM requirements, a DCO must use models that generate IM requirements sufficient to cover the DCO's potential future exposures to clearing members based upon price movements in the interval between the last collection of VM and the liquidation times set forth in the regulation. The actual coverage of the IM must meet an established confidence level, of at least 99 percent, based on data from an appropriate historic time period and be commensurate with the specific characteristics and risks of each product and portfolio.

Because stress testing, by definition, involves extreme moves, hypothetical results will exceed IM requirements on a product basis, *i.e.*, the price moves will be in the 1 percent tail. Many large traders, however, carry portfolios of positions with offsetting characteristics. In addition, many traders and clearing members deposit excess IM in their accounts. Therefore, even under stressed conditions, in many instances the total IM available may exceed potential losses or the shortfall may be relatively small.

2. Trader Assets

If the potential losses significantly exceed IM, RSG looks at other resources of the trader. RSG can contact a trader or self-clearing firm directly or obtain additional information about their resources from the FCM and/or DCO.

3. Clearing Member Capital

If a trader defaults on its obligations, the second layer of protection after IM is the clearing firm's capital. RSG monitors the financial statements of clearing members. Many clearing members are registered as FCMs and are required to file financial reports with the Commission. For those clearing members that are not FCMs, RSG routinely relies on the DCO to provide financial reports. The financial statements allow RSG staff to review assets, liabilities, and capital of the clearing member. These financial data are compared to the potential

losses obtained through stress testing.

4. DCO Resources

If a clearing member defaults on its obligations, the third layer of protection is the DCO. RSG compares the risk posed by clearing members to a DCO's financial resources package. This package typically includes IM, a guaranty fund, the DCO's capital, and a clearing member loss mutualization procedure.

Pursuant to CFTC regulation 39.11(a), a DCO must have sufficient financial resources to meet its obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions. Pursuant to CFTC regulation 39.33(a), a SIDCO that is systemically important in multiple jurisdictions or is involved in activities with a more complex risk profile must maintain sufficient financial resources to enable it to meet its obligations to clearing members notwithstanding a default by the two clearing members creating the largest combined loss to the DCO. RSG periodically compares stress test results with DCOs to assess their financial capacity.

E. Assessing Risk Management Practices

1. Traders

a. Follow-up on particular accounts or positions

RSG staff routinely detect traders with risk that appears to be potentially excessive. In these instances, RSG staff seek additional information from the trader or the FCM such as account statements or other financial documentation. This information often allays the concerns. If concerns remain, RSG staff often interview clearing member or trader staff. These interviews focus on the trader's financial resources, trading strategy, trading techniques, and trading experience. For example, if the trader demonstrated that it was following a hedging strategy or had established a line of credit to fulfill margin calls, the concerns might dissipate.

b. On-site reviews

RSG has conducted on-site risk reviews with traders ranging from the largest hedge fund operators to individuals who write options and clear through small FCMs. Traders generally appreciate the opportunity to discuss RSG's analysis of the trader's risk. Traders usually have been forthcoming about the nature of their strategies, the financial resources available to cover the risk, and any risk-reducing positions they carry in

markets not subject to the Commission's jurisdiction.

As discussed below, RSG comments or inquiries about traders often lead to follow-up by the clearing member or by the DCO. Similarly, from time to time, FCMs or DCOs provide information about traders generating follow-up by RSG.

c. Special studies

RSG periodically conducts special studies of traders targeting particular issues. For example, RSG has met with large asset managers to discuss the use of particular products in their hedging strategies.

2. Clearing Members

a. Follow-up on particular accounts or positions

As part of daily surveillance, RSG identifies clearing members that carry large risks. The positions may be in the house account, the customer account in the aggregate, or individual customer accounts. RSG staff routinely discusses risk practices with clearing members in these contexts. For example, as a follow-up to a trader review, RSG might compare its stress test results with those of the FCM clearing that account or gather information about the financial resources of a particular trader. There have been instances where, as a result of RSG comments or inquiries, FCMs have collected additional IM from traders or instructed traders to reduce their position.

b. Monitoring of trends

RSG produces a number of internal reports to track industry trends affecting clearing members. For example, certain daily reports track which clearing members had large VM payments relative to IM on deposit, large VM payments across DCOs, or strings of consecutive days with VM losses. Monthly reports summarize IM adequacy by product, profile the industry as measured by IM, and show which clearing members' risks are increasing at particular DCOs or across DCOs and which clearing members' risks are decreasing.

c. On site reviews

CFTC regulation 1.73, "Clearing Futures Commission Merchant Risk Management," requires clearing members that are registered as FCMs to

conduct screening of orders, to stress test customer and proprietary positions, to evaluate their ability to meet IM requirements, to evaluate their ability to meet VM payments, and to evaluate their ability to liquidate positions quickly.

