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

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

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

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

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

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

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

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

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

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

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

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

Jean A. Webb,

Secretary of the Commission.

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

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 39

RIN 3038–AB57

A New Regulatory Framework for Clearing Organizations

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed Rulemaking.

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

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

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

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

SUPPLEMENTARY INFORMATION:

I. Background

The Commission is proposing a new Part 39 regulatory framework that would apply to clearing organizations (*i.e.*, entities that perform a credit enhancement function by becoming a universal counterparty to market participants or by operating a facility for the netting of obligations and payments). This proposal, centered on broad, flexible, core principles, is part of an initiative described in separate companion releases published in this edition of the **Federal Register** proposing a new regulatory framework applicable to multilateral transaction execution facilities and to market intermediaries.

Clearing organizations perform valuable functions in exchange-traded futures and option markets. They serve to mitigate counterparty credit risk, facilitate the netting and offsetting of contractual obligations, and decrease systemic risk. The development of similar clearing facilities for the clearing of over-the-counter derivatives should be encouraged.[1] However, the performance of these functions may raise concerns regarding concentration of financial and credit risk in a single entity. Accordingly, clearing organizations should be subject to regulatory oversight to ensure that such facilities are capitalized sufficiently and that they establish and implement a risk management program that is designed to control the credit concentration risk associated with centralized clearing. The Commission notes that it currently oversees the clearing organizations that are associated or affiliated with U.S. futures and option exchanges.[2]

The Commission is proposing to require, pursuant to proposed part 39 of its regulations, that certain transactions be cleared only by recognized clearing organizations (RCOs). An entity may become recognized by the Commission by effectively demonstrating that it satisfies core principles covering, among other areas, financial resources, risk management, treatment of client funds and settlement procedures. U.S. clearing organizations that currently perform clearing services for transactions executed on domestic futures and option exchanges generally satisfy the core principles and, thus, would not be required to make any additional showing or change their method of operation. Consistent with recommendations made in the President's Working Group report,[3] the Commission recognizes that the form and degree of regulatory oversight imposed upon a clearing organization should be consistent with the types of instruments and markets for which it clears and the class of market participants for whom it clears. Part 39 would specify entities other than and in addition to RCOs that could serve as clearing organizations for transactions executed pursuant to part 35 of the Commission's regulations or effected on an exempt multilateral transaction execution facility under part 36 of the Commission's regulations. These entities may be: (1) A securities clearing agency regulated by the Securities and Exchange Commission (SEC); (2) a clearing system organized as, among other things, a bank, and subject to the jurisdiction of the Board of Governors of the Federal Reserve System; or (3) a foreign clearing organization that demonstrates to the Commission that it: (a) Is subject to home country regulation and oversight comparable to the standards set forth by the Commission for recognition of clearing organizations under part 39; and (b) is a party to and abides by appropriate and adequate information-sharing agreements.

II. The Proposed Rules

Proposed part 39 rules would require that every transaction effected on a designated contract market, recognized futures exchange or derivatives transaction facility, if cleared, be cleared by an RCO. RCOs also would be authorized to clear transactions that are exempt under part 35 or part 36. RCOs would not be required by part 39 to be affiliated with any of the foregoing entities. Moreover, nothing in the Commission's rules prohibits an RCO from clearing any other type of cash market or derivative instrument.[4] In addition to RCOs, the following entities also are authorized to clear transactions exempt under part 35 or part 36 of the Commission's rules: (1) Securities clearing agencies subject to the supervisory jurisdiction of the SEC; (2) clearing systems organized as a bank, bank subsidiary, bank affiliate, or Edge Act corporation;[5] or (3) foreign clearing organizations that demonstrate to the Commission that they are: (i) Subject to home country regulation and oversight comparable to the standards set forth by the Commission for recognition of clearing organizations under part 39; and (ii) parties to appropriate and adequate information-sharing agreements. The Commission would defer to oversight by the clearing organization's primary regulator in connection with the clearance of such exempt transactions.

To be recognized as an RCO, an entity must have already been clearing nondormant contracts on a U.S.-designated contract market as of January 1, 2000, or must apply to the Commission for recognition as an RCO under part 39. An application would address how the core principles would be satisfied by the applicant's proposed rules, procedures, and framework for operation by addressing the matters set forth in the guidance provided to applicants in the appendix to part 39.

A clearing organization seeking recognition would be deemed recognized sixty days after the Commission received the application, unless it appeared that the applicant and/or its rules or procedures might violate a specific provision of the Commodity Exchange Act (Act), or the Commission's regulations or the form and content requirements of part 39. In that event, the Commission could notify the applicant that the Commission would review the proposal under the procedures of section 6 of the Act.[6] An

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[1] *See* the Report of the President's Working Group on Financial Markets, Over the Counter Derivatives Markets and the Commodity Exchange Act (Nov. 1999).

[2] The Commission is aware of the standards set forth in the Bank of International Settlements' 1993 Lamfalussy Report on multilateral netting systems, the recommendations with respect to clearing and settlement of securities transactions of the Group of Thirty, a private sector group representing leading banking and securities firms from around the world, and the recommendations of the President's Working Group in response to the market break of October, 1987. Currently existing clearing organizations for U.S. futures and options exchanges meet or exceed these standards and recommendations as a result of the Commission's review of these entities' rules and procedures and the Commission's ongoing oversight program. These standards and recommendations, along with others, were taken into account in formulation proposed part 39.

[3] *See* footnote 1, above.

[4] Indeed, the benefits of clearing noted above could be enhanced were RCOs to clear both cash market and derivative instruments. In this regard, the Commission seeks comment on what obstacles, if any, exist to combining such clearing functions in an RCO, whether such obstacles are specific to particular commodities and what steps can be taken to address them.

[5] 12 U.S.C. 611 *et seq.* An Edge Act corporation is an organization chartered by the Federal Reserve to engage in international banking operations. The Federal Reserve Board acts upon applications by U.S. and foreign banking organizations to establish Edge Act corporations. It also examines Edge Act corporations and their subsidiaries. The Edge Act corporation gets its name from Senator Walter Edge of New Jersey, the sponsor of the original legislation to permit formation of such organization.

[6] Section 6 of the Act is applicable to clearing organizations as well as contract markets. Commission Regulation 1.41(a)(3) defines the term ''contract market'' to include a clearing organization that clears trades for a contract market. The authority of the Commission to define and treat a clearing organization as a contract market for purposes of the Act and the Commission's regulations was upheld in Board of Trade Clearing Corporation v. U.S., (DCDC Jan 11, 1978), '77–'80 CCH Dec. ¶ 20,534.

entity seeking recognition as an RCO may request that the Commission approve its initial set of rules under section 5a(a)(12)(A) of the Act and Commission regulations thereunder.

Part 39 rules would provide that, after an entity was recognized as an RCO, it would submit new rules and rule amendments to the Commission pursuant to proposed amended Commission regulation 1.41. An RCO also could request the Commission to approve new rules or rule amendments under section 5a(a)(12)(A) of the Act and Commission regulation 1.41. An RCO also could request the Commission to issue an order considering whether the RCO, in adopting and implementing a rule, endeavored to take the least anticompetitive means of achieving the objective, purposes, and policies of the Act.

The fraud and manipulation provisions of the Act would apply with respect to transactions cleared by an RCO.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA''), 5 U.S.C. 601–611, requires that agencies, in proposing regulations, consider the impact of those regulations on small entities. Information of the type that would be required under the proposed rule does not involve any small organizations.

B. Paperwork Reduction Act

Part 39 contains information collection requirements. As required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), the Commission has submitted a copy of this part to the Office of Management and Budget (''OMB'') for its review.

Collection of Information

Submissions of Applicants for Recognition as Recognized Clearing Organizations, OMB Control Number 3038–XXXX.

The burden associated with the proposed new part is estimated to be 2,000 hours which will result from new submission requirements for first-time applicants for recognition as Recognized Clearing Organizations.

The estimated burden of the proposed new part was calculated as follows:

Estimated number of respondents: 10.

Reports Annually by each respondent: 1.

Total Annual Responses: 10.

Estimated Average Number of Hours Per Response: 200.

Estimated Total Number of Hours of Annual Burden in Fiscal Year: 2,000.

Organizations and individuals desiring to submit comments on the information collection requirements should direct them to the Office of Information and Regulatory Affairs, OMB, Room 10235 New Executive Office Building, Washington, DC 20503, Attention: Desk Officer for the Commodity Futures Trading Commission.

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

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

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

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

List of Subjects in 17 CFR Part 39

Clearing, Clearing organizations, Commodity futures, Consumer protection.

In consideration of the foregoing, and pursuant to the authority contained in Sections 2, 6(c), 7a, and 12a(5) of the U.S.C., the Commission proposes to amend Chapter I of Title 17 of the Code of Federal Regulations by adding Part 39 to read as follows:

PART 39—RECOGNIZED CLEARING ORGANIZATIONS

Sec.

Authority: 7 U.S.C. 2, 6(c), 7a, 12a(5).

§ 39.1 Definitions and Scope.

(a) Definitions. For purposes of this part:

(1) *Clearing organization* means a person, entity or association thereof, which performs a credit enhancement function in connection with transactions executed on a designated contract market or pursuant to parts 35–38 of this chapter by becoming a universal counterparty to market participants or by operating a facility for the netting of obligations and payments of such transactions; but does not include those netting arrangements specified in § 35.2(d)(1) and (d)(2), nor does it include an entity that is a single counterparty offering to enter into, or entering into, bilateral transactions with multiple counterparties.

(b) Scope. (1) This section applies to all cleared transactions effected on or through a designated contract market, a recognized futures exchange under part 38 of this chapter, a derivatives transaction facility under part 37 of this chapter, an exempt multilateral transaction execution facility under part 36 of this chapter, and to exempt bilateral transactions under part 35 of this chapter.

(2) A clearing organization that has been recognized by the Commission under § 39.3 of this part shall be deemed to be a contract market for purposes of the Act, and Commission rules thereunder; provided, however, a recognized clearing organization shall be exempt from all provisions of the Act and Commission regulations thereunder except as reserved in § 39.5 of this part.

§ 39.2 Permitted clearing.

(a) Any transaction effected on a designated contract market, recognized futures exchange, or derivatives transaction facility, if cleared, shall be cleared by a recognized clearing organization.

(b) A transaction effected pursuant to Part 35 or Part 36 of this chapter, if cleared, shall be cleared by any of the following authorized clearing organizations:

(1) A recognized clearing organization under this part;

(2) A securities clearing agency subject to the supervisory jurisdiction of the Securities and Exchange Commission;

(3) A clearing system organized as a bank, bank subsidiary, affiliate of a bank, or Edge Act corporation established under the Federal Reserve Act authorized to engage in international banking or financial activities, and subject to the jurisdiction of the Federal Reserve or Comptroller of the Currency; or

(4) A foreign clearing organization that demonstrates to the Commission that it:

(i) Is subject to home country regulation and oversight comparable to the standards set forth by the Commission for recognition of clearing organizations under this part; and

(ii) Is a party to and abides by appropriate and adequate information-sharing arrangements.

(c) Transactions not specified in § 39.1(b)(1) of this part may also be cleared by a recognized clearing organization.

§ 39.3 Conditions for Recognition as a Recognized Clearing Organization.

To be recognized by the Commission under this part 39 as a recognized clearing organization, an entity:

(a) Need not be affiliated with a designated contract market or recognized futures exchange under part 38 of this chapter, derivatives transaction facility under part 37 of this chapter or exempt multilateral transaction execution facility under part 36 of this chapter;

(b) Must have rules and procedures relating to its governance and the operation of its clearing function; and

(c) Must initially, and on a continuing basis, meet and adhere to the following fourteen core principles:

(1) Financial resources: Adequate capital resources to fulfill its guarantee function without interruption in various market conditions.

(2) Participant and product eligibility: Appropriate admission and continuing eligibility standards for members or participants of the organization and defined criteria for instruments it will accept for clearing.

(3) Risk management: Ability to manage the risks associated with carrying out its guarantee function through the use of appropriate tools and procedures.

(4) Settlement procedures: Ability to complete settlements on a timely basis under varying circumstances, to maintain an adequate record of the flow of funds associated with each transaction it clears, and to comply with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations.

(5) Treatment of client funds: Adequate standards and procedures designed to protect and ensure the safety of client funds.

(6) Default rules and procedures: Rules and procedures designed to allow for efficient, fair, and safe management of events when members or participants become insolvent or otherwise default on their obligations to the clearing organization.

(7) Rule enforcement: Adequate arrangements and resources for the effective monitoring and enforcement of compliance with its rules and for resolution of disputes.

(8) System safeguards: An adequate program of oversight and risk analysis to ensure that its automated systems function properly and have adequate capacity, security, and emergency and disaster recovery procedures.

(9) Governance: Have fitness standards for owners or operators with greater than ten percent interest or an affiliate of such an owner, and for members of the governing board, and have a means to address conflicts of interest in making decisions.

(10) Reporting: Provision to the Commission of all information necessary for the Commission to conduct its oversight function of the clearing organization's activities.

(11) Recordkeeping: Maintain full books and records of all activities related to business as a recognized clearing organization in a form and manner acceptable to the Commission for a period of five years.

(12) Public information: Public disclosure of information concerning the rules and operating procedures governing its clearing and settlement systems, including default procedures.

(13) Information sharing: Enter into and abide by the terms of all appropriate and applicable domestic and international information-sharing agreements and use relevant information obtained from such agreements in carrying out the clearing organization's risk management program.

(14) Competition: Endeavor to avoid unreasonable restraints of trade or imposing any burden on competition not necessary or appropriate in furtherance of the objectives of the Act or the regulations thereunder.

§ 39.4 Procedures for Recognition.

(a) Recognition by certification. A clearing organization that cleared for at least one nondormant contract within the meaning of § 5.4 of this chapter on January 1, 2000, will be recognized by the Commission as a recognized clearing organization upon receipt by the Commission at its Washington, DC, headquarters of a copy of the clearing organization's rules and a certification by the clearing organization that it meets the conditions for recognition under this part.

(b) Recognition by application. A clearing organization shall be recognized by the Commission as a recognized clearing organization sixty days after receipt by the Commission of an application for recognition unless notified otherwise during that period, if:

(1) The application demonstrates that the applicant satisfies the conditions for recognition under this part;

(2) The submission is labeled as being submitted pursuant to this part;

(3) The submission includes a copy of the applicant's rules and a brief explanation of how the rules satisfy each of the conditions for recognition under § 39.3 of this part;

(4) The applicant does not amend or supplement the application for recognition, except as requested by the Commission or for correction of typographical errors, renumbering or other nonsubstantive revisions, during that period; and

(5) The applicant has not instructed the Commission in writing during the review period to review the application pursuant to procedures under section 6 of the Act.

(6) Attached to this part as Appendix A is guidance to applicants concerning how the core principles set forth above could be satisfied.

(c) Termination of Part 39 Review. During the sixty-day period for review pursuant to paragraph (b) of this section, the Commission shall notify the applicant seeking recognition that the Commission is terminating review under this section and will review the proposal under the procedures of section 6 of the Act, if it appears that the application fails to meet the conditions for recognition under this part. This termination notification will state the nature of the issues raised and the specific condition of recognition that the application appears to violate, is contrary to or fails to meet. Within ten days of receipt of this termination notification, the applicant seeking recognition may request that the Commission render a decision whether to recognize the clearing organization or to institute a proceeding to disapprove the proposed submission under procedures specified in section 6 of the Act by notifying the Commission that the applicant seeking recognition views

its submission as complete and final as submitted.

(d) Delegation of Authority. (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Trading and Markets or the Director's delegatee, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to notify an entity seeking recognition under paragraph (b) of this section that review under those procedures is being terminated.

(2) The Director of the Division of Trading and Markets may submit to the Commission for its consideration any matter which has been delegated in this paragraph.

(3) Nothing in the paragraph prohibits the Commission, at its election, from exercising the authority delegated in paragraph (d)(1) of this section.

(e) Request for Commission Approval of Rules. (1) An applicant for recognition as a recognized clearing organization may request that the Commission approve any or all of its rules and subsequent amendments thereto, at the time of recognition or thereafter, under section 5a(a)(12) of the Act and § 1.41 of this chapter. The recognized clearing organization may label such rules as having been approved by the Commission. In addition, rules of the recognized clearing organization not submitted pursuant to § 39.4(b)(3) shall be submitted to the Commission pursuant to § 1.41 of this chapter.

(2) An applicant seeking recognition as a recognized clearing organization may request that the Commission consider under the provisions of section 15 of the Act any of the entity's rules or policies at the time of recognition or thereafter.

(f) Request for withdrawal of recognition. A recognized clearing organization may withdraw from Commission recognition by filing with the Commission at its Washington, DC, headquarters such a request. Withdrawal from recognition shall not affect any action taken or to be taken by the Commission based upon actions, activities, or events occurring during the time that the clearing organization was recognized by the Commission.

§ 39.5 Enforceability.

In accordance with the proviso in § 39.1(b)(2), sections 1a, 2(a)(1), 4, 4b, 4c, 4d, 4g, 4i, 4o, 5(7), the rule disapproval procedures of sections 5a(a)(12), 5b, 6, 6b, 6c, 8(a), 8(c), 8a(6), 8a(7), 8a(9), 8c(a), 8c(b), 8(c)(c), 8(c)(d), 9(a), 9(f), 20 and 22 of the Act and §§ 1.3, 1.20, 1.24, 1.25, 1.26, 1.27 1.31, 1.38, 1.41, 33.10, parts 15–21, part 39, and part 190 of this chapter continue to apply.

§ 39.6 Fraud and Manipulation in Connection with transactions cleared by a Recognized Clearing Organization.

It shall be unlawful for any person, directly or indirectly, in or in connection with any transaction cleared by a recognized clearing organization:

(a) To cheat or defraud or attempt to cheat or defraud any other person;

(b) Willfully to make or cause to be made to any other person any false report or statement thereof or cause to be entered for any person any false record thereof; or

(c) Willfully to deceive or attempt to deceive any other person by any means whatsoever.

Appendix A to Part 39—Application Guidance

This appendix provides guidance to applicants for recognition as recognized clearing organizations in connection with satisfying each of the core principles of § 39.4. In addressing the core principles, applicants should address the matters set forth below.

Core Principle 1—Financial Resources. Adequate Capital Resources to Fulfill the Guarantee Function Without Interruption in Various Market Conditions

In addressing core principle 1, applicants should describe or otherwise document:

1. The amount of resources dedicated to supporting the clearing function:

a. The amount of resources available to the clearing organization and the sufficiency of those resources such that no break in clearing operations would occur in a variety of market conditions; and

b. The level of member/participant default such resources could support as demonstrated through use of a hypothetical default scenario that explains assumptions and variables factored into the illustration.

2. The nature of resources dedicated to supporting the clearing function:

a. The type of the resources, including their liquidity, and how they could be accessed and applied by the clearing organization without delay; and

b. Any legal or operational impediments or conditions to access.

Core Principle 2—Participant and Product Eligibility. Appropriate Admission and Continuing Eligibility Standards for Members or Participants of the Organization and Defined Criteria for Instruments it Will Accept for Clearing

In addressing core principle 2, applicants should describe or otherwise document:

1. Member/participant admission criteria:

a. How admission standards for its clearing members would contribute to the soundness and integrity of operations; and

b. Matters such as whether these criteria would be in the form of organization rules that apply to all clearing members, whether different levels of membership would relate to different levels of net worth, income, and creditworthiness of members, and whether margin levels, position limits and other controls would vary in accordance with these levels.

2. Member/participant continuing eligibility criteria:

a. A program for monitoring the financial status of its members; and

b. Whether/how the clearing organization would be able to change continuing eligibility criteria in accordance with changes in a member's financial status.

3. Criteria for instruments acceptable for clearing:

a. How the clearing organization would establish specific criteria for the types of derivatives it will clear; and

b. How those criteria take into account the different risks inherent in clearing different derivatives and how they affect maintenance of assets to support the guarantee function in varying risk environments.

4. Clearing function for each instrument:

a. The clearing function for each instrument the organization undertakes to clear; and

b. How different functions would be made known to participants.

Core Principle 3—Risk Management. Ability to Manage the Risks Associated With Carrying Out the Guarantee Function Through the Use of Appropriate Tools and Procedures

In addressing core principle 3, applicants should describe or otherwise document:

1. Use of risk analysis tools and procedures:

a. How the adequacy of the overall level of financial resources would be tested on an ongoing periodic basis in a variety of market conditions; and

b. How the organization would use specific risk management tools including stress testing and value at risk calculations.

2. Use of collateral:

a. How appropriate forms and levels of collateral would be established and collected;

b. How amounts would be adequate to secure prudentially obligations arising from clearing transactions and performing as central counterparty;

c. Why particular margin levels would be appropriate for a contract cleared and the clearing member clearing the contract;

d. The appropriateness of required or allowed forms of margin given the liquidity and related requirements of the clearing organization;

e. How the clearing organization would ensure appropriate valuation of open positions and valuation of collateral assets; and

f. The proposed margin collection schedule and how it would synchronize with changes in the value of market positions and collateral values.

3. Use of credit limits:

If and how systems would be implemented that would prevent members and other market participants from exceeding appropriate credit limits; and

4. Appropriate use of cross margin reduction programs:

How collateral assets subject to cross-margining programs would provide for clear,

fair, and efficient loss-sharing arrangements in the event of a program participant default.

Core Principle 4—Settlement Procedures. Ability To Complete Settlements on a Timely Basis Under Varying Circumstances, To Maintain an Adequate Record of the Flow of Funds Associated With Each Transaction it Clears, and To Comply With the Terms and Conditions of Any Permitted Netting or Offset Arrangements With Other Clearing Organizations

In addressing core principle 4, applicants should describe or otherwise document:

1. Settlement timeframe:

a. Procedures for completing settlements on a timely basis during times of normal operating conditions; and

b. Procedures for completing settlements on a timely basis in varying market circumstances including during a period when a significant participant or member has defaulted.

2. Recordkeeping:

a. The nature and quality of the information collected concerning the flow of funds involved in clearing and settlement; and

b. How the flow of funds associated with each cleared transaction would be recorded, maintained and easily accessed.

3. Appropriate interfaces with other clearing organizations:

How compliance with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations would be met, including, among others, common banking or common clearing programs.

Core Principle 5—Treatment of Client Funds. Standards and Procedures Designed To Protect and Ensure the Safety of Client Funds

In addressing core principle 5, applicants should describe or otherwise document:

1. Safe custody:

a. The safekeeping of client funds, whether in accounts, in depositories, or with custodians, and how it would meet industry standards of safety;

b. Any written terms regarding the legal status of the funds and the specific conditions or prerequisites for movement of the funds; and

c. How the deposit of client funds in accounts in depositories or with custodians would also ensure adequate diversification of concentration of risk.

2. Segregation between customer and proprietary funds:

a. Requirements for segregation and requiring members or participants that clear trades executed on behalf of customers to segregate customer accounts and funds; and

b. Requirements or restrictions regarding commingling customer with proprietary funds, obligating customer funds for any purpose other than to purchase, clear, and settle the products the clearing organization is clearing, and any other aspects of customer fund segregation.

3. Investment standards:

How customer funds would be invested to meet high standards of safety and the proposed recordkeeping regarding all details of such investments.

Core Principle 6—Default Rules and Procedures. Rules and Procedures Designed To Allow for Efficient, Fair, and Safe Management of Events When Members or Participants Become Insolvent or Otherwise Default on Their Obligations to the Clearing Organization

In addressing core principle 6, applicants should describe or otherwise document:

1. Definition of default:

a. The definition of default and how it would be established and enforced; and

b. How it would address failure to meet margin requirements, the insolvent financial condition of a member or participant, failure to comply with certain rules, failure to maintain eligibility standards, actions taken by other regulatory bodies, or other events.

2. Remedial action:

The authority pursuant to which, and how, the clearing organization would take appropriate action in the event of the default of a member which may include, among other things, closing out positions, replacing positions, set-off, and applying margin;

3. Process to address shortfalls:

Procedures for the prompt, fair, and safe application of Clearing Organization and/or member financial resources to eliminate any monetary shortfall resulting from a default.

4. Customer priority rule:

Rules and procedures regarding priority of customer accounts over proprietary accounts of intermediary members or participants and where applicable, in the context of other programs, such as specialized margin reduction programs like cross-margining or trading links with other exchanges.

Core Principle 7—Rule Enforcement. Adequate Arrangements and Resources for the Effective Monitoring and Enforcement of Compliance With its Rules and for Resolution of Disputes

In addressing core principle 7, applicants should describe or otherwise document:

1. Surveillance:

Arrangements and resources for the effective monitoring of compliance with rules including any clearing practice and financial surveillance programs.

2. Enforcement:

a. Arrangements and resources for effective enforcement of rules and authority and ability to discipline and limit or suspend a member's or participant's activities; and

b. Authority and ability to terminate a member's or participant's activities pursuant to clear and fair standards.

3. Dispute resolution:

Arrangements and resources for resolution of disputes between customers and members, and between members.

Core Principle 8—System Safeguards. An Adequate Program of Oversight and Risk Analysis to Ensure That Its Automated Systems Function Properly and have Adequate Capacity, Security, and Emergency and Disaster Recovery Procedures

In addressing core principle 8, applicants should describe or otherwise document:

1. Oversight/risk analysis program:

a. Any program of oversight and risk analysis and whether it addresses appropriate principles for the oversight of automated systems to ensure that its clearing system functions properly and has adequate capacity and security;

b. Emergency procedures and a plan for disaster recovery; and

c. Periodic testing of back-up facilities and ability to ensure daily processing, clearing, and settlement of transactions.

2. Appropriate periodic objective system reviews/testing:

a. Any program for the periodic objective testing and review of the system; and

b. Confirmation that such testing and review would be performed by an independent third-party professional that is a certified member of the Information Systems Audit and Control Association with an appropriate level of experience in the industry.

Core Principle 9—Governance. Have Fitness Standards for Owners or Operators With Greater Than Ten Percent Interest, or an Affiliate of Such an Owner, and for Members of the Governing Board, and Have a Means to Address Conflicts of Interest in Making Decisions

In addressing core principle 9, applicants should describe or otherwise document:

1. Appropriate standards for fitness for clearing organization owners, operators, affiliates of owners or operators, and members of the governing board based on disqualification standards under section 8a(2) of the Act.

2. Collection and verification of information supporting compliance with standards:

a. Verification information could be registration information or certification of fitness or affidavit of fitness by outside counsel based on other verified information.

3. Methods to ascertain presence of conflicts of interest and methods of making decisions in that event.

Core Principle 10—Reporting. Provision to the Commission of all Information Necessary for the Commission to Conduct its Oversight Function of the Recognized Clearing Organization's Activities

In addressing core principle 10, applicants should describe or otherwise document:

1. Information necessary for the Commission to perform its oversight activities of the recognized clearing organization's activities:

a. All information available to or generated by the clearing organization that will be made available to the Commission as appropriate to enable the Commission to perform properly its oversight function, including counterparties and their positions, stress test results, internal governance, legal proceedings, and other clearing activities;

b. The types of information which are not believed to be necessary to provide to the Commission and why; and

c. The information the organization intends to make routinely available to members/participants or the general public.

2. Provision of information:

a. The manner in which all relevant information will be provided to the Commission whether by electronic or other means; and

b. The means by which any information will be made available to members/participants and/or the general public.

Core Principle 11—Recordkeeping. Maintaining Complete Books and Records of all Activities Related to Business as a Recognized Clearing Organization in a Form and Manner Acceptable to the Commission for a Period of Five Years

In addressing core principle 11, applicants should describe or otherwise document:

1. Maintaining records of all activities related to the function of a clearing organization:

a. The different activities related to the function of the clearing organization for which the organization intends to keep books or records; and

b. Any activity related to the function of a clearing organization for which the organization does not intend to keep books or records and why this is not viewed as necessary.

2. Maintenance of full books and records in a form and manner acceptable to the Commission:

3. How the entity would satisfy the requirements of Commission Regulation 1.31 including:

a. What ''complete'' would encompass with respect to each type of book or record that would be maintained;

b. How books or records would be compiled and maintained with respect to each type of activity for which such books or records would be kept;

c. Confirmation that books and records would be open to inspection by any representative of the Commission or of the U.S. Department of Justice;

d. How long books and records would be readily available and how they would be made readily available during the first two years; and

e. How long books and records would ultimately be maintained (and confirmation that, in any event, they would be maintained for at least five years).

Core Principle 12—Public Information. Disclosure of Information Concerning the Rules and Operating Procedures Governing its Clearing and Settlement Systems, Including Default Procedures

In addressing core principle 12, applicants should describe or otherwise document:

1. Disclosure of information regarding rules and operating procedures governing clearing and settlement systems:

a. Which rules and operating procedures governing clearing and settlement systems should be disclosed to the public, to whom they would be disclosed, and how they would be disclosed;

b. What other information would be available regarding the operation, purpose and effect of rules;

c. How member/participants may become familiar with such procedures before participating in operations; and

d. How member/participants will be informed of their specific rights and obligations preceding a default and upon a default, and of the specific rights, options and obligations of the clearing organization preceding and upon the participant's default.

Core Principle 13—Information Sharing. Entering Into and Abiding by the Terms of all Appropriate and Applicable Domestic and International Information-Sharing Agreements and Using Relevant Information Obtained from such Agreements in Carrying out the Recognized Clearing Organization's Risk Management Program

In addressing core principle 13, applicants should describe or otherwise document:

1. Becoming a party to applicable appropriate domestic and international information-sharing agreements and arrangements:

a. The utility of entering into various types of information-sharing arrangements;

b. The different types of domestic and international information-sharing arrangements, both formal and informal, which the clearing organization views as appropriate and applicable to its operations; and

c. The specific information-sharing agreements or other arrangements to which the clearing organization would become a party and how it would abide by the terms of these agreements.

2. Using information obtained from information-sharing arrangements in carrying out risk management and surveillance programs:

a. How information obtained from any information-sharing arrangements would be used to further the objectives of the clearing organization's risk management program and any of its surveillance programs including financial surveillance and continuing eligibility of its members/participants;

b. How accurate information is expected to be obtained and the mechanisms or procedures which would make timely use and application of all information; and

c. The types of information expected to be shared and how that information would be shared.

Core Principle 14—Competition. Endeavoring to Avoid Unreasonable Restraints of Trade or Imposing Any Burden on Competition not Necessary or Appropriate in Furtherance of the Objectives of the Act or the Regulations Thereunder

In addressing core principle 14, applicants should describe or otherwise document:

1. Avoiding unreasonable restraints of trade:

a. Terms and conditions of access and provision of services;

b. Any contracts or agreements to which the organization is a party which contain any noncompete clauses or limitations on future activity which may compete with the interests of either party to the contract.

2. Avoiding burdening competition:

a. Any practice of the clearing organization that may appear to affect the competitiveness of any other entity or the practice of any entity that may appear to affect the competitive ability of the clearing organization; and

b. The extent to which the entity has endeavored to adopt a rule or practice that is the least anticompetitive means of achieving the objective, purposes and policies of the Act.

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

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 00–14916 Filed 6–21–00; 8:45 am]

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 35

RIN 3038–AB58

Exemption for Bilateral Transactions

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed Rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is proposing to clarify the operation of the current swaps exemption, 17 CFR Part 35. In addition, in a companion notice of proposed rulemaking on clearing, the Commission is proposing rules clarifying that transactions under its Part 35 swaps exemption can be cleared. The Commission, in companion releases published in this edition of the **Federal Register**, also is proposing a new regulatory framework to apply to multilateral transaction execution facilities, to market intermediaries and to clearing organizations. This new framework establishes a number of new market categories, including a category of exempt multilateral transaction execution facility. Nothing in these releases, however, would affect the continued vitality of the Commission's exemption for swaps transactions under Part 35 of its rules, or any of its other existing exemptions, policy statements or interpretations.

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

ADDRESSES: Comments should be sent to the Commodity Futures Trading Commission, Three Lafayette Centre, 1125 21st Street, NW., Washington, DC 20581, attention: Office of the Secretariat. Comments may be sent by facsimile transmission to (202) 418–5521 or, by e-mail to secretary@cftc.gov. Reference should be made to ''Exemption for Bilateral Transactions.''

FOR FURTHER INFORMATION CONTACT: Paul M. Architzel, Chief Counsel, Division of Economic Analysis, Commodity Futures Trading Commission, Three Lafayette Centre, 1125 21st Street, NW, Washington, DC 20581. Telephone: (202) 418–5260. E-mail: [PArchitzel@cftc.gov].

SUPPLEMENTARY INFORMATION: