

hundred and eighty day review procedures set forth in section 5a(a)(12)(A) of the Act.

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Secretary of the Commission.

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## 17 CFR Parts 1 and 5

### Revised Procedures for Commission Review and Approval of Applications for Contract Market Designation and of Exchange Rules Relating to Contract Terms and Conditions

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Final rulemaking.

**SUMMARY:** On November 22, 1996, the Commodity Futures Trading Commission ("Commission") proposed rules amending its procedures relating to the review and approval of applications for contract market designation and proposed exchange rule amendments relating to contract terms and conditions. Based upon its consideration of the comments received in response to its Notice of Proposed Rulemaking, 61 FR 59386 (November 22, 1996), and upon its independent analysis, the Commission is promulgating new rule 5.1.

Rule 5.1 establishes fast-track procedures for Commission review of exchange applications for contract market designation as an alternative to the current review procedures. Under these alternative procedures, applications for designation of cash-settled and other specified futures and option contracts will be deemed to be approved ten days—and all others, forty-five days—after receipt, unless the exchange is notified otherwise. The final rules have been modified, in response to public comment, by including within the ten-day category proposed option contracts based upon futures contracts that are already designated and by confirming explicitly within the rule that exchanges may modify applications nonsubstantively under the fast-track review procedures.

The Commission also is amending rule 1.41, as proposed, to provide an alternative fast-track review of proposed amendments to contract terms or conditions. These procedures are similar to those for contract market designations and include both ten-day and forty-five-day review periods. These review periods can be extended for one

thirty-day period in appropriate instances. In a companion notice published separately in the Federal Register, the Commission also is adopting fast-track procedures relating to the review of proposed exchange rules which do not relate to contract terms or conditions.

**EFFECTIVE DATE:** April 7, 1997.

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#### SUPPLEMENTARY INFORMATION:

I. Statutory and Regulatory Requirements for Commission Designation of Proposed Contract Markets

The requirement that boards of trade meet specified conditions in order to be designated as contract markets has been a fundamental tool of federal regulation of commodity futures exchanges for the past seventy-five years.<sup>1</sup> Prior to the 1974 amendments to the Commodity Exchange Act, 7 U.S.C. 1 *et seq.* ("Act"), however, the statutory scheme did not require the Commodity Exchange Authority ("CEA"), the Commission's predecessor agency, to approve in advance the trading of all new futures contracts,<sup>2</sup> nor did it require agency approval of exchange rules before they became effective. Rather, exchange rules amending the terms and conditions of futures contracts were subject only to disapproval after becoming effective.

<sup>1</sup> See, Futures Trading Act of 1921, Pub. L. 67-66, 42 Stat. 187 (1921). Designation as a contract market under the 1921 Act was contingent upon a board of trade's meeting specified statutory criteria, including providing for the prevention of manipulative activity. Although the constitutionality of this Act was successfully challenged as an improper use of the Congressional taxing power in *Hill v. Wallace*, 259 U.S. 44 (1922), all subsequent legislation regulating the futures industry followed this pattern.

<sup>2</sup> Prior to 1974, the Act defined "commodity" by specific enumeration. Accordingly, new contracts that were not so enumerated were unregulated. The definition of commodity periodically would be updated to include additional commodities in which trading had commenced on those exchanges which traded other regulated contracts. For example, livestock and livestock products were added to the Act's definition of "commodity" as part of the 1968 amendments to the Act, after such contracts had already begun trading on the Chicago Mercantile Exchange. Pub. L. 90-258 section 1(a), 49 Stat. 1491 (1968).

Other futures exchanges, including the Commodity Exchange, Inc. and the former Coffee and Sugar and Cocoa exchanges, operated wholly outside of the regulatory scheme.

See, Pub. L. 90-258, sec. 23, 82 Stat. 33 (1968).

The 1974 amendments to the Act rejected that approach. Instead, as part of Congress' overall intent to strengthen federal regulatory oversight of the futures industry, the 1974 amendments provided for a meaningful government review of all new futures contracts before trading could begin and of proposed amendments to the terms or conditions of existing contracts. See, H. Rep. No. 93-975, 93d Cong., 2d Sess. at 78, 82 (1974).

Subsequently, Congress reinforced this determination by enhancing the opportunity for public participation in the Commission's review procedures. As part of the 1978 amendments to the Act, Congress added the provision requiring a public comment period for economically significant proposed exchange rules. That amendment to section 5a(a)(12) of the Act was offered from the floor during debate in the House of Representatives. In offering this amendment, Representative AuCoin reasoned that

[m]any of the notifications [of changes to exchange rules] approved by this Commission are technical and rather noncontroversial.

However, there are a number of proposed rule changes that are controversial because of their expected impact on the way a particular commodity is traded or on the broader effects that a change may bring about in the production and distribution of that commodity.

124 Cong. Rec. H7312 (July 26, 1978).

Over the years, the Commission has demonstrated flexibility in implementing its regulatory mandate to review and approve new contracts and amendments to existing contracts. Based upon its administrative experience, the Commission periodically has revised and updated its procedures to provide exchanges with more specific criteria for meeting the contract market designation requirements; to reflect new developments in futures trading—such as the introduction of financial futures, futures on aggregates or indices of securities and cash settlement as a substitute for physical delivery; and, where appropriate, to lessen the burden on applicants by reducing the information required and streamlining the form of application.

In this regard, Guideline No. 1, 17 CFR part 5, appendix A, which provides guidance on the information to be included in designation applications and on the criteria for meeting the statutory designation requirements, was last amended in January 1992. The 1992 amendment substantially reduced and streamlined the guideline's

requirements. Indeed, much of the application for option contracts has been reduced to the form of a checklist. Moreover, under the 1992 amendments, applications for designation of futures contracts need not duplicate any of the analysis or justification of contract terms which have been previously approved, reducing greatly the length of the justification or analysis required in a typical application for designation.

Despite the progress already made in reducing the paperwork requirements associated with designation applications, the Commission, in proposing these fast-track review rules, gave notice of its intention broadly to reexamine the form and content requirements of Guideline No. 1. This would include consideration of the possible applicability of an option-style checklist to applications for designation of proposed futures contracts. 61 FR 5991.<sup>3</sup> Implementation of fast-track review and approval procedures, separately and together with the planned revision of the format and content requirements for designation applications, should result in significantly streamlining the procedures and regulatory requirements associated with the current contract designation process.<sup>4</sup>

## II. The Proposed Rules

The Commission proposed rules streamlining the procedures for the review of applications for contract market designation and of proposed exchange rule amendments relating to the terms and conditions of existing contracts. The thirty-day comment period ended on December 23, 1996, but was extended at the request of several exchanges until January 16, 1997, 61 FR 68175 (December 27, 1996).<sup>5</sup>

<sup>3</sup>Several commenters questioned the Commission's commitment to undertake this review expeditiously, citing the Commission's determination to propose these fast-track review rules separately. Rather than indicating a lack of commitment to its expressed intention, this statement accurately assessed the relative complexity of the undertaking and demonstrated an intention to put improvements to its review and approval procedures in place as soon as possible.

<sup>4</sup>The Commission has also modified many of its internal procedures to expedite further the review and approval of new contracts and proposed amendments to existing contracts. In 1992, the Commission established a policy to notify the public of the availability of proposed contract terms for comment by publication in the Federal Register within one week of receipt of an application. In addition, under these procedures, substantive issues are identified and communicated informally to the exchange very shortly after receipt, permitting a prompt resolution.

<sup>5</sup>By Petition dated December 17, 1996, the New York Mercantile Exchange, joined by the Chicago Board of Trade and the Chicago Mercantile Exchange, requested that the thirty-day comment

period on fast-track designation procedures be extended.

Although the Commission proposed rules whereby the overall time to review and act on exchange submissions could be significantly shortened, the proposed rules did not alter the underlying legal requirement that these rules be subject to Commission review and prior approval before becoming effective. The Commission reasoned that prior Commission approval of proposed contracts remains in the public interest because,

[i]n the absence of properly designed contract terms, damage to hedgers or industry pricing may result before corrections to the contract can be made. The impact of a market manipulation or other disruption in a newly introduced futures contract potentially could be far wider than the futures market itself, adversely affecting the underlying cash market, as well. Correcting this type of problem after trading has already begun may require extraordinary measures such as emergency action. At a minimum, such an occurrence would probably result in diminished credibility for futures trading in that contract, and possibly for futures trading, generally.

61 FR 59386 (footnote deleted).

Specifically, the Commission proposed a new rule 5.1 providing for a ten-day review period, after which—absent any contrary action by the Commission—the contracts would be automatically deemed to be approved. The Commission proposed that this procedure be applicable to all cash-settled futures and option contracts, except those for the domestic agricultural commodities enumerated in section 1a(3) of the Act or subject to the special procedures of the Johnson-Shad jurisdictional accord,<sup>6</sup> and to all futures and option contracts on foreign currency. This is the same time period as provided under the Commission Part 36 exemptive rules. See, Commission rule 36.4, 17 CFR 36.4 (1996).

For all other contracts, the Commission proposed to reduce by half the average time now required for contract market designation. These applications for contract market designation would be deemed to be approved by the Commission forty-five days after receipt. As proposed, both the ten-day and forty-five-day review periods could be extended for one thirty-day period, in appropriate instances. The fast-track review periods would be available only for applications for designation that are complete and not substantively amended after filing,

period on fast-track designation procedures be extended.

<sup>6</sup>See, section 2(a)(1)(B) of the Act. Proposed contracts subject to this provision of the Act are not eligible for fast-track treatment generally, under either the ten-day review provision or the forty-five day review period discussed below.

except as requested by the Commission. The Commission would continue to publish for public comment notice of the availability of the terms of those applications for designation subject to the forty-five-day review period, but proposed to reduce the public comment period for such fast-track applications from thirty days, as currently provided under appendix D to part 5, to fifteen days.

The Commission proposed to amend its procedures for reviewing proposed exchange rule amendments to the terms and conditions of existing contracts consistent with the proposed changes to its review of applications for new designations.<sup>7</sup> Thus, in light of the existing provisions for ten-day review of many categories of such proposed exchange rule amendments, the Commission proposed to add to Commission rule 1.41(b) a fast-track review procedure consistent with the proposed forty-five-day fast-track review for designation applications.

With regard to publication for public comment, the Commission proposed to reduce the comment period to fifteen days for those rules published as a matter of discretion based upon a finding that "publication \* \* \* is in the public interest and will assist the Commission in considering the views of interested persons." Commission rule 140.96(b), 17 CFR 140.96(b). The Commission determined to maintain a thirty-day comment period for those rules that are published because they are determined to be of major economic significance. See, section 5a(a)(12)(A) of the Act.

## III. Comments Received and Final Rules

The Commission received seven comment letters from eight commenters. The commenters included four futures exchanges, a securities exchange, an industry association, and two academics. All but two of the commenters advanced the position that the proposed rulemaking, although well-intentioned, did not go far enough to relieve the exchanges from the perceived competitive burden which they argued the approval process entails. These commenters argued that only through amendment of the Act can the exchanges' competitiveness be restored. Those comments are best

<sup>7</sup>In general, only contract terms and conditions, with the exception of rules setting margin, are required to be submitted for Commission review and approval. See, section 5a(a)(12)(A) of the Act. Changes to contract specifications, which can modify a contract significantly, are given the same type of review they would receive if submitted as part of an application for a new designation.

addressed by Congress. Nevertheless, it may be instructive to respond to those comments here, particularly insofar as they are likely based upon assumptions and premises common to those comments which respond to the proposed rules.

*a. Competitiveness as the Impetus for Fundamental Restructuring of the Process for Contract and Rule Amendment Approval*

The Commission, from its inception, has always been careful to consider the effect of its actions on competition in, and the competitiveness of, the U.S. futures industry. It routinely strives to impose the least restrictive regulatory approach necessary to accomplish the goals and objectives of the Act.<sup>8</sup> After carefully considering the comments, the Commission believes that streamlining the current procedures, while maintaining the current prior approval standards, offers the best balance between protection of the public and cost reduction, as well as best conserving both Commission and exchange staff resources.

In this regard, the Commission carefully and fully analyzed the nature of global competition in the futures industry in a major 1994 study mandated by Congress as part of the 1992 amendments to the Act. That study analyzed the growth of futures trading in non-U.S. markets and the relative decline in the global market share of U.S. exchanges and concluded that U.S. exchanges remain leaders in innovation and generally have reached the global market first with new products.

The Commission is supportive, in general, of initiatives of U.S. exchanges to become more competitive.<sup>9</sup> However, fundamentally restructuring the process for listing new products as advocated by many of the commenters will not address the real factors which explain the growth of foreign markets. Foreign exchanges, by and large, have succeeded by developing products similar to those offered on U.S. exchanges but tailored to their home markets.<sup>10</sup> A second strength enjoyed by foreign competitors arises from time-zone advantages, whereby foreign futures exchanges are open for trading at the same time as important

centers for trading in the underlying cash market.

The Commission found no evidence, however, that disparities in the regulatory frameworks of various jurisdictions, and of the procedures for listing new contracts in particular, were a major factor explaining the success of various exchanges in the global market. Moreover, in general, the trend among foreign authorities has been to strengthen their regulatory regimes, rather than to weaken them. This is a process supported and advanced by the Commission.<sup>11</sup> Thus, the appropriateness of the Commission's proposed rules for fast-track review should be analyzed solely on their own merit, and not measured against a vague notion that restructuring the approval process will address the competitive challenges faced by the exchanges.

*b. The General Role of Self-Regulation in the Rule Approval Process*

In addition to their arguments based on competitiveness, several exchanges also reject the fast-track approach on general philosophical grounds concerning the appropriate scope of government oversight of self-regulatory organizations ("SROs"). The Chicago Board of Trade ("CBT"), for example, argues that the Act's current preapproval framework is premised upon the erroneous presumption that "exchanges are either incapable of acting or cannot be trusted to act as responsible SROs in compliance with (their) obligations under the CEA." The CBT therefore advocates a fundamental legislative restructuring of the Act's review provisions.

The CBT maintains that Commission oversight can, and should, be relaxed because market incentives, such as avoidance of damage to its valuable reputation, will guide exchanges to take appropriate self-regulatory actions. The CBT, in its view, already provides sufficient opportunity for public input into its design of contracts and rule changes as a matter of business self-interest; public participation at a later stage of review under the aegis of government oversight is unnecessary because "business judgment tells \* \* \* (the CBT) (to) be careful and diligent in the exercise of (its) regulatory judgment \* \* \* ." CBT Comment Letter dated

January 16, 1997, at 9 (emphasis in original).

The Commission agrees that market incentives, enlightened business judgment and the desire to protect reputation are strong motivations which can lead to a high degree of self-regulation. Far from having a presumption that exchanges are either incapable of acting responsibly or not to be trusted, the Commission presumes that the exchanges will, in fact, act responsibly. Nevertheless, experience demonstrates that there have been instances when government oversight and action have been required to address particular instances where business judgments by the exchange membership did not appear to offer sufficient guidance to inform fully an SRO's regulatory judgment.<sup>12</sup>

The exchanges also argue that replacing prior approval with post-introduction intervention in troubled markets is a superior approach to these issues. For example, although the CBT agrees that "[n]o one questions that contract design flaws could make a contract susceptible to manipulation," it disagrees with the Commission's assessment that review of contracts before they begin to trade is one of the most effective market surveillance tools. The CBT states that, based on its experience, the exchange's "comprehensive market surveillance program is the most effective way to protect our markets."

The Commission advocates careful preapproval review in order to reduce the need to intervene in markets which are trading. The Commission agrees that futures exchanges generally have adequate programs of market surveillance, as is required by the current provisions of the Act and Commission rules. Where contract terms are appropriately set, however, market forces will respond to factors of supply and demand, without the need for regulatory intervention—by either the SRO or the government. Thus, the hand of regulation may be heaviest where preapproval review is lessened in favor of the more drastic forms of intervention necessary to address problems after

<sup>12</sup> Often, the Commission receives few or no public comments on contract market designations or on exchange rule changes. This is to be expected. It indicates that the exchange has indeed received and considered input from interested outside sources in connection with a proposal. However, there are more than a few designation applications or proposed exchange rule changes every year that elicit a significant number of comments, casting doubt upon the exchange's theory that its business self-interest will reliably inform all of its regulatory judgements. See e.g., Notification to the CBT to Amend Delivery Specifications, 61 FR 68175 (December 12, 1995).

<sup>8</sup> See, section 15 of the Act.

<sup>9</sup> The Commission has encouraged industry-wide innovation and modernization in trading systems. In this regard, for example, the Commission sponsored a round-table on October 16, 1996, to highlight issues relating to electronic order routing and trading systems.

<sup>10</sup> For example, many foreign exchanges trade interest-rate contracts based upon the sovereign debt of the nation in which they are located.

<sup>11</sup> The Commission has been a world-leader in promoting the strengthening of regulatory oversight as futures trading becomes more global in nature. This process has accelerated in light of developments in connection with the Barings, Plc. and Sumitomo Corp. situations. See, Windsor Declaration issued May 17, 1995, and London Communiqué on Supervision of Commodity Futures Markets (November 26, 1996).

trading begins. Accordingly, the Commission remains convinced that the current structure of the Act best serves the public interest.

In addition to opposition to the rulemaking in favor of legislative action, certain exchanges raised objections to specific provisions of the proposed rules. For example, the New York Mercantile Exchange ("NYMEX") opined that the ten-day review provision should be applied more broadly, stating that, "if Commission staff can review (cash-settled) contracts within ten days, the same time frame also should apply to contracts involving physical delivery." As explained in the Notice of Proposed Rulemaking, the Commission afforded ten-day treatment to foreign currency and cash-settled contracts based on its many years of administrative experience reviewing applications for designation from all of the nation's futures exchanges. In the Commission's experience, contracts for foreign currency and (with the exception of those agricultural commodities which are enumerated in section 1a(3) of the Act) contracts providing for cash-settlement for the most part raise fewer issues requiring careful analysis than do contracts for physical delivery. This is especially true where the cash-settlement price is determined by a reputable third-party for commercial purposes other than solely for settlement of the futures contract.<sup>13</sup>

NYMEX also questions why the ten-day review period is available only to options on those foreign currency and cash-settled futures contracts eligible for ten-day review. Although options on physicals may raise issues regarding delivery and deliverable supplies, options on futures contracts generally raise few issues independent of the underlying futures contracts. Accordingly, as NYMEX's question suggests, options on futures typically could be included under the ten-day review period.

However, applications for designation of new futures contracts and options on those futures contracts generally are

<sup>13</sup> Many of the exchange commenters complain, as does the CBT, that cash-settled contracts raise issues which are not inherently more or less complicated than those raised by contracts for physical delivery. The Commission agrees that some cash-settled contracts do raise issues which would require more than ten days to analyze. That is why it proposed to maintain a degree of flexibility in the process by permitting the Commission to extend the ten-day review period for those cash-settled contracts that raise novel or complex issues. In this way, the Commission has sought to balance the need for speedy, yet meaningful contract review.

submitted together.<sup>14</sup> Because such an option is exercised into the futures contract, the underlying futures contract must be approved for trading as well. See, rule 33.41(a)(1)(ii). Accordingly, both the futures contract and its associated option should be assigned the same review period, notwithstanding the fact that an option on a futures contract raises few independent issues. Nevertheless, there have been rare instances where an option has been proposed to trade subsequent to designation of its underlying futures contract. In those instances, a ten-day review period is appropriate. The final rules reflect this modification.

In addition, all of the exchanges question inclusion in the fast-track procedures of any extension of time, even for novel or complex contracts. The Chicago Mercantile Exchange (CME) complains that the Commission could extend the time because a contract is novel or complex without "any necessary nexus between the nature of such issues and the provisions of the Act and regulations."

This proposed provision was not intended by the Commission to be a means of enlarging the time for review routinely or merely because a contract is novel. The Commission has a laudable record of encouraging innovation and of removing regulatory hurdles to novel contract proposals. However, where more time is needed to determine whether an application meets the requirements for designation because there are questions remaining on complex or novel issues, it would be ill-advised not to provide for a short extension.

Of course, the Commission agrees that extensions of the review period should not be frivolous or unwarranted. Accordingly, it proposed to notify exchanges of such extensions, specifying the particular "issues for which additional time for review is required." Such a requirement is intended to assure against unnecessary extensions of time for review. If after actual experience with this rule, however, the exchanges believe that it has been abused, they can petition the Commission to amend it. Such flexibility is a primary benefit of an agency's establishing such procedures by rule, rather than through congressional statutory amendment.

<sup>14</sup> The fees associated with applications for contract market designation recognize the efficiency of reviewing and designating an option and its underlying futures contract together and are set at a lower rate than are fees for a futures contract and a related option contract that are submitted separately.

Several exchanges also commented negatively on including as a proposed ground for terminating fast-track review an application's failure to comply with the applicable form or content requirements. The CME argues that Guideline No. 1 asks for a great deal of information, "much of which may not be relevant to the ultimate question of whether the contract should be disapproved for violating a statutory or regulatory condition of designation." The CBT argues that, "given the level and extent of detail required by Guideline No. 1, coupled with the open-ended obligation Guideline No. 1 imposes \* \* \* the determination of whether an application is 'complete upon submission' is highly subjective and open to misuse." CBT Comment Letter at 11.

The facts, however, do not justify such fears. The informational requirements of Guideline No. 1 are in fact related to whether the terms of a proposed contract violate a provision of the Act or Commission rules. The vast majority of the information required to be provided under Guideline No. 1 relates to consistency of the delivery terms of the proposed contract to the underlying cash market, based upon the statutory requirements that delivery terms be set so that contracts are not readily susceptible to manipulation. Compare, Part 5, Appendix A(a)(2)(i)-(v) and (3) to sections 5 and 5a of the Act. Moreover, the number of times that proposed contracts are formally deemed to be materially incomplete are relatively few.<sup>15</sup>

The CME concedes that it "can sympathize with the CFTC's position that it should not be required to give expedited review to an application that contains material deficiencies." It suggests that where such deficiencies exist, rather than the proposed contract's becoming ineligible for fast-track review, the exchange

should be afforded an opportunity to correct the deficiency and then resume the fast-track

<sup>15</sup> The Commission rarely deems a contract application to be incomplete on the basis that additional information is needed. Rather, the typical practice is for staff to make targeted requests to exchanges for additional information which is necessary to make clear whether particular terms or conditions violate or may violate a provision of the Act or Commission rules. Generally, applications for designation are found to be "materially incomplete" only when actual modifications to the specific terms that have been submitted for review are required to bring the proposed contract into compliance with the Act or Commission regulations.

Similarly, few proposed amendments to contract terms are remitted for failure to comply with the applicable form or content requirements. No such rule amendments have been remitted in the current fiscal year or in fiscal year 1996.

review process. The statement in the CFTC proposal that an amendment or supplement to an exchange's application renders the application ineligible for fast-track review seems overly harsh. At worst, an amendment or supplement to the application should cause the clock for the fast-track process to be reset.

CME Comment Letter, dated January 16, 1997, at 7.

A careful reading of the proposed rules reveals that the Commission, under proposed rule 5.1(a)(ii)(6), did indeed leave open the possibility that in appropriate circumstances the Commission could request that exchanges substantively amend the terms of a proposed contract under the fast-track procedures. The Commission anticipates that such requests would be made to exchanges where a term or condition of a proposed contract appears to violate a provision of the Act or Commission rules, but could be cured readily within the time remaining.<sup>16</sup>

In this regard, the thirty-day extension available for certain novel or complex applications should not be viewed by the exchanges as an additional period within which to cure defects in otherwise straightforward applications. Nor is the Commission modifying the proposed rule to provide that in such instances the time for fast-track review be reset. This would add an unnecessary level of complexity to the fast-track review procedures, particularly in light of the relatively prompt review and approval of submissions under current procedures.<sup>17</sup> Where Commission staff identify serious defects in the contract terms that cannot be cured within the time remaining for fast-track review and which would result in a recommendation that the Commission disapprove a proposal, the Commission will terminate fast-track review. Because disapproving applications for designation or proposed exchange amendments requires significant staff resources, this termination provision is intended to offer exchanges the opportunity to supplement an incomplete record or cure a defect in a proposed application for contract

<sup>16</sup> For example, where a contract for foreign currency called for delivery in a manner contrary to the law of the issuing sovereign, but the delivery provisions could be modified to make delivery legal, the Commission could request that the modification be made, provided that there were sufficient time in the ten-day review period for the exchange to comply.

<sup>17</sup> Of course, where an exchange wishes to cure a defect in a proposed contract after submission, it is free to withdraw the original submission and submit a new, amended application for fast-track review. This, in essence, is a mechanism within the contours of the rules as proposed by which an exchange can "reset" the review period simply, without adding undue complexity to these rules.

designation or amendment of a contract term without engaging in a disapproval proceeding.

Although the Commission would prefer to permit exchanges an opportunity to supplement an incomplete record or to cure a potential defect and then to move forward toward approval of the application, rather than to initiate disapproval proceedings, the final determination in such instances of whether disapproval proceedings should be initiated will rest with the exchange. As the Commission explained in the Notice of Proposed Rulemaking, an exchange may require the Commission to decide either to approve or to initiate disapproval of a contract or proposed exchange rule at the time that fast-track review is terminated. It stated that,

[w]here a proposed contract originally filed for fast-track review appears to violate a statutory or regulatory requirement, the Commission presumes that the exchange would prefer to convert the application to one for review under current procedures \* \* \*. However, when exchanges prefer that the Commission render a decision whether to disapprove the application as filed, the Commission will institute a formal disapproval proceeding upon notification that the exchange views its application as complete and final as submitted.

61 FR 59389 (footnote omitted).

Finally, several of the exchanges complained that not permitting them substantively to revise their applications or rule submissions penalized them for trying to improve the proposed contract or rule.<sup>18</sup> This argument is somewhat at odds with the exchanges' other arguments that, because they expend such great resources in perfecting their proposed contracts, Commission review is unnecessary and wasteful. The CME argues, somewhat more consistently, that substantive revisions are made to proposed contracts during the review period, but only because exchanges "currently have an incentive to rush new contract applications in as soon as possible to 'start the clock.'"

The exchanges have maintained that, as a consequence of business incentives, new contracts are thoroughly analyzed by the exchanges. If so, one would expect new contract applications to be complete when submitted. Moreover, to the extent that the time period for review at the outset is known to be brief, the incentive to submit incomplete

<sup>18</sup> Both NYMEX and the Coffee, Sugar and Cocoa Exchange noted that, although the preamble stated that exchanges would be permitted to make non-substantive amendments to their submissions, such as correcting typographical errors, the proposed rule did not explicitly include such a provision. The final rule has been modified so to provide.

applications for review prematurely should be diminished. In either case, these fast-track procedures will realign the contract approval process along the lines advocated by the exchanges. Complete, well-thought-out proposed contracts, even novel or complex ones, should speed through the review process, validating the quality of the exchanges' proposals and conserving scarce Commission resources.

One commenter, the Futures Industry Association ("FIA"), supported the Commission's proposed fast-track rules as "an essential next step in the evolution of the Commission's rule review procedures." The FIA "estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets." It notes that "although exchanges have the obligation to act in the public interest and may be expected to do so, the determination with respect to whether a particular contract or rule is in the public interest is properly vested in the Commission."

Moreover, the FIA agrees with the Commission's concern that the procedures applicable to contract market designation and approval of rules retain a measure of flexibility, stating:

The vast majority of exchange rule submissions, whether in the form of an initial application for designation as a contract market or a subsequent amendment have been approved without controversy, and such rules will benefit from the expedited review procedures. However, \* \* \* from time to time certain exchange rules relating to the terms and conditions of contracts have raised significant concerns for FIA members as well as other market participants. Moreover, the impact of a particular rule has not always been evident on its face, either to the Commission, industry participants or, in some cases, the submitting exchange. It is essential, therefore, that the Commission retain the flexibility inherent in the proposed rules to assure the opportunity for thoughtful analysis and comment in appropriate circumstances.

FIA Comment Letter, dated January 21, 1997 at 3.<sup>19</sup>

In addition, the FIA notes that membership organizations, and the exchanges themselves, will have difficulty in responding within the time frames provided under these rules.

<sup>19</sup> An additional commenter, the New York Stock Exchange, while not commenting on the fast-track review procedures, noted its interest in preserving the public's ability to comment on particular rule amendments. The NYSE requested that the Commission publish all proposals to amend circuit breakers. It is the Commission's current policy, which it will continue, to publish for public comment all proposed amendments affecting circuit breakers coordinated among markets. See, e.g., 61 FR 68722 (December 30, 1996).

Indeed, several exchanges requested an extension of the comment period in this very proposed rulemaking.<sup>20</sup> Accordingly, the FIA requests that the Commission consider taking steps in addition to publication in the Federal Register to disseminate more quickly information regarding matters pending under these fast-track procedures. It suggests, in particular, that the Commission use its internet web site to do so.

The Commission agrees with the FIA's assessment that all interested parties—the Commission, the exchanges, industry member associations and other interested membership organizations or individuals—will have difficulty meeting the shortened time frames of these fast-track procedures and will endeavor to find ways to ease this burden on interested parties. The Commission intends to implement FIA's suggestion and will post notice on the internet of the filing of all proposed designation applications and amendments to contract terms, including the dates when the review period terminates. The Commission also encourages the use of electronic filing of comments and other submissions in order to reduce the time burdens imposed by these rules.

#### IV. Implementation

These rules constitute a necessary first step in a potentially profound restructuring of the relationship between the Commission and the exchanges with respect to the Commission's oversight and review and approval of contract market applications and proposed rule amendments. Applications for contract market designation that have been submitted in advance of the effective date of these rules may not have been prepared by the exchanges with this new relationship and timetable in mind, with the expectation that adjustments to the pending submissions would be made during the review process.

The Commission, in implementing these rules will offer the exchanges the maximum regulatory relief and flexibility possible. Accordingly, when these rules become effective, the Commission will treat all pending contracts and proposed rule amendments as having been submitted under the fast-track procedures as of the rules' effective date, unless instructed otherwise by the exchange. However,

<sup>20</sup> As noted above, the thirty-day comment period on these proposed rules was extended pursuant to a petition for extension by NYMEX, joined by several of the exchanges.

where approval of pending contract applications or proposed rule amendments would be accelerated by using existing procedures, the Commission will continue to process those designation applications or proposed rule amendments under those existing procedures.

#### V. Related Matters

##### A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), 5 U.S.C 601 *et seq.*, requires that agencies, in promulgating rules, consider the impact of these rules on small entities. The Commission has previously determined that contract markets are not "small entities" for purposes of the RFA, 5 U.S.C. 601 *et seq.* 47 FR 18618 (April 30, 1982). These amendments establish alternative streamlined procedures for Commission review and approval of applications by contract markets for additional designations and of amendments to contract terms and conditions. Accordingly, the Chairperson, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the action taken herein will not have a significant economic impact on a substantial number of small entities.

##### B. Paperwork Reduction Act

The Paperwork Reduction Act ("PRA") of 1980 (Act), 44 U.S.C. 501 *et seq.*, imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. While this rulemaking imposes no burden, the group of rules (3038-0022) of which these are a part has the following burden:

Average burden hours per response—3,546,26.  
Number of respondents—10,971.  
Frequency of response—on occasion.

Copies of the OMB-approved information collection package associated with this rule may be obtained from Gerald P. Smith, Clearance Officer, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581. Telephone: (202) 418-5160.

#### List of Subjects

##### 17 CFR Part 1

Commodity exchanges, Contract market rules, Rule review procedures.

##### 17 CFR Part 5

Contract markets, Designation application.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act and, in particular, sections 4c, 5, 5a, 6 and 8a thereof, 7 U.S.C. 6c, 7, 7a, 8, and 12a, the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

#### PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 2, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 7, 7a, 9, 12, 12a, 12c, 13a-1, 13a-2, 16, 19, 21, 23 and 24.

2. In § 1.41(b), the introductory text, paragraphs (b)(1), (b)(2), (b)(3), (b)(4), (b)(5) and the concluding text are redesignated as (b)(1)(i), (b)(1)(i)(A), (b)(1)(i)(B), (b)(1)(i)(C), (b)(1)(i)(D), (b)(1)(i)(E), and (b)(1)(ii), respectively; the first sentence of newly redesignated paragraph (b)(1)(i) and newly redesignated paragraph (b)(1)(ii) are revised; and paragraphs (b)(2) through (b)(4) are added, to read as follows:

#### § 1.41 Contract market rules; submission of rules to the Commission; exemption of certain rules.

\* \* \* \* \*

(b) *Rules that relate to terms and conditions.* (1)(i) Except as provided herein and in paragraph (f) of this section, all proposed contract market rules that relate to terms and conditions must be submitted to the Commission for approval pursuant to section 5a(a)(12)(A) of the Act prior to their proposed effective dates. \* \* \*

(ii) The Commission may remit to the contract market, with an appropriate explanation where practicable, and not accept for review any rule submission that does not comply with the form and content requirements of paragraphs (b)(1)(i) (A) through (E) of this section.

(2) All proposed contract market rules that relate to terms and conditions submitted for review under paragraph (b)(1) shall be deemed approved by the Commission under section 5a(a)(12)(A) of the Act, forty-five days after receipt by the Commission, unless notified otherwise within that period, if:

(i) The contract market labels the submission as being submitted pursuant to Commission rule 1.41(b)—Fast Track Review;

(ii) The submission complies with the requirements of paragraphs (b)(1)(i) (A) through (E), of this section or for dormant contracts, the requirements of § 5.2 of this chapter;

(iii) The contract market does not amend the proposed rule or supplement

the submission, except as requested by the Commission, during the pendency of the review period; and

(iv) The contract market has not instructed the Commission in writing during the review period to review the proposed rule under the usual procedures under section 5a(a)(12)(A) of the Act and paragraph (b)(1) of this section.

(3) The Commission, within forty-five days after receipt of a submission filed pursuant to paragraph (b)(2) of this section, may notify the contract market making the submission that the review period has been extended for a period of thirty days where the proposed rule raises novel or complex issues which require additional time for review. This notification will briefly specify the nature of the specific issues for which additional time for review is required. Upon such notification, the period for fast-track review of paragraph (b)(2) of this section shall be extended for a period of thirty days.

(4) During the forty-five day period for fast-track review, or the thirty-day extension when the period has been enlarged under paragraph (b)(3) of this section, the Commission shall notify the contract market that the Commission is terminating fast-track review procedures and will review the proposed rule under the usual procedures of section 5a(a)(12)(A) of the Act and paragraph (b)(1) of this section, if it appears that the proposed rule may violate a specific provision of the Act, regulation, or form or content requirement of this section. This termination notification will briefly specify the nature of the issues raised and the specific provision of the Act, regulation, or form or content requirement of this section that the proposed rule appears to violate. Within ten days of receipt of this termination notification, the contract market may request that the Commission render a decision whether to approve the proposed rule or to institute a proceeding to disapprove the proposed rule under the procedures specified in section 5a(a)(12)(A) of the Act by notifying the Commission that the contract market views its submission as complete and final as submitted.

\* \* \* \* \*  
 3. Section 1.41b is amended by revising paragraph (b) to read as follows:

**§ 1.41b. Delegation of authority to the Director of the Division of Trading and Markets and Director of the Division of Economic Analysis.**

\* \* \* \* \*  
 (b) The Commission hereby delegates, until the Commission orders otherwise:  
 (1) To the Director of the Division of

Economic Analysis, with the concurrence of the General Counsel or the General Counsel's delegatee, to be exercised by such Director or by such other employee or employees of the Commission under the supervision of such Director as may be designated from time to time by the Director, the authority to approve, pursuant to section 5a(a)(12)(A) of the Act and § 1.41(b), contract market proposals, submitted pursuant to § 5.2, to list additional trading months or expiration for, or to otherwise recommence trading in, a contract that is dormant within the meaning of § 5.2; and

(2) To the Director of the Division of Economic Analysis, and to the Director of the Division of Trading and Markets, with the concurrence of the General Counsel or the General Counsel's delegatee, to be exercised by such Director or by such other employee or employees of the Commission under the supervision of such Director as may be designated from time to time by the Director, authority to request under § 1.41(b)(2)(iii) that the contract market amend the proposed rule or supplement the submission, to notify a contract market under § 1.41(b)(3) that the time for review of a proposed contract term submitted under that section for fast-track review has been extended, and to notify the contract market under § 1.41(b)(4) that fast-track procedures are being terminated.

**PART 5—DESIGNATION OF AND CONTINUING COMPLIANCE BY CONTRACT MARKETS**

3. The authority citation for Part 5 is revised it to read as follows:

Authority: 7 U.S.C. 6(c), 6c, 7, 7a, 8 and 12a.

4. Part 5 is amended by adding a new § 5.1, and in Appendix D, by revising the second sentence, to read as follows:

**§ 5.1 Fast-track designation review.**

(a) *Cash-settled contracts.* Boards of trade seeking designation as a contract market under sections 4c, 5, 5a, and 6 of the Act, and regulations thereunder, shall be deemed to be designated as a contract market under section 6 of the Act ten days after receipt by the Commission of the application for designation, unless notified otherwise within that period, if:

(1) The board of trade labels the submission as being submitted pursuant to Commission rule 5.1—Fast Track Ten-Day Review;

(2)(i) The application for designation is for a futures contract providing for cash settlement or for delivery of a foreign currency for which there is no

legal impediment to delivery and for which there exists a liquid cash market; or

(ii) For an option contract that is itself cash-settled, is for delivery of a foreign currency which meets the requirements of paragraph (a)(2)(i) of this section or is to be exercised into a futures contract which has already been designated as a contract market;

(3) The application for designation is for a commodity other than those enumerated in section 1a(3) of the Act or subject to the procedures of section 2(a)(1)(B) of the Act;

(4) The board of trade currently is designated as a contract market for at least one contract which is not dormant within the meaning of this part;

(5) The submission complies with the requirements of Appendix A of this part—Guideline No. 1 and § 1.61 of this chapter;

(6) The board of trade does not amend the terms or conditions of the proposed contract or supplement the application for designation, except as requested by the Commission or for correction of typographical errors, renumbering or other such nonsubstantive revisions, during that period; and

(7) The board of trade has not instructed the Commission in writing during the review period to review the application for designation under the usual procedures under section 6 of the Act.

(b) *Contracts for physical delivery.* Boards of trade seeking designation as a contract market under sections 4c, 5, 5a, and 6 of the Act, and regulations thereunder, shall be deemed to be designated as a contract market under section 6 of the Act forty-five days after receipt by the Commission of the application for designation, unless notified otherwise within that period, if:

(1) The board of trade labels the submission as being submitted pursuant to Commission rule 5.1—Fast Track Forty-Five Day Review;

(2) The application for designation is for a commodity other than those subject to the procedures of section 2(a)(1)(B) of the Act;

(3) The board of trade currently is designated as a contract market for at least one contract which is not dormant within the meaning of this part;

(4) The submission complies with the requirements of Appendix A of this part—Guideline No. 1 and § 1.61 of this chapter;

(5) The board of trade does not amend the terms or conditions of the proposed contract or supplement the application for designation, except as requested by the Commission or for correction of typographical errors, renumbering or

other such nonsubstantive revisions, during that period; and

(6) The board of trade has not instructed the Commission in writing during the forty-five day review period to review the application for designation under the usual procedures under section 6 of the Act.

(c) *Notification of extension of time.* The Commission, within ten days after receipt of a submission filed under paragraph (a) of this section, or forty-five days after receipt of a submission filed under paragraph (b) of this section, may notify the board of trade making the submission that the review period has been extended for a period of thirty days where the designation application raises novel or complex issues which require additional time for review. This notification will briefly specify the nature of the specific issues for which additional time for review is required. Upon such notification, the period for fast-track review of paragraphs (a) and (b) of this section shall be extended for a period of thirty days.

(d) *Notification of termination of fast-track procedures.* During the fast-track review period provided under paragraphs (a) or (b) of this section, or of the thirty-day extension when the period has been enlarged under paragraph (c) of this section, the Commission shall notify the board of trade that the Commission is terminating fast-track review procedures and will review the proposed rule under the usual procedures of section 6 of the Act, if it appears that the proposed contract may violate a specific provision of the Act, regulation, or form or content requirement of Appendix A of this part. This termination notification will briefly specify the nature of the issues raised and the specific provision of the Act, regulation, or form or content requirement of Appendix A of this part that the proposed contract appears to violate. Within ten days of receipt of this termination notification, the board of trade may request that the Commission render a decision whether to approve the designation or to institute a proceeding to disapprove the proposed application for designation under the procedures specified in section 6 of the Act by notifying the Commission that the exchange views its application as complete and final as submitted.

(e) *Delegation of authority.* (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Economic Analysis or to the Director's delegatee, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to request under paragraphs

(a)(6) and (b)(5) of this section that the contract market amend the proposed contract or supplement the application, to notify a board of trade under paragraph (c) of this section that the time for review of a proposed contract term submitted for review under paragraphs (a) or (b) of this section has been extended, and to notify the contract market under paragraph (d) of this section that the fast-track procedures of this section are being terminated.

(2) The Director of the Division of Economic Analysis may submit to the Commission for its consideration any matter which has been delegated in paragraph (e)(1) of this section.

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

#### Appendix D—Internal Procedure Regarding Period for Public Comment

\* \* \* Generally, the Commission will provide for a public comment period of thirty days on such applications for designation; *provided*, however, that the public comment period will be fifteen days for those applications submitted for review under the fast-track procedures of § 5.1(b) of this part.

\* \* \* \* \*

Issued in Washington, D.C., this 27th day of February, 1997, by the Commodity Futures Trading Commission.

Jean A. Webb,

*Secretary of the Commission.*

[FR Doc. 97-5567 Filed 3-6-97; 8:45 am]

BILLING CODE 6351-01-P

## 17 CFR Parts 1 and 31

### Financial Reports of Futures Commission Merchants, Introducing Brokers and Leverage Transaction Merchants

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Final Rules.

**SUMMARY:** The Commodity Futures Trading Commission ("CFTC" or "Commission") is amending its Rule 1.10(d)(4), which requires that each Form 1-FR filed with the Commission contain an oath or affirmation attesting that, to the best knowledge and belief of the individual making such oath or affirmation, the information contained therein is true and correct. The amended rule provides that, for the purