

June 23, 2000

Honorable Richard G. Lugar
Chairman
Committee on Agriculture, Nutrition
and Forestry
United States Senate
Washington DC 20510

Honorable Tom Harkin
Ranking Member
Committee on Agriculture, Nutrition
and Forestry
United States Senate
Washington DC 20510

Re: S. 2697—Commodity Futures Modernization Act of 2000

Dear Chairman Lugar and Senator Harkin:

The Futures Industry Association (“FIA”) welcomes this opportunity to comment on the provisions of S. 2697, the Commodity Futures Modernization Act of 2000. FIA is a principal spokesman for the commodity futures and options industry. Our regular membership is comprised of approximately 60 of the largest futures brokerage firms—known as futures commission merchants or FCMs—in the United States. Among our associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of our membership, FIA estimates that our members effect more than 80 percent of all customer transactions executed on US contract markets. The provisions of S. 2697, therefore, are of vital concern to our members.

The Purpose of the Legislation

The proposed legislation would amend the provisions of the Commodity Exchange Act (“Act”) to achieve several important goals. First, the bill would implement certain of the recommendations the President’s Working Group on Financial Markets (“PWG”) set forth in its November 1999 report *Over the Counter Derivatives Markets and the Commodity Exchange Act* (“Report”). Implementation of these recommendations would enhance legal certainty for swaps and other over the counter (“OTC”) transactions, permit such transactions to be executed through electronic trading systems and reduce systemic risk by allowing these transactions to be cleared through derivatives clearing organizations. In addition, the provisions of the so-called Treasury Amendment would be revised to clarify that transactions in all Treasury Amendment products are generally excluded from the Act, unless they are conducted on an organized exchange. The Commodity Futures Trading Commission (“Commission”) would continue to have authority to address the problems associated with foreign currency “bucket shops.”

Second, S. 2697 would authorize contract markets and national securities exchanges to trade futures and options on futures on single equity securities and indices composed of four or fewer

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equity securities. Third, the bill would codify certain provisions of the Commission's regulatory reform proposal, which the Commission recently released for public comment. Finally, the bill would reauthorize the Commission for an additional five-year period.

FIA strongly endorses the goals of S. 2697 and congratulates the Committee on Agriculture, Nutrition for undertaking to develop legislation in this difficult area. The issues that S. 2697 is designed to address have inhibited the development of the US derivatives markets, both exchange and OTC, for far too long. If we are to have the authority and flexibility to compete in an increasingly challenging international marketplace, the existing regulatory structure that governs the derivatives markets must be revised.

As discussed in detail below, certain provisions of the bill would place FCMs at a competitive disadvantage to broker-dealers and financial institutions, whose ability to participate in the OTC derivatives markets and derivatives transaction execution facilities will be enhanced. In this regard, therefore, FIA urges the Committee to amend S. 2697 consistent with the comments that follow.

The Treasury Amendment

As noted above, in accordance with the recommendations of the PWG, the proposed legislation would amend the provisions of the Treasury Amendment to confirm that the products listed in that section of the Act are generally excluded from the Commission's jurisdiction, unless they are traded on an organized exchange. FIA supports this provision of the bill and believes that it accurately reflects judicial interpretations of the current law.¹

Moreover, FIA supports in principle the provision of the bill that would exclude from Commission jurisdiction OTC transactions in foreign currencies involving retail customers with respect to which the counterparty is a broker-dealer, financial institution, insurance company, financial holding company or investment bank.² We respectfully request, however, that the Committee further amend this provision to authorize FCMs to act as counterparties in such transactions. The failure to adopt such an amendment would place FCMs at a competitive disadvantage to other entities in the financial services industry. As important, the ability of the many FCMs that are also registered with the Securities and Exchange Commission ("SEC") as broker-dealers to act as counterparties under this provision would be uncertain.

We understand that the purpose of this provision is to grant the Commission jurisdiction over unlawful "bucket shops" marketing OTC foreign currency futures and options on futures to retail customers, without interfering with lawful activities of otherwise regulated entities. We agree with the underlying purpose of the provision. However, the consequence of this provision in its current form is that FCMs potentially would be subject to the panoply of the Commission's regulatory regime with respect to these transactions, including the possibility that the Commission

¹ Proposed new section 2(c)(1) and 2(c)(2)(A), pp. 19-21.

² Proposed new section 2(c)(2)(B), pp. 21-22.

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could prohibit FCMs from engaging in such transactions entirely. Meanwhile, broker-dealers, banks and other entities subject to the jurisdiction of other financial services regulatory authorities would be able to engage in these transactions subject, perhaps, only to appropriate capital charges.

In effecting transactions in OTC futures and options on futures on foreign currencies, FCMs would be subject to essentially the same capital charges as broker-dealers. Moreover, FCMs already have considerable expertise in these products in connection with their activities on exchange traded markets. Many FCMs also engage in foreign currency transactions in the interbank market on their own behalf and behalf of their customers. Therefore, FCMs certainly have no less—and, in many cases, far more—knowledge or expertise in these products than other entities that would be authorized to act as counterparties under the provisions of this bill. FCMs, therefore, should be able to engage in these transactions on behalf of retail customers under terms and conditions that are no more stringent than those that are applicable to such entities.

Moreover, FIA notes that all but two of the fifty largest FCMs are also registered with the SEC as broker-dealers. If enacted into law, this provision of the bill would result in considerable confusion and legal uncertainty for these FCMs. Would their activities be excluded from the Commission's jurisdiction because they are registered as broker-dealers or would they be prohibited from acting as counterparties because they are registered as FCMs? The authority of FCMs and broker-dealers to act as counterparties with retail customers in connection with OTC futures and options on futures transactions in foreign currencies must be the same. For the convenience of the Committee, a proposed amendment to implement this recommendation is enclosed (Exhibit A).

Futures on Securities

Section 8 of S. 2697 would amend the Act to add a new section 2(g) to authorize US futures exchanges and national securities exchanges to list futures and options on futures on single equity securities and groups or indices composed of fewer than five equity securities. Similarly, these products would be able to be cleared through either a clearing organization subject to the Commission's jurisdiction or a securities clearing agency subject to the jurisdiction of the SEC.

As a matter of policy, FIA believes that the markets, not a particular regulatory regime, should determine whether these products should be traded on a futures exchange or a securities exchange. However, we also note that, under the Senate bill, securities exchanges and clearing agencies would have a substantial competitive advantage over the futures exchanges and related clearing organizations. Therefore, the provisions of the Senate bill would have to be amended before FIA could support them in their entirety.

The proposed legislation would effectively authorize securities exchanges and securities clearing agencies to list and clear futures on individual securities, as well as cash securities and options on such securities. Futures exchanges and clearing organizations, however, would not have the same authority. Securities exchanges, therefore, would be able to offer participants that wish to engage in transactions across product types a far more efficient and cost effective means of trading.

Broker-dealers, in turn, would be able to hold customer funds and positions in a single account and provide their customers with a single statement. As a consequence, securities exchanges and broker-dealers would have a significant competitive advantage. FIA respectfully suggests that market and regulatory parity can be achieved only if futures exchanges and futures clearing organizations have the ability to clear securities, and FCMs are able to carry securities and securities options in a futures customer segregated account. In this regard, FCMs should be able to become clearing members of securities clearing agencies for the purpose of carrying contracts in equity futures on behalf of their customers without being required to be registered as with the SEC as broker-dealers and becoming members of NASD Regulation, Inc.

FIA strongly supports the enactment of provisions that would permit Commission-registered derivatives clearing organizations to clear securities and other products in a single entity. The ability of a clearing organization to net obligations across markets potentially offers a substantial benefit by permitting intermediaries to reduce systemic risk associated with holding positions in multiple clearing organizations. FIA notes that international clearing organizations and intermediaries generally are authorized to clear multiple products in a single account, and we believe US clearing organizations should have the same ability.

We recognize that the practical and regulatory issues that would arise under this proposal may be complex. However, we also note that the Commission and the SEC have previously agreed on an approach by which professional traders have been authorized to carry futures on stock indices and related options on stock indices in a single "cross-margin" account. The cross-margin accounts previously authorized are limited both with respect to the nature of the participants permitted to take advantage of them and the positions that could be carried. Therefore, they do constitute a perfect example of the structure that such accounts could take. However, they are an example of the ability of the Commission and the SEC to resolve difficult issues when they act in good faith to do so.

Stock Index Products Listed on Foreign Exchanges

Separately, FIA encourages the Committee to adopt an amendment to S. 2697 that would facilitate transactions in futures on foreign securities or stock indices that are executed on behalf of US customers. As described below, the current restrictions often prevent US customers from hedging foreign stock and government bond portfolios in the manner they would prefer and impair their ability to use the most efficient and effective hedging vehicles.

As the Committee is aware, section 2(a)(1)(B) of the Act precludes the Commission from authorizing a US futures exchange to trade contracts on individual securities that are not "exempt securities" under the securities acts.³ It also establishes certain criteria that a stock index futures

³ Foreign government debt securities are not exempt securities. Therefore, the Commission and the SEC also have taken the position that US FCMs may not offer contracts on foreign debt securities for execution either on US or on foreign futures exchanges, unless and until the SEC, by rule, determines that they are exempt for these purposes.

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contract must satisfy before the Commission, following consultation with the SEC, may authorize a US exchange to trade that product. Section 2(a)(1)(B) is silent with respect to futures on securities or securities indices traded on a foreign exchange. Nonetheless, citing congressional report language, the Commission has determined that this section of the Act also prohibits US persons from entering into a stock index contract traded on a foreign exchange, unless the contract conforms to the requirements set forth in that section.⁴

Therefore, the Commission initially prohibited FCMs from carrying positions in such stock index contracts for any customers, until the foreign exchange has filed an application for, and has received, Commission approval to offer the stock index contract to US persons. Under the procedure the Commission established to review these contracts, the cooperation, if not the consent, of the SEC is essential before these products may be offered in the US.⁵

We do not believe that Congress ever intended to preclude a foreign futures exchange from offering futures on foreign stock indices or foreign government debt instruments to US customers. Nor do we believe that Congress intended to require such foreign exchanges to apply for and receive Commission approval before doing so. As clearly reflected in the provisions of section 2(a)(1)(B), the sole regulatory purpose that Congress sought to achieve was to protect the integrity of the underlying US securities markets by assuring that trading in a particular stock index futures contract "is not being used in the manipulation of the price of any underlying security [or] option on such security."⁶ With respect to futures contracts on foreign securities offered on a foreign exchange, we respectfully suggest that this determination appropriately resides with the regulatory authorities that oversee the markets on which the relevant securities are traded, not with the Commission or the SEC.

In their testimony and related written explanations of the Accord that formed the nucleus of section 2(a)(1)(B), neither Chairman Johnson nor Chairman Shad indicated that the Accord was intended to apply to foreign products. More important, the Commission's position conflicts directly with the provisions of section 4(b) of the Act, which specifically provides that the Commission may not require that the terms and conditions of any foreign exchange-traded contract be submitted to the Commission for approval. In this regard, it should be noted that section 2(a)(1)(B) and section 4(b) were both added to the Act in the Futures Trading Act of 1982.

In 1992, the Commission, after consultation with the SEC, revised its interpretation of section 2(a)(1)(B), and issued an Order authorizing US FCMs to solicit and accept orders from non-US customers for foreign exchange-traded stock indices and foreign government debt securities. The

⁴ H. R. Rep. 565, 97th Cong., 2d Sess., p. 85.

⁵ As of May 25, 2000, the Commission has authorized 40 stock index contracts traded on foreign exchanges, and applications with respect to nine stock index contracts are pending. Futures on debt securities of 21 countries have been approved.

⁶ Section 2(a)(1)(B)(ii)(II).

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Order was subject to the condition that the contract could not “be based on an index of which ten percent (10%) or more of the weighting of the index is derived from securities whose primary trading market is in the United States.”⁷ In issuing this Order, the Commission stated that there appeared to be no US customer protection interest advanced by continuing to prohibit US FCMs from offering these products to non-US persons. Further, “such transactions did not appear to have any unique impact on the financial and operational viability of a registered FCM.”⁸

The Commission’s rationale for limiting the relief to non-US persons makes little sense. As discussed above, the underlying regulatory purpose of this section is neither concern for the protection of customers nor perceived threats to the financial or operational viability of US FCMs. No public policy is served, therefore, by excluding certain foreign contracts from trading by US customers, especially institutions. This is particularly true since these same customers, including US pension funds, can freely trade in the underlying foreign securities and in OTC derivatives instruments that can be used as substitutes for these contracts.⁹ For these same reasons, we can discern no US regulatory purpose to be served by preventing US customers from using foreign futures on single securities, provided that the US is not the primary trading market for such securities. US customers who invest in the underlying foreign securities are deprived of a valuable hedging tool by being precluded from trading foreign futures contracts on the same securities.¹⁰

FIA wishes to emphasize that its proposed amendment relating to foreign stock indices is independent of the provisions of the bill relating to single stock futures. It is essential that this amendment be enacted whether or not the other provisions of section 2(g) are adopted. For the benefit of the Committee, we have enclosed a proposed amendment to S. 2697 that would implement the above recommendations (Exhibit B).

⁷ 57 Fed.Reg. 36369 (August 13, 1992).

⁸ Id. In this Order, the Commission also authorized registered commodity trading advisors and introducing brokers to provide services with respect to such products to persons located outside of the United States.

⁹ In this regard, it should be noted that emerging countries, in particular, may find it difficult to meet the standards that the Commission employs in approving the offer and sale of foreign stock index products. The inability to hedge investments in the securities of emerging country companies inhibits the flow of US capital to these countries.

¹⁰ In this regard, certain FIA member firms have indicated that the recent delay in approving the S&P/TSE 60 stock index futures contract traded on the Montreal Exchange, in particular in light of the fact that the related Toronto Stock Exchange index contracts were being eliminated, effectively forced many institutional participants to enter into economically comparable OTC instruments in connection with the expiration of their futures positions.

Regulatory Reform

FIA supports the provisions of S. 2697 that would codify the regulatory reform proposal that the Commission recently published for comment in the *Federal Register*. The Commission's proposal holds the promise of providing significant regulatory relief to derivatives markets and market participants. However, we are recommending two additional amendments that FIA believes will further enhance the Committee's goals.

Section 11 of S. 2697 would amend section 4c of the Act to authorize FCMs, in accordance with the rules of the applicable market, to enter into transactions with their customers, as principal or agent, away from the trading facility.¹¹ These transactions then could be submitted to the regulated exchange where they would be cleared pursuant to exchange rules. FIA supports the purpose of this amendment, which would provide exchange markets with needed flexibility, liquidity and efficiency.

Nonetheless, in analyzing this section of the bill, FIA concluded that the transactions these provisions authorized should not be included in the same section that prohibits other transactions described in that section, such as wash sales, accommodation trades or fictitious sales. As noted, many of these the authorized transactions have been an integral part of the regulated futures markets for a substantial period of time. They are nothing more than alternative means of effecting an exchange transaction and should not be presumed to be prohibited or somehow improper unless specially approved by the Commission. To the contrary, the rules governing such transactions should be subject to the same degree of Commission scrutiny as any other exchange rule. We respectfully suggest, therefore, that the provisions in section 4c(a)(3) and (4) of the Act, as proposed to be amended, be deleted. Instead, these provisions, in slightly modified form, would be added to proposed new sections 5 and 5a of the Act as permissible transactions under the rules of the applicable trading facility. A proposed amendment in this regard is enclosed (Exhibit C).

Second, although the Commission has identified certain core principles that should govern the regulation of intermediaries, it has chosen not to adopt them. Instead, it has stated that it will use the core principles to develop its regulatory policy with respect to intermediaries. In this regard, the Commission has indicated that it intends to propose amendments to its regulations that will benefit FCMs and other intermediaries. In several cases, FIA has been recommending relief in these areas for several years.

FIA believes that, as with exchanges and clearing organizations, the Commission can and should do more to replace its prescriptive regulations with statements of core principles and interpretations of acceptable business practices. Rather than insert these principles in this legislation, however, FIA is proposing an amendment to the Act that would require the Commission to conduct a study. Among other things, this amendment would require the

¹¹ See pp. 45-47. Section 4c also authorizes other transactions that historically have been effected away from the exchange trading facility, including exchange of futures for cash commodities, transfer or office trades and, more recently, exchange of futures for swaps.

Commission to identify the core principles and interpretations of acceptable business practices that it has adopted or intends to adopt to replace the provisions of the Act and the Commission's rules and regulations thereunder and the rules and regulations that the Commission has determined must be retained and the reasons therefor. The Commission would submit a report on the results of its study to the applicable committee of the House of Representatives and Senate within a year after the enactment of this bill. A proposed amendment for this purpose is enclosed (Exhibit D).

Other Comments

Eligible Contract Participant. FIA generally supports the definition of an "eligible contract participant" set forth in proposed new section 1a(10). In particular, we support the provisions of this definition that would establish a \$10 million asset test for individuals. This is the test that the Commission adopted in defining an eligible swap participant. This test has been employed in the swaps market without incident.

FIA also supports the decision to include within this definition commodity trading advisors, investment advisers and persons performing similar fiduciary responsibilities acting on behalf of eligible contract participants. However, we would encourage the Committee to extend this definition to all persons whose accounts are managed by qualified investment managers.¹² Because an investment manager is a fiduciary to its customer, FIA believes it is more appropriate to look only to the sophistication of the advisor in determining whether a customer should be considered an eligible contract participant. The net worth of the underlying customer or the aggregate value of the individual customer's assets should be irrelevant.

Bona Fide Principal-to Principal Transactions. Proposed new section 2(d)(2)(A) of the Act would exclude from the Commission's jurisdiction transactions in certain "excluded commodities" effected through an electronic trading facility, if the transactions are entered into on a "bona fide" principal-to-principal basis between eligible contract participants¹³. FIA understands that, in his testimony before the Committee on June 21, Chairman Greenspan expressed concern that the use of the term "bona fide" could be interpreted to preclude an eligible contract participant from entering into "back-to-back" principal transactions. Mr. Greenspan stated that the Federal Reserve Board could identify no public policy reason for precluding such transactions. FIA agrees with the concerns expressed by Chairman Greenspan and respectfully suggests that the term "bona fide" be removed from each of these provisions of the bill.

Composition of Governing Boards. FIA believes that the provisions of proposed new section 5(d)(16), which provides that the governing boards of mutually-owned contract markets should

¹² In this connection, FIA has previously recommended that qualified investment managers should have at least \$25 million under management.

¹³ See pp. 23-24.

“reflect[] market participants,” is too vague.¹⁴ FIA prefers the language in current section 5a(a)(14), which states that a contract market must provide for “meaningful representation” on its governing board of the “diversity of interests” that trade on that contract market.

Eligible Traders. The provisions of proposed new section 5a(b)(3) appear to require a derivatives execution transaction facility to approve every person trading on that facility, even if that person is trading through an FCM. We do not believe this is the Committee’s intent. We believe this section should the subparagraphs of this provision should be reorganized to provide that a trader *either* (a)(i) must be authorized by the board of trade to trade on the facility and (ii) be an eligible contract participant, *or* (b) be a person trading through a futures commission merchant that satisfies the requirements currently contained in proposed new section 5a(d)(3)(B)(ii)(I)-(IV).¹⁵

Use of Broker-Dealers and Depository Institutions as Intermediaries. FIA supports the provisions of S. 2697 that would authorize broker-dealers and depository institutions to introduce and execute orders on behalf of eligible contract participants on a derivatives transaction execution facility.¹⁶ The Committee should make clear, however, that, in coordinating with the SEC and bank regulatory authorities to implement these provisions, the Commission should ensure that FCMs are subject to no more stringent recordkeeping or reporting requirements than those to which broker-dealers or financial institutions will be subject. All intermediaries effecting transactions on behalf of customers on a derivatives transaction execution facility should be required to comply with the same recordkeeping and reporting requirements.

Linking of Regulated Clearing Facilities. FIA supports the provisions of proposed new section 5b(g) of the Act that would require the Commission to coordinate with the SEC and bank regulatory agencies to facilitate the ability of derivatives clearing organizations registered under the Act to link with other clearing agencies for the purpose of coordinating the settlement of cleared transactions.¹⁷ Further, as we have previously indicated, derivatives clearing organizations should be authorized to clear securities and securities options directly as well.

Predispute Resolution Agreements. FIA supports the provisions amending section 14 of the Act.¹⁸ However, we believe this section should be revised further to clarify that FCMs may require an eligible contract participant to sign a predispute agreement requiring the participant to submit all claims to arbitration. A proposed amendment to section 14 is enclosed (Exhibit E).

¹⁴ See p. 54.

¹⁵ See p. 57.

¹⁶ Proposed new section 5a(e), pp. 62-64.

¹⁷ See p. 75.74.

¹⁸ See p. 83.

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Contract Enforcement Between Eligible Counterparties. FIA supports the proposed amendment to section 22(a) of the Act that would provide that no agreement between eligible contract participants would be voidable or unenforceable based on the failure of the agreement to comply with the terms and conditions of any exclusion or exemption from any provision of the Act or Commission regulation.¹⁹

Thank you again for this opportunity to comment on the provisions of S. 2697. If you have any questions concerning this letter, please contact Barbara Wierzynski, FIA's General Counsel, or me at (202) 466-5460.

Sincerely,

John M. Damgard
President

cc: Honorable Phil Gramm (w/enclosures)
Honorable Peter G. Fitzgerald (w/enclosures)

¹⁹ See p. 85.

Section 2(c)(2)(B)(ii)(II) and (III), as proposed to be added by section 4 of S. 2697, is further amended as follows:

“(B) AGREEMENTS, CONTRACTS, AND TRANSACTIONS IN FOREIGN CURRENCY.— This Act applies to, and the Commission shall have jurisdiction over, an agreement, contract, or transaction in foreign currency that—

* * * * *

“(ii) is offered to, or entered into with, a natural person who is not an eligible contract participant, unless the counterparty, or the person offering to be the counterparty, of the natural person is—

* * * * *

“(II) a broker or dealer registered under section 15(b) or 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b), 78o-5) or a futures commission merchant registered under this Act; or

“(III) an associated person of a broker or dealer registered under section 15(b) or 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b), 78o-5), or an affiliated person of a futures commission merchant registered under this Act, concerning whose financial or securities activities the registered person makes and keeps records under section 15C(b) or 17(h) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-5(b), 78q(h)) or section 4f(c)(2)(B) of this Act.”.

* * * * *

**Amendment to S. 2697
Foreign Stock Indices**

Section 8 of S. 2697, adding a new section 2(g) to the Act, is hereby further amended to add new paragraph 2(g)(9) at the end thereof to read as follows:

(9)(A) Nothing in this section or in any other section of this Act shall be construed to require or authorize the Commission to review or approve, directly or indirectly, any contract, rule, regulation or action adopted by a foreign board of trade, exchange, or market, or a clearinghouse for such board of trade, exchange, or market relating to any transactions involving contracts of sale for future delivery (or options on such contracts) in or involving any security, including any foreign government debt security, or group or index of such securities: *Provided*, That, with respect to a contract of sale for future delivery (or option on such contract) on a single equity security, the United States shall not be the primary trading market for the underlying security: *And, provided further*, That, with respect to any group or index of equity securities, less than twenty-five percent of the weighting of the group or index is derived from securities for which the United States is the primary trading market for the securities underlying such contract for future delivery (or option on such contract): *And, provided, further*, That settlement of or delivery on a contract for future delivery (or option on such contract) of the types described in this paragraph (9)(A) shall be effected in cash or by means other than the transfer or receipt of a security in the United States other than an exempted security.

(B) Within ninety days of the date of the enactment of this paragraph, the Commission shall adopt such procedures as it deems appropriate pursuant to which, consistent with the provisions of this Act, the Commission shall authorize the offer and sale in the United States of any contract of sale for future delivery (or option on such contract) of a security, other than a security of the type described in the first proviso to paragraph (9)(A) of this section or a group or index of securities of the type described in the second proviso to paragraph (9)(A) of this section, traded on or subject to the rules of a foreign board of trade, exchange, or market, or a clearinghouse for such board of trade, exchange, or market: *Provided, however*, That the procedures the Commission adopts under this paragraph shall not require such foreign board of trade, exchange, or market, or a clearinghouse for such board of trade, exchange, or market to apply for designation as a contract market under the Act with respect to such contract for future delivery (or option on such contract).

“SEC. 4c. PROHIBITED TRANSACTIONS. (Page 45-47)

“(a) IN GENERAL.—

“(1) PROHIBITION.—It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of a transaction described in paragraph (2) involving any commodity if the transaction is used or may be used to—

“(A) hedge any transaction in interstate commerce in the commodity or the product or byproduct of the commodity;

“(B) determine the price basis of any such transaction in interstate commerce in the commodity; or

“(C) deliver any such commodity sold, shipped, or received in interstate commerce for the execution of the transaction.

“(2) TRANSACTION.—A transaction referred to in paragraph (1) is a transaction that—

“(A) (i) is, is of the character of, or is commonly known to the trade as, a ‘wash sale’, [‘cross trade’,] or ‘accommodation trade’; or

“(ii) is a fictitious sale; or

“(B) is used to cause any price to be reported, registered, or recorded that is not a true and bona fide price.

[“(3) EFFECT OF SUBSECTION.—Nothing in this subsection—

“(A) makes unlawful an exchange of—

“(i) futures in connection with a cash commodity transaction;

“(ii) futures for cash commodities;

“(iii) transfer trades or office trades; or

“(iv) futures for swaps;

if the exchange is made in accordance with rules of the contract market or derivatives transaction execution facility that apply to such transactions, and those rules have been approved by the Commission; or

“(B) makes it unlawful for a futures commission merchant, acting as principal or agent, to enter into, execute, or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, and cleared in accordance with the rules of a contract market or derivatives transaction execution facility.”]

**“SEC. 5. DESIGNATION OF BOARDS OF TRADE AS CONTRACT MARKETS.
(Page 48)**

“(a) APPLICATIONS.—A board of trade applying to the Commission for designation as a contract market shall submit an application to the Commission that includes any relevant materials and records the Commission may require consistent with this Act.

“(b) CRITERIA FOR DESIGNATION.—

* * * * *

“(3) FAIR AND EQUITABLE TRADING.—The board of trade shall establish and enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and the capacity to detect, investigate, and discipline any person that violates the rules. Such trading rules may authorize—

“(A) an exchange of—

“(i) futures in connection with a cash commodity transaction;

“(ii) futures for cash commodities;

“(iii) transfer trades or office trades; or

“(iv) futures for swaps; and

“(B) a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, and cleared in accordance with the rules of the contract market.”

**“SEC. 5a. DERIVATIVES TRANSACTION EXECUTION FACILITIES.
(Page 59)**

“(c) CRITERIA FOR REGISTRATION.—

“(1) IN GENERAL.—To be registered as a registered derivatives transaction execution facility, the board of trade shall demonstrate to the Commission that the board of trade meets the criteria specified in this paragraph.

* * * * *

“(3) TRADING PROCEDURES.—The board of trade shall establish and enforce rules or terms and conditions defining, or specifications detailing, trading procedures to be used in entering and executing orders traded on the facilities of the board of trade. Such trading rules may authorize—

“(A) an exchange of—

“(i) futures in connection with a cash commodity transaction;

“(ii) futures for cash commodities;

“(iii) transfer trades or office trades; or

“(iv) futures for swaps; and

“(B) a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, and cleared in accordance with the rules of the registered derivatives transaction execution facility.”

“SEC ___. REGULATION OF REGISTRANTS.

“(a) CORE PRINCIPLES.—For the purposes of continuing the process of streamlining and eliminating unnecessary regulation of persons required to be registered with the Commission and of transforming the Commission’s role from direct regulation of the futures industry to that of an oversight agency, the Commission shall review the provisions of the Act and the rules, regulations and interpretations thereunder and, to the extent appropriate consistent with the provisions of this Act, shall replace such provisions with core principles and interpretations of acceptable business practices.

“(b) INTERPRETATIVE STATEMENTS.—

“(1) In lieu of promulgating prescriptive rules, regulations or orders under this Act, the Commission is authorized, and shall endeavor, to issue interpretations, or approve interpretations submitted to the Commission, describing what would constitute acceptable business practices under this Act.

“(2) TIME FOR APPROVAL.—If any person submits an interpretation of acceptable business practices to the Commission for approval, the Commission shall take final action on the interpretation not later than 90 days after submission, unless the person submitting the interpretation agrees to an extension of the time limitation established under this paragraph. The Commission shall approve any such interpretation unless the Commission finds that the interpretation would violate this Act.

“(3) EFFECT OF INTERPRETATION.—An interpretation issued under paragraph (1) shall not provide the exclusive means of complying with the core principles adopted in accordance with this section.

“(c) REPORT TO CONGRESS.

“(1) The Commission shall undertake and complete a study of this Act and the Commission’s rules, regulations and orders governing the conduct of persons required to be registered under this Act not later than one year following the enactment of the Commodity Futures Modernization Act of 2000. This study shall identify—

“(A) the core principles and interpretations of acceptable business practices that the Commission has adopted or intends to adopt to replace the provisions of the Act and the Commission’s rules and regulations thereunder;

“(B) the rules and regulations that the Commission has determined must be retained and the reasons therefor.

“(C) the extent to which the Commission believes it can effect the changes identified in paragraph (A) through its exemptive authority under section 4(c) of this Act; and

“(D) the regulatory functions the Commission currently performs that can be delegated to a registered futures association and the regulatory functions that the Commission has determined must be retained and the reasons therefor.

“(2) In conducting this study, the Commission shall solicit the views of the public as well as Commission registrants, registered entities and registered futures associations.

“(3) The Commission shall transmit to the Committee on Agriculture of the House of Representatives and the Committee on Agriculture, Nutrition and Forestry of the Senate a report of the results of its study, which shall include—

“(A) an analysis of comments received; and

“(B) a timetable, which shall not exceed six (6) months from the date of the report, by which the Commission shall have adopted the core principles and interpretations identified pursuant to paragraph (1)(A) of this subsection.

“(d) EFFECT OF SECTION.—Nothing in this section is intended to prohibit the Commission, acting directly or by delegation to its staff, from exercising its authority under this Act to grant exemptions or other appropriate relief to any person or group of persons from any provision of this Act or any rule, regulation or order thereunder.”

Section 19 of S. 2697, amending section 14 of the Act, is hereby further amended to read as follows: [Additions are underlined.]

SEC. 20. PREDISPUTE RESOLUTION AGREEMENTS FOR INSTITUTIONAL CUSTOMERS.

Section 14 of the Commodity Exchange Act (7 U.S.C. §18) is amended by striking subsection (g) and inserting the following:

“(g) PREDISPUTE RESOLUTION AGREEMENTS FOR INSTITUTIONAL CUSTOMERS.— Nothing in this section or in any other section of this Act prohibits a registered futures commission merchant from requiring a customer that is an eligible contract participant, as a condition to the futures commission merchant’s conducting a transaction for the customer, to enter into an agreement waiving the right to file a claim under this section and otherwise agreeing to submit any claim the customer may have against the futures commission merchant to binding arbitration pursuant to the rules and procedures of a registered entity or registered futures association or such other forum authorized to hear such claims.