RSG has a program to ensure compliance with CFTC regulation 1.73. Each review is initiated with the issuance of an engagement letter and document request to the FCM. RSG staff analyzes the provided documents and subsequently conducts an on-site review at the clearing member. After completion of the review, RSG staff conducts an exit interview and issues a compliance letter detailing any changes necessary to come into compliance with the regulation.

3. DCOs

a. Follow-up on particular accounts or positions

RSG frequently discusses the risks of particular accounts or positions with DCO staff. For example, as a follow-up to a trader review, RSG might compare its stress test results with those of the DCO. As also noted above in the case of FCMs, there have been instances where, as a result of RSG comments or inquiries, DCOs have taken action.

b. Monitoring of trends

RSG produces a number of internal reports to track industry trends affecting DCOs. For example, certain daily reports summarize DCO IM and VM data and show products with large market moves relative to their IM requirement.

c. Back testing of margin coverage

As stated above, DCOs must set IM to cover 99 percent of one-day price changes. RSG evaluates each DCO's margin adequacy at both the product and portfolio level. RSG works with DCOs to obtain the data necessary to conduct the back testing program. RSG also discusses with DCOs their back testing methodology.

d. Evaluation of margin models

RSG is responsible for reviewing proposed DCO margin models. As discussed in more detail below, margin models can be extremely complex.

In order to ensure consistency in the manner in which the models of different DCOs are evaluated, RSG has developed a standard questionnaire that has been provided to DCOs submitting models. RSG also documented its analysis both in more detailed, technical reports and in more policy-oriented, non-technical reports.

(b) Access to information, if needed, on the size and beneficial ownership of positions held by direct customers of market intermediaries?

Yes. The CFTC operates a comprehensive system of collecting information on market participants as part of its market surveillance program. Under the CFTC's regulations, the Commission collects market data and position information from exchanges, clearing members, FCMs, foreign brokers, and traders. Market surveillance staff assesses individual trader's activities and potential market power and enforces speculative position limits by using a large trader reporting system.

Under Part 16 of the CFTC's regulations, DCMs must provide the Commission with confidential information on the aggregate positions and trading activity for each of their clearing members. Each day, exchanges report each clearing member's open long and short positions, purchases and sales, exchanges of futures for cash, and futures delivery notices for the previous trading day. This data is reported separately by proprietary and customer accounts by futures month, and for options by puts and calls, expiration date and strike price.

Under Part 17 of the CFTC's regulations, clearing members, FCMs, and foreign brokers (collectively called reporting firms) file daily reports with the Commission. The reports show futures and options positions of traders with positions at or above specific reporting levels as set by the Commission. Since traders frequently carry futures positions through more than one broker and control or have a financial interest in more than one account, the Commission routinely collects information that enables its surveillance staff to aggregate related accounts. Reporting firms must file a form which identifies each new account with reportable positions for each futures contract. In addition, if a trader's position reaches a reportable level, the trader may be required to file a more detailed identification report to identify accounts and reveal any relationships that may exist with other accounts or traders.

Under Parts 18 and 21 of the CFTC's regulations, market surveillance staff may investigate further the positions of large traders by instituting a "special call." The special call is designed to gain additional information about a firm's traders and/or about a participant's trading and delivery activity, including information on persons who control or have a financial interest in the account. The special call may also request information about positions and transactions in the underlying commodity. This mechanism may be used when a trader is using too many firms to be easily

monitored through required reports.

Under Part 20 of the CFTC's regulations, routine reports are required from DCOs, as well as clearing members and swap dealers with reportable positions in certain covered physical commodity swaps. Such large trader reporting provides the Commission with data regarding large positions in swaps that are linked, directly or indirectly, to a discrete list of U.S.-listed physical commodity futures contracts, in order to enable the Commission to implement and conduct effective surveillance of these economically equivalent swaps and futures. To facilitate surveillance efforts and the monitoring of trading across the swaps and futures markets, swaps positions are converted to equivalent positions of the related U.S. futures contract for reporting purposes. This system is intended to enable the Commission, in a prompt and efficient manner, to identify significant traders in the covered physical commodity swaps and to collect data on their trading activity in order to reconstruct market events.

The Commission thus has the authority and techniques to investigate and discover the identities of the true account owners and controllers of large positions, whether domestic or foreign.

Part 39 of the Commission's regulations requires DCOs to report account level information of positions and IM for futures and for swaps. This requirement goes beyond Part 17 – which is restricted to just large positions.

- (c) The power to take appropriate action against a market participant that does not provide relevant information needed to evaluate an exposure (e.g., require liquidation of positions, increase margin requirements and/or revoke trading privileges)?

Yes. The CFTC, as well as DCMs and SEFs, have the power to intervene in the market, including for: the liquidation of positions, the establishment of special margin requirements, and the suspension or curtailment of trading. Section 8a(7) of the CEA authorizes the CFTC to alter or supplement the rules of a registered entity, and Section 8a(9) of the CEA authorizes the CFTC to direct a registered entity to take such action as in the CFTC's judgment is necessary to maintain or restore orderly trading in or liquidation of any contract. CFTC enforcement powers are comprehensive and authorize civil injunctive actions for failing to comply with requests for required information and subpoena enforcement actions for failure to comply with subpoena demand for documents or testimony. Failure to comply with a court order is punishable by contempt of court.

DCMs. DCM Core Principle 6 provides that:

The board of trade (*i.e.*, DCM), in consultation or cooperation with the

Commission, shall adopt rules to provide for the exercise of emergency authority, as is necessary and appropriate, including the authority to –

- (A) to liquidate or transfer open positions in any contract;
- (B) to suspend or curtail trading in any contract; and
- (C) to require market participants in any contract to meet special margin requirements.

Under Part 38 of the CFTC's regulations, the CFTC set out the following guidance and acceptable practices in connection with DCM Core Principle 6:

(a) Guidance. In consultation and cooperation with the Commission, a DCM should have the authority to intervene as necessary to maintain markets with fair and orderly trading and to prevent or address manipulation or disruptive trading practices, whether the need for intervention arises exclusively from the DCM's market or as part of a coordinated, cross-market intervention. DCM rules should include procedures and guidelines to avoid conflicts of interest in accordance with the provisions of part 40.9 of this chapter, and include alternate lines of communication and approval procedures to address emergencies associated with real-time events. To address perceived market threats, the designated contract market should have rules that allow it to take certain actions in the event of an emergency, as defined in part 40.1(h) of this chapter, including: imposing or modifying position limits, price limits, and intraday market restrictions; imposing special margin requirements; ordering the liquidation or transfer of open positions in any contract; ordering the fixing of a settlement price; extending or shortening the expiration date or the trading hours; suspending or curtailing trading in any contract; transferring customer contracts and the margin or altering any contract's settlement terms or conditions; and, where applicable, providing for the carrying out of such actions through its agreements with its third-party provider of clearing or regulatory services. In situations where a contract is fungible with a contract on another platform, emergency action to liquidate or transfer open interest must be as directed, or agreed to, by the Commission or the Commission's staff. The DCM has the authority to independently respond to emergencies in an effective and timely manner consistent with the nature of the emergency, as long as all such actions taken by the DCM are made in good faith to protect the integrity of the markets. The Commission should be notified promptly of the DCM's exercise of emergency action, explaining how conflicts of interest were minimized, including the extent to which the DCM considered the effect of its emergency action on the underlying markets and on markets that are linked or referenced to the contract market and similar markets on other trading venues. Information on all regulatory actions carried out pursuant to a DCM's emergency authority should be included in a timely submission

of a certified rule pursuant to part 40 of this chapter.

(b) **Acceptable Practices.** A DCM must have procedures and guidelines for decision-making and implementation of emergency intervention in the market. At a minimum, the DCM must have the authority to liquidate or transfer open positions in the market, suspend or curtail trading in any contract, and require market participants in any contract to meet special margin requirements. In situations where a contract is fungible with a contract on another platform, emergency action to liquidate or transfer open interest must be directed, or agreed to, by the Commission or the Commission's staff. The DCM must promptly notify the Commission of the exercise of its emergency authority, documenting its decision-making process, including how conflicts of interest were minimized, and the reasons for using its emergency authority. The DCM must also have rules that allow it to take such market actions as may be directed by the Commission.

SEFs. SEF Core Principle 8 provides that:

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

Under Part 37 of the CFTC's regulations, the CFTC set out the following guidance in connection with SEF Core Principle 8:

(a) A SEF should have rules that authorize it to take certain actions in the event of an emergency, as defined in part 40.1(h) of this chapter. A swap execution facility should have the authority to intervene as necessary to maintain markets with fair and orderly trading and to prevent or address manipulation or disruptive trading practices, whether the need for intervention arises exclusively from the swap execution facility's market or as part of a coordinated, cross-market intervention. A swap execution facility should have the flexibility and independence to address market emergencies in an effective and timely manner consistent with the nature of the emergency, as long as all such actions taken by the swap execution facility are made in good faith to protect the integrity of the markets. However, the swap execution facility should also have rules that allow it to take market actions as may be directed by the Commission. Additionally, in situations where a swap is traded on more than one platform, emergency action to liquidate or transfer open interest shall be as directed, or agreed to, by the Commission or the Commission's staff. Swap execution facility rules should include procedures and guidelines for decision-making and implementation of emergency intervention that avoid conflicts of interest in accordance with the provisions of section 40.9 of this chapter, and include alternate lines of communication and approval

| |
|---|
| <p>procedures to address emergencies associated with real time events. To address perceived market threats, the swap execution facility should have rules that allow it to take emergency actions, including imposing or modifying position limits, imposing or modifying price limits, imposing or modifying intraday market restrictions, imposing special margin requirements, ordering the liquidation or transfer of open positions in any contract, ordering the fixing of a settlement price, extending or shortening the expiration date or the trading hours, suspending or curtailing trading in any contract, transferring customer contracts and the margin, or altering any contract's settlement terms or conditions, or, if applicable, providing for the carrying out of such actions through its agreements with its third-party provider of clearing or regulatory services.</p> <p>(b) A swap execution facility should promptly notify the Commission of its exercise of emergency action, explaining its decision-making process, the reasons for using its emergency authority, and how conflicts of interest were minimized, including the extent to which the swap execution facility considered the effect of its emergency action on the underlying markets and on markets that are linked or referenced to the contracts traded on its facility, including similar markets on other trading venues. Information on all regulatory actions carried out pursuant to a swap execution facility's emergency authority should be included in a timely submission of a certified rule pursuant to part 40 of this chapter.</p> |
| <p>(d) The general power to take appropriate action, such as to compel market participants carrying, or controlling, large positions to reduce their exposures or to post increased margin?</p> |
| <p>Yes. See response to Principle 34, Question 1.</p> |
| <p>2. Do arrangements, whether formal or informal, exist to enable markets and regulators to share information on large exposures of common market participants, or on related products:</p> |
| <p>(a) In the domestic jurisdiction?</p> |
| <p>Yes. The CFTC operates a comprehensive system of collecting information on market participants. Under regulations set out in Parts 15, 16, 17, 18, 19, and 21 of the CFTC's regulations, the Commission collects market data and position information from exchanges, clearing members, futures commission merchants, foreign brokers, and traders.</p> <p>CFTC regulation 16.02 requires DCMs and SEFs to provide trade and supporting data reports to the Commission on a daily basis. Such reports must include transaction level trade data and related order information for each futures or options contract. Reports must also include time and sales data, reference files and other information as the Commission or its designee may require. All reports must be submitted at the time, and in the manner and format, and with the specific</p> |

content specified by the Commission or its designee. Upon request, such information must be accompanied by data that identifies or facilitates the identification of each trader for each transaction or order included in a submitted trade and supporting data report if the reporting market maintains such data.

The CFTC and DCMs and SEFs have created arrangements to share information that is prompted by, among other things, large exposures. The Commission essentially has the same information that DCMs and SEFs have with respect to large exposure information. Wherever the exchanges manage position limits, they inform the Commission of any exemptions granted. The exchanges are able to monitor the exposure size within each contract on an intraday basis. Frequent conversations occur between an exchange and Commission staff when liquidation or acquisitions of large exposures create a heightened concern. This has become more relevant with the increased open interest held by large passive long-only traders (index traders).

In some specific contracts, when traders hold positions above a certain threshold they are required to disclose their full portfolio of related products. This rule was implemented in the wake of the disruptive activity by Amaranth Advisors in the Natural Gas futures contract traded on the NYMEX. These “exposure forms” are filed before the last day of trading of a specific contract month and are forwarded to CFTC surveillance staff. The need for this special disclosure derives from the existence of a large OTC market that is directly linked to the futures contract, and for positions which are not observable by the exchange. This model could be replicated in other contracts as the need arises. Surveillance staff briefs Commissioners in closed meetings on Fridays when appropriate.

Surveillance staff briefs Commissioners in closed meetings on Fridays when appropriate. *See also* response to Principle 36, Question 4.

(b) In other relevant jurisdictions?

The Declaration, and its companion Exchange MOU,¹⁹² discussed in response to Principle 36, Question 4, were at the core of improvements in international cooperation contemplated at the 1995 Windsor meeting (which was convened following the collapse of Barings Plc.). That meeting, and the resulting Windsor Declaration, set in motion a series of international initiatives at both the regulatory and market level intended to enhance the resilience of the financial marketplace against the shocks or stress caused by such defaults. The Declaration (and companion Exchange MOU) were created to address the problem of accessing

¹⁹² IOSCO, *Report on Cooperation Between Market Authorities and Default Procedures*, at page 4 ¶ 8 (regarding the promotion of formal/informal mechanisms). *See also* IOSCO, *Report on Trading Halts and Market Closures* (Oct. 2002) at pp. 23-24.

information about large exposures where exchange member firms and market participants typically trade on multiple exchanges and no one regulator or market authority will have all of the information necessary to evaluate the risks in its markets.

Under the Declaration, the occurrence of agreed triggering events affecting an exchange member's financial resources, positions, price movements or price relationships, or events suggesting manipulation or other abusive conduct, will prompt the sharing of information. See Declaration paragraphs 2.2 and 2.3. Although the Declaration is a multilateral arrangement containing appropriate confidentiality and use restrictions (and can serve as an independent arrangement for structuring the sharing of information), the *specific* implementation of any request pursuant to the Declaration will be on a bilateral basis and remain subject to any existing bilateral Arrangements.

A special situation arose in WTI Crude Oil with the trading of a financially-settled futures contract on ICE Futures Europe which settlement price is directly linked to a contract trading on NYMEX. Given that these two contracts are in effect a single market, on November 17, 2006, the CFTC and the United Kingdom Financial Services Authority (effective April 1, 2013, the Financial Conduct Authority (FCA)) entered into a Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight. Under this Arrangement, the FCA and CFTC share information on a daily basis regarding large exposures.

3. With respect to exchange-traded physical commodity derivatives markets, do relevant market authorities (i) require the reporting of large trader positions for the relevant on-exchange commodity derivatives contracts and (ii) publish the aggregate exposures of different classes of large traders, especially commercial and non-commercial participants, within the bounds of maintaining trader confidence?

Various CFTC regulations require the reporting of large trader positions for future and swaps, including exchange-traded physical commodity derivatives. The CFTC publishes aggregated exposures of different classes of large traders, including for physical commodity derivatives, on its website on a regular basis.

Default Procedures – Transparency and Effectiveness

4. Does a market authority make its default procedures available to market participants, including, specifically, information concerning:

(a) The general circumstances in which action may be taken?

(b) Who may take it?

(c) The scope of actions which may be taken.

As mentioned above, if an FCM is executing transactions on a DCM, then such FCM

| | |
|---|---|
| | <p>must clear such transactions through a DCO. A DCO is essential to managing systemic and counterparty risks in the event that a member FCM fails. Because of the importance of the DCO in the management of such risks, Section 5b(c)(2)(L) of the CEA requires that a DCO make “information concerning the rules and operating procedures governing the clearing and settlement systems (including default procedures) of the DCO available to market participants.” In general, most DCOs make their default procedures, including the information referenced in Questions 3(a), (b), and (c) above, accessible to the public via their website.</p> <p>Also, as mentioned above in response to Principle 32, Question 1, if an FCM becomes the subject of bankruptcy proceedings, then Subchapter IV and Part 190 set forth a clear structure for the liquidation of such FCM.</p> |
| 5. | <p>Do default procedures, and/or national law, permit markets, and/or the clearing and settlement system(s), to promptly isolate the problem of a failing firm by addressing its open proprietary positions, and positions it holds on behalf of customers; or otherwise protect customer funds and assets, from an intermediary’s default under national law?</p> |
| | <p>Yes. See response to Principle 32, Question 1.</p> |
| 6. | <p>Is there a mechanism by which market authorities for related products can consult with each other in order to minimize the adverse effects of market disruptions?</p> |
| | <p>Yes. See response to Principle 32, Question 1.</p> |
| <p><i>Short Selling on Equity Markets</i></p> | |
| 7. | <p>Does the relevant market authority provide for:</p> |
| (a) | <p>Controls which are appropriate to the equity market in question and that have as their goal: to reduce or minimize the potential risks that could affect the orderly and efficient functioning and stability of equity markets including, at a minimum, a strict settlement of failed trades?</p> |
| | <p>Not applicable to the CFTC. Questions relating to securities in the equity markets are outside the scope of the CFTC’s jurisdiction.</p> |
| (b) | <p>A reporting regime that provides timely short selling information to the market or, as a minimum requirement, to market authorities?</p> |
| | <p>Not applicable to the CFTC. Questions relating to securities in the equity markets are outside the scope of the CFTC’s jurisdiction.</p> |
| (c) | <p>As part of an effective compliance and enforcement system (assessed under Principle 11): (i) measures that promote settlement discipline, including regular monitoring by the market authority of settlement failures; and (ii) surveillance of</p> |

| |
|---|
| <p>short selling activities. Any deficiency here should also be taken into account in the assessment of Principle 11.</p> |
| <p>Not applicable to the CFTC. Questions relating to securities in the equity markets are outside the scope of the CFTC's jurisdiction.</p> |
| <p>(d) Appropriate exceptions for certain types of transactions for efficient market functioning and development (such as, but not limited to, bona fide hedging, market making and arbitrage activities)?</p> |
| <p>Not applicable to the CFTC. Questions relating to securities in the equity markets are outside the scope of the CFTC's jurisdiction.</p> |
| <p><i>Addressing Risks in the Commodity Derivatives Markets</i></p> |
| <p>8. Regarding authorities responsible for the supervision of exchange-traded physical commodity derivatives markets (e.g., either the market, a governmental regulator or an SRO) ("commodity derivatives market authorities):</p> |
| <p>(a) Does the relevant market authority have and use formal position management powers, including the power to set ex-ante position limits, particularly in the delivery month?</p> |
| <p>(b) Does the relevant market authority have the powers to employ additional measures, as appropriate to address market disruption or the perceived threat of such disruption?</p> |
| <p>Please refer to the authorities described above in response to Principle 37, Question 1(c). These authorities are broad and encompass the supervision of exchange-traded physical commodity derivatives markets.</p> |
| <p><i>Transactions in OTC Derivatives Markets</i></p> |
| <p>9. Are standardized OTC derivatives contracts with a suitable degree of liquidity required to be traded on "exchanges or electronic trading platforms" provided that a flexible approach encompassing a range of platforms that would qualify as "exchanges or electronic trading platforms" for OTC derivatives is taken?</p> |
| <p>Although there is no requirement that contracts with a suitable degree of liquidity be traded on exchanges or electronic trading platforms, liquidity is taken into consideration in determining which contracts will be subject to a mandatory trading requirement. Section 2(h)(8) of the CEA requires that transactions involving swaps subject to the clearing requirement under Section 2(h)(1) of the CEA occur on a DCM or a SEF, except where no DCM or SEF makes the swap "available to trade" or the transaction is subject to an exception or exemption from the swap clearing requirement. CFTC regulations 37.10 and 38.12 provide that any SEF or DCM may submit a determination that a swap is available to trade for purposes of Section 2(h)(8) of the CEA. A DCM or SEF may submit its determination under the</p> |

| | |
|-----|--|
| | <p>CFTC regulation 40.5 rule approval process or the CFTC regulation 40.6 certification process for a swap (1) that it lists or offers for trading and (2) that is subject to the clearing requirement under Part 50 of CFTC’s regulations. Such a determination must consider, as appropriate, one or more of the following factors with respect to the swap: (1) whether there are ready and willing buyers and sellers; (2) the frequency or size of transactions; (3) the trading volume; (4) the number and types of market participants; (5) the bid/ask spread; or (6) the usual number of resting firm or indicative bids and offers. During the Commission’s rule review process, market participants have the opportunity to provide the Commission with comments on the determination submitted by a DCM or SEF.</p> |
| 10. | <p>Are the platforms which may qualify as exchanges or electronic trading platforms for mandatory OTC derivatives trading appropriately identified as such?</p> |
| | <p>Once a swap is approved or deemed certified as available to trade, all other DCMs and SEFs that list or offer that swap for trading must do so in accordance with the trade execution requirement. All DCMs and SEFs seeking designation and registration, respectively, must be approved by the Commission and are listed and identified as such on the Commission’s website.</p> |
| 11. | <p>Are standardized OTC derivatives required to be cleared through CCPs? In particular, has the market authority a clear process in place for the determination that a product or set of products should be subject to a mandatory clearing obligation?</p> |
| | <p>Yes. Section 2(h) of the CEA requires that the Commission consider whether swaps subject to its jurisdiction be required to be cleared through a DCO. The process for determining whether a swap or class of swaps should be required to be cleared is set forth in the CEA and CFTC regulation 39.5. Part 50 of the CFTC’s regulations sets forth the classes of interest rate and credit default swaps that are required to be cleared.</p> |
| 12. | <p>Is the determining authority able to consult with foreign authorities to minimize inconsistencies among different regulatory standards on non-centrally cleared OTC derivatives?</p> |
| | <p>Yes. The CFTC has the ability to consult with foreign authorities regarding regulatory standards for uncleared swaps. With regard to margin requirements for uncleared swaps, the CFTC has the authority to grant substituted compliance with respect to the uncleared OTC derivatives margin requirements of foreign jurisdictions that the CFTC determines are comparable in outcome. <i>See</i> Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016). Pursuant to this rule, the CFTC, in consultation with the appropriate foreign regulator, has issued comparability determinations for Japan, Europe, and Australia. <i>See</i> 81 FR 63376, 82 FR 48394, and 84 FR 12908, respectively. With regard to other requirements for SDs promulgated under section 4s of the CEA, the CFTC has</p> |

consulted with foreign jurisdictions and issued comparability determinations in December 2013 for multiple jurisdictions. See 78 FR 78864 (Australia), 78 FR 78839 (Canada), 78 FR 78923 (EU), 78 FR 78852 (Hong Kong), 78 FR 78910 (Japan), and 78 FR 78899 (Switzerland); see also Cross-Border Guidance, 78 FR 45292 (July 26, 2013).

With regards to reporting standards for non-centrally cleared OTC derivatives, CFTC has consulted with foreign authorities, both bilaterally and as part of structured international data harmonization initiatives, in order to minimize inconsistencies in swaps data reporting, including efforts relating to the legal entity identifier (LEI), unique transaction identifier (UTI), unique product identifier (UPI), and critical data elements (CDE).

13. Are all OTC derivatives transactions not cleared by CCPs subject to appropriate margining practices?

Yes. All OTC derivatives transactions that are swaps as defined in section 1a(47) of the CEA and not centrally cleared are subject to appropriate margining practices. CEA Section 4s(e) requires the adoption of rules establishing margin requirements for SDs and MSPs, and applies a bifurcated approach that requires each SD and MSP for which there is a prudential regulator¹⁹³ to meet the capital and margin requirements established by the applicable prudential regulator, and each SD and MSP for which there is no prudential regulator to comply with the CFTC's margin regulations. The CFTC published final margin requirements for SDs and MSPs for which there is no prudential regulator in January 2016.¹⁹⁴

14. Are all financial firms and systemically important non-financial entities that engage in non-centrally cleared OTC derivatives required to exchange initial and variation margin as appropriate to the counterparty risks posed by such transactions?

Yes. See answer to Principle 37, Question 2, above, and response to Principle 6, Question 1. There are currently no registered MSPs.

¹⁹³ The term "prudential regulator" is defined in Section 1a(39) of the CEA to include the Federal Reserve Board, the OCC, the FDIC, the FCA, and the FHFA. The definition also specifies the entities for which these agencies act as prudential regulators, and these consist generally of federally insured deposit institutions; farm credit banks; federal home loan banks; the Federal Home Loan Mortgage Corporation; and the Federal National Mortgage Association. In the case of the Federal Reserve Board, it is the prudential regulator not only for certain banks, but also for bank holding companies and any foreign banks treated as bank holding companies. The Federal Reserve Board also is the prudential regulator for subsidiaries of these bank holding companies and foreign banks, but excluding their nonbank subsidiaries that are required to be registered with the CFTC as SDs or MSPs.

¹⁹⁴ See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 FR 636 (Jan. 6, 2016). The CFTC Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission's regulations. See CFTC regulations 23.150-159, 23.161.

| |
|--|
| |
| <p>15. Where required by the authority, do financial entities and systemically important non-financial entities that engage in non-centrally cleared OTC derivatives employ risk mitigation techniques consistent with the standards set out by IOSCO in the report <i>Risk Mitigation Standards for Non-Centrally Cleared OTC Derivatives</i>?</p> |
| <p>Yes. SDs and MSPs are subject to Commission regulations consistent with the IOSCO Risk Mitigation Standards. See CFTC regulations 23.504 (swap trading relationship documentation), 23.501 (swap confirmation), 23.504(b)(4) (valuation with counterparties), 23.502 (portfolio reconciliation), 23.503 (portfolio compression), and 23.504(b)(4)(ii)(B) and 23.502(a)(5) (dispute resolution).</p> |
| <p>16. Are OTC derivatives contracts required to be reported to TRs?</p> |
| <p>Yes. All OTC derivatives contracts where at least one counterparty is a U.S. person, swap dealer, or major swap participant are required to be reported to a CFTC-registered SDR as required under Part 45 of the CFTC's regulations. While still required to be reported under Part 45 of the CFTC's regulations, non-price forming swaps, including inter-affiliate swaps and portfolio compression exercises, are not required under Part 43 of the CFTC's regulations to be reported to a SDR for public dissemination.</p> |
| <p>17. Are transaction-level data on OTC derivatives required to be reported to TRs, including at least transaction economics, counterparty information, underlier information, operational data and event data?</p> |
| <p>Yes. Transaction-level data, including transaction economics, counterparty information, underlier information, operational data and event data, on OTC derivatives is required to be reported to a CFTC-registered SDR under Part 45 of the CFTC's regulations. Counterparty information is not reported under Part 43 of the CFTC's regulations to a SDR for public dissemination.</p> |
| <p>18. Does the market authority have sufficient and timely access to relevant data in order to carry out its respective mandate related to OTC derivatives?</p> |
| <p>Yes. The CFTC has sufficient and timely access to relevant data in order to carry out its mandate relating to OTC derivatives. With regards to sufficiency of data, the CFTC has direct access to the full scope of swap data reported to CFTC-registered SDRs pursuant to Parts 43 and 45 of the CFTC's regulations. With regards to timeliness of data, data for new trades are reportable to a CFTC-registered SDR as soon as technologically practicable after execution and continuation and valuation data for existing swaps are reportable daily.</p> |
| <p>19. Do reporting entities and counterparties have appropriate access to their own data stored</p> |

with TRs?

Yes. Counterparties have appropriate access to their own data under CFTC regulations. CFTC regulation 49.17(f) generally prohibits access to data maintained by SDRs within the CFTC's jurisdiction, but provides an explicit exception that allows the counterparties to a swap to access data related to that swap maintained by the SDR (within limits designed to preserve anonymity for certain anonymously-executed trades). Section 21(c) of the CEA and CFTC regulation 49.11 also require SDRs to confirm the accuracy of submitted data with swap counterparties. The CFTC has also recently proposed amendments to Part 49 of the CFTC's regulations that would require SDRs to regularly confirm the accuracy of data with the reporting counterparty for each swap.