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September 14, 2009

David A. Stawick, Secretary  
Commodity Futures Trading Commission  
1155 21<sup>ST</sup> Street NW  
Washington DC 20581

Elizabeth M. Murphy, Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington DC 20549-1090

**Re: Submission For The Record On Harmonization  
File Number 4-588**

Dear Mr. Stawick and Ms. Murphy:

The Futures Industry Association submits these comments for the record on the possible harmonization of market regulation under the federal securities laws and the Commodity Exchange Act.<sup>1</sup> FIA was privileged to be invited to participate at one of the two joint Commission hearings on this subject. FIA appreciates the Commissions' decision to keep the hearing record open for 10 additional days to allow interested persons to submit additional views. We are submitting this letter for the record in order to summarize FIA's views on the list of harmonization issues Chairman Gensler identified after we testified.

### **Overview**

Like the Commissions, the FIA has learned a good deal about the harmonization issues from the excellent hearings on September 2 and 3, including some areas where consensus emerged. Just about every witness at these hearings observed that the harmonization issues were very important and very complex. Just about every witness accepted that futures and securities markets have many differences and that their regulation properly should reflect those differences even when trying to achieve common regulatory objectives. Just about every witness urged each Commission to respect the view that its regulatory system was not the only way to achieve successful regulatory outcomes; comparable, not identical, regulation should be the goal of harmonization. And just about every witness at these hearings, including ourselves and even many of the legal experts, understandably appeared to know more about one side of this regulatory equation than the other. In FIA's view, these areas of consensus underscore the need for the agencies to communicate well and to work together wherever possible to make sure both securities and futures regulation better serve the public interest.

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<sup>1</sup> For the record, FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants ("FCMs") in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States designated contract markets.

**1. Product listing: self certification or prior approval.**

FIA understands the securities exchanges' frustration at not being able to introduce innovative products quickly based on exchange self-certification. FIA believes the self-certification system may have been misunderstood, however. That system does not mean that the agency's review role is eliminated. In practice, self-certification simply means that the agency's review occurs typically earlier in the product development process (and through staff), as a matter of consultation and questioning. It also means the agency review role largely occurs out of the view of other exchanges and market participants. If the SEC wanted to entertain allowing the securities exchanges to employ some system of self-certification, FIA believes that reform could promote innovation and competition.

During the hearings, both futures and securities exchanges testified that in some cases, and by no means most cases, they are uncertain whether a new product should be listed on a securities exchange or a futures exchange, as a matter of law. Two methods were proposed for dealing with this legal uncertainty where both Commissions' claim jurisdiction. One was to allow a tie-breaker of sorts in the Executive Branch, perhaps through the Treasury Department. The other was to create truly common ground where the applicant exchange could elect whether to introduce the product as a security solely under SEC jurisdiction or a futures contract solely under CFTC jurisdiction. Of these two approaches, FIA favors the exchange election. This would remove legal uncertainty about the new product, avoid litigation and promote incentives for responsible innovation and fair competition.

**2. Exchange and Clearinghouse rules: self-certification or prior approval.**

FIA sees no reason why the CFTC and the SEC should not have virtually the same process for review and consideration of the rules of all self-regulatory organizations, including a common approval standard. Those rules often are at least as important as statutes passed by Congress or regulations adopted by agencies. FIA believes that before SRO rules are imposed on market participants some public process, including a 30 day notice and comment period, should be afforded to interested parties.<sup>2</sup> FIA believes this transparent process should allow for expeditious action by the relevant Commission on the proposed SRO rules.

**3. Risk-based ("portfolio") margining with cross-margining of futures and securities products.**

FIA has consistently supported the adoption of procedures to permit, in appropriate circumstances, both non-futures position margin and other property to be held in the customer segregated account and futures margin and other property deposited on behalf of qualified customers to be held outside of a segregated account.<sup>3</sup> A comprehensive regulatory regime authorizing risk-based portfolio margining

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<sup>2</sup> FIA also believes that if a common approval process for rules is adopted then futures and securities SROs should enjoy the same measure of antitrust law immunity in connection with the administration of those rules.

<sup>3</sup> Letter from John M. Damgard, President, Futures Industry Association, to Jean A. Webb, Secretary to the CFTC, dated April 2, 2002; Letter from John M. Damgard, President, Futures Industry Association, to Jonathan G. Katz, Secretary to the SEC, dated March 2, 2005.

across markets, *i.e.*, securities, commodities and OTC derivatives on securities and commodities, should reduce systemic risk, while allowing for more efficient use of capital. The current portfolio margining procedures, limited only to securities and securities derivatives, are a step in the right direction, but only a step. FIA encourages the Commissions to renew their efforts to agree on a market-neutral regulatory regime that will permit portfolio margining across markets.

In making this recommendation, we are mindful that portfolio margining across markets may raise substantial operational concerns for many firms. However, our member firms are unwilling to address these concerns without a firm commitment from the Commissions to authorize a meaningful portfolio margining regime.

More important, we recognize that portfolio margining will require the Commissions to confront and resolve significant legal and regulatory issues. We emphasize that it is essential that the Commissions be confident of their legal authority to authorize portfolio margining across markets as well as the treatment of assets held in a portfolio margin account in the event of the failure of the broker-dealer/FCM carrying the account. The Commissions should use this opportunity to request Congress to confirm their respective authority in this regard, as well as the application of the relevant provisions of the Bankruptcy Code.<sup>4</sup>

#### **4. Fungibility and competition among execution platforms.**

FIA has been a vocal and constant supporter of fair competition in futures trading among execution platforms in order to best serve the interests of efficient price discovery and the needs of all market participants. FIA, therefore, applauds the Obama Administration's swaps legislation for embracing competition among swaps execution platforms. We know that futures exchanges in the U.S. and overseas have opted for the vertical silo approach whereby the trade execution platform and clearing system are controlled by the same corporate parent. As we have said in the past, we would welcome a review of these market structure issues and their effect on competition and market efficiency by the CFTC, the Treasury or other authoritative governmental body.

#### **5. Uniform customer account and bankruptcy/insolvency regime.**

Even in the absence of comprehensive portfolio margining, it is essential that the Commissions develop and implement procedures with respect to the liquidation of a joint broker-dealer/FCM. A broker-dealer, of course, is generally liquidated in accordance with the provisions of the Securities Investor Protection Act, while an FCM is liquidated in accordance with the provisions of Chapter 7, Subchapter IV of the Bankruptcy Code and the CFTC's Bankruptcy Rules, 17 CFR Part 190 rules. A trustee appointed by Securities Investor Protection Corporation ("SIPC") will not necessarily have the authority, or knowledge, to liquidate the broker-dealer/FCM's futures-related business activities.

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<sup>4</sup> Pending legislative proposals to require securities clearing agencies and derivatives clearing organizations to provide clearing services for standardized swaps will almost certainly force Congress to enact changes in the Commissions' governing statutes and the Bankruptcy Code in any event.

Moreover, the trustee will need appropriate guidance to resolve potentially competing claims on the defaulting firm's assets.

As early as 1983, in adopting its Bankruptcy Rules, the CFTC noted the potential problems that could arise in the bankruptcy of a joint broker-dealer/FCM and stated that it would instruct its staff to initiate discussions with SIPC with a view towards developing a common proposal or understanding as to the appropriate treatment of the joint broker-dealer/FCM in bankruptcy. More than 25 years later, the agencies have yet to reach such an understanding.

The Commissions have been fortunate to date that the bankruptcy of a joint broker-dealer/FCM has not implicated substantial commodity customer positions. As broker-dealer/FCMs may be called upon to carry a wider range of products, *i.e.*, standardized swaps, it is essential that the Commissions agree on uniform procedures for overseeing the liquidation of a bankrupt firm.

**6. Market structure: separate versus linked markets.**

FIA has addressed one market structure issue under #4 above. We would welcome a comprehensive study of how best to improve competition and provide additional cost- efficiencies for exchange-traded markets. Everything should be on the table. This study should analyze market structures for both futures and listed options markets. As the hearing testimony of many witnesses confirmed, the existing market structures for both types of products reflect at least in part differences in the inherent nature of the products traded as well as the regulatory history of those products. The Commissions' hearings also confirmed that the structures for the futures and listed options markets have positive and negative aspects in terms of promoting competition, efficiency and innovation. A comprehensive, balanced review of these issues today would be in the best interests of all market participants we serve.

**7. Standards for prosecuting market manipulation.**

FIA would strongly oppose any change to the well-settled elements constituting the offense of futures price manipulation. Proof that the defendant acted intentionally to create an artificial price has long been required to establish price manipulation under the CEA. Price manipulation by definition involves misconduct that causes an artificial price. The need to prove specific intent is essential to make sure that legitimate trading that affects price is not confused with, or mischaracterized as, manipulation.

Concerns about the strength of the CFTC's enforcement powers in this area are misplaced. By statute, the CFTC's enforcement arsenal is not limited to having to prove actual price manipulation, including price artificiality. The CFTC may prosecute market participants for attempted price manipulation, as well. For those cases, there is no need to show that a futures price was artificial. An attempt to manipulate is established when it is proven that a party "intended to create an artificial price." The CFTC's considerable recent success in prosecuting attempted manipulation cases is the best evidence possible that being required to prove specific intent to create an artificial price has not hindered the CFTC's enforcement efforts. The *Amaranth* case is the most recent illustration that the CFTC's powers in this area do not need strengthening. The CFTC has more than adequate power which the agency deploys forcefully and often, as the evidence warrants.

**8. Punishing insider trading in derivatives markets.**

Insider trading is punished today for securities-based derivatives, including security futures and security-based swaps. FIA supports retaining those provisions.

FIA does not believe, however, that traditional, classic securities law insider trading concepts should be applied to futures markets. The hearing testimony supports our view. No one testified in favor of punishing futures market hedgers for the trading they engage in regularly based on private, material market information. Other than the price and quantity of a bid or offer, futures market participants are not, and should not be required, to disclose publicly any information about the basis for their market opinions or other private information they may have concerning relevant cash market conditions. As Kenneth Raisler pointed out in his testimony, the CFTC's 1984 study of the use of nonpublic market information in the futures markets remains as relevant today as it was 25 years ago.

In a different area of so-called insider trading, FIA would urge consideration of possible amendments to the CEA. As noted at the hearing on September 2, the CEA today prohibits criminally and civilly CFTC and futures SRO officials and staff from using for their own trading purposes any nonpublic information they receive through their official duties. The CEA also prohibits CFTC or SRO personnel from tipping off anyone about trading opportunities based on nonpublic information received in their official capacities. FIA believes these prohibitions should be extended to all other SROs (like securities exchanges), other U.S. government agencies and departments, members of Congress as well as their staff. We can see no justification for leaving this omission in current law.<sup>5</sup>

As some witnesses testified, in some instances, the application of SEC Rule 10b-5 has been expanded to cover more than classic insider trading, under the doctrine of misappropriation. The Supreme Court and other federal courts have recognized that trading on the basis of nonpublic material market information pertaining to a security may be actionable by the SEC even without establishing a violation of a corporate insider's fiduciary duty that had been a predicate for traditional securities insider trading. For example, where a lawyer misappropriated information about a client's corporate takeover plan (and traded ahead of the public announcement of that plan in the stock or stock options of the takeover target), the Court has found a violation of federal securities law. *United States v. O'Hagan*, 521 U.S. 642 (1997). Similarly, and most recently, one court of appeals has found that computer hackers that steal private corporate financial information and then use that private information in making trading decisions could be found to have violated SEC 10b-5 if the hacking was in fact based on deception and not just pure theft. *SEC v. Dorozhko*, 2009 U.S. App. LEXIS 16057 (2d Cir. July 22, 2009).

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<sup>5</sup> While FIA would support expanding the CEA's criminal provisions to encompass governmental insider trading of all kinds, FIA believes that prosecution of these offenses should remain the province of the Department of Justice. DOJ and the CFTC should maintain a liaison to ensure that if the CFTC's market surveillance and enforcement efforts detect any abnormal pricing or other patterns in any derivative subject to CFTC jurisdiction, DOJ will be positioned to act quickly to investigate and prosecute any regulator or government official engaged in insider trading.

These evolving misappropriation theories may or may not have application to futures trading in various scenarios. Theft or a breach of ethical duties for personal enrichment by professionals of any kind is always wrong, and the CFTC and the SROs have ample authority under current law to prosecute employees of regulated intermediaries who breach an intermediary's duties to its customers by purloining a customer's trading plans or strategy and trading ahead for personal gain.

**9. Customer protection: suitability or disclosure.**

One area where FIA does not believe further harmonization of regulatory standards is appropriate is with respect to the differing views of the Financial Industry Regulatory Authority ("FINRA") and the National Futures Association ("NFA") with respect to the implementation of a suitability requirement. As Daniel Roth, NFA's President, explained in his testimony on September 3, FINRA's Rule 2310 recognizes that different securities have varying degrees of risk potential that serve very different investment objectives. Consequently, it is appropriate that FINRA's Rule 2310 requires a member, in recommending a securities transaction, to have a reasonable basis for believing that the recommendation is suitable for the customer based upon the customer's securities holdings and financial situation and needs.

In contrast, all trading in any futures contract has the same risk. Trading futures on corn is no more or less suitable than trading futures on Treasury bills. Consequently, NFA's Compliance Rule 2-30 requires a member to obtain certain essential information about an individual customer and, based upon that information, provide the customer with such disclosure concerning the risks of futures that the customer can make an informed decision whether trading futures is appropriate for that customer. This position is consistent with the CFTC's historic position on the importance of providing adequate risk disclosure to customers.

**10. Customer protection: fiduciary obligations for intermediaries.**

FIA appreciates that this issue is now under active consideration at the SEC in the context of the legal duties owed by broker-dealers and investment advisers. As our answer to #9 reflects, the differences in the risk profiles of securities and futures should caution against simply applying a securities law standard to futures intermediaries. FIA recommends awaiting the outcome of the SEC's deliberations on that issue before trying to determine whether the SEC's resolution could or should be applied to futures commission merchants.

**11. Mutual recognition of entities regulated by foreign jurisdictions.**

The CFTC has long recognized that the financial markets, especially for derivatives, are international in scope. As instructed by Congress in the CEA, the CFTC has undertaken a comprehensive program "to coordinate with foreign regulatory authorities, . . . in order to encourage (1) the facilitation of cross-border transactions through the removal or lessening of any unnecessary legal or practical obstacles; (2) the development of internationally accepted regulatory standards of best practice; (3) the enhancement of international supervisory cooperation and emergency standards; (4) the strengthening of international cooperation for customer and market protection; and (5) improvements in the quality and timeliness of international information sharing."

The CFTC has implemented that congressional directive successfully through (i) the no-action procedures pursuant to which bona fide foreign boards of trade that are subject to comprehensive regulation in their home jurisdiction are authorized to permit direct access to their markets from the US, and (ii) exemption procedures under CFTC Rule 30.10 pursuant to which persons that are subject to comparable regulation in their home jurisdiction may offer and sell foreign futures and foreign options to US customers without first being registered with the CFTC. Both programs have enhanced global regulation and operated without incident for more than a decade. The CFTC's willingness to recognize the regulatory programs of other countries, rather than seeking to impose its regulatory regime globally, has facilitated progress in achieving each of the regulatory goals noted above. FIA encourages the SEC to amend its procedures to follow more closely the CFTC's procedures.

FIA also encourages the SEC and CFTC to take appropriate steps comply with their mutual obligations under the Commodity Futures Modernization Act of 2000 to "jointly issue such rules, regulations, or orders, as may be necessary and appropriate to permit the offer and sale of a security futures product traded on or subject to the rules of a foreign board of trade to United States persons." As an initial step we ask that the SEC amend its May 30, 2009 order regarding foreign security futures to be consistent with the provisions of section 2(a)(1)(F)(ii) of the CEA, which provides: "Nothing in this chapter is intended to prohibit any eligible contract participant located in the United States from purchasing or carrying securities futures products traded on or subject to the rules of a foreign board of trade, exchange, or market to the same extent such person may be authorized to purchase or carry other securities traded on a foreign board of trade, exchange, or market so long as any underlying security for such security futures products is traded principally on, by, or through any exchange or market located outside the United States."

Although not a matter requiring harmonization between the SEC and CFTC, we take this opportunity to urge the CFTC to withdraw its policy requiring foreign boards of trade to obtain a no-action position from the CFTC's General Counsel before it may offer a broad based stock index contract to US persons. Historically, the Commission has required a foreign exchange wishing to offer broad-based security index contracts to US persons to demonstrate that the contract meets the criteria applicable to US exchanges set out in former CEA section 2(a)(1)(B).

The CFMA amended the CEA to permit US exchanges to list broad based index products by self-certification. However, the CFTC continues to require foreign exchanges to apply for authorization from the Office of General Counsel before US customers can trade their broad based index products. We see no reason for this disparate treatment.

## **12. Principles-based versus rules-based regulatory oversight.**

FIA has long championed principles-based regulation. The regulatory model comprised of a statutory principle coupled with agency guidance on acceptable practices provides the needed measures of flexibility and certainty to foster the kind of collaborative relationship that leads to stronger market regulation. In the past, FIA has expressed frustration that principles-based regulation has not been extended to intermediaries. FIA would hope the agencies could use the harmonization process to propose a principle-based regime for broker-dealers and futures commission merchants alike.

## **Other Areas of Consideration**

Witnesses at the hearings urged the Commissions to consolidate the many definitions of an “institutional customer.” FIA supports this recommendation. The different definitions employed by both Commissions are frequently confusing to institutions, difficult explain and onerous to implement.

Finally, FIA member firms have one other area of concern that we would hope the Commissions would add to the harmonization agenda. Although registered SROs derive their power from their respective authorizing statutes, they sometimes assert the authority to exceed those jurisdictional limitations.

Two recent examples involving FINRA illustrate this point. First, in Regulatory Notice 09-25, requesting comment on proposed consolidated rules governing suitability and know-your-customer, FINRA suggested that its rules could govern a member’s activities, even when such activities did not involve securities:

In light of the more expansive application of some FINRA rules, such as those addressing just and equitable principles of trade and communications with the public, and given the seamless nature of a broker-dealer’s business in providing financial services, FINRA also seeks comment on whether it should propose expanding suitability obligations to all recommendations of investment products, services and strategies made in connection with a firm’s business, regardless of whether the recommendations involve securities.

FIA filed a comment letter with FINRA strongly opposing such a broad expansion of FINRA’s authority. As we explained, adoption of this proposal and its application to the futures-related activities of its member firms would be contrary to the provisions of the CEA, which vests the CFTC with exclusive jurisdiction over commodity futures trading, and would conflict with the sales practice rules adopted by NFA and approved by the CFTC.<sup>6</sup>

Second, in an interpretation of its arbitration rules, FINRA has declined to refer to NFA arbitration claims against a joint broker-dealer/FCM where the alleged misconduct solely involves futures transactions. This has been true even when otherwise necessary parties that are not subject to FINRA jurisdiction, *i.e.*, a commodity trading advisor or introducing broker, decline to participate in the arbitration, thereby denying the broker-dealer/FCM an opportunity to properly defend itself.

Both examples reflect the harmonization implications and pitfalls in allowing SROs to exceed statutory boundaries. Both examples also demonstrate the need for better inter-SRO coordination and deference under current law. FIA believes it is important that neither FINRA nor NFA adopts, and that neither the SEC nor the CFTC approves, rules or interpretations governing the conduct of their member firms that fall within the jurisdiction of the other SRO and its authorizing regulatory body.

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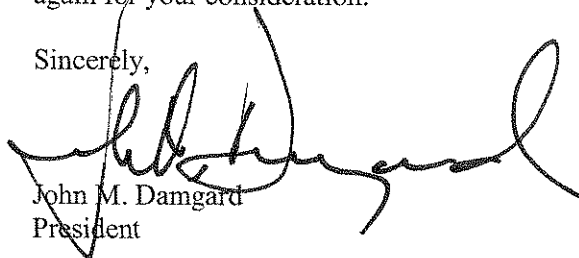
<sup>6</sup> Letter from John M. Damgard, President, Futures Industry Association, to Marcia E. Asquith, Secretary, Financial Industry Regulatory Authority, dated June 29, 2009.

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**Conclusion**

As we testified on September 2, 2009, FIA is aware of the magnitude of the challenge President Obama has presented to both Commissions. FIA believes that both Commissions have the leadership and talent to meet that challenge. We would be pleased to assist you in any way we can. Thank you again for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "John M. Damgard". The signature is written in a cursive style with a large, prominent initial "J".

John M. Damgard  
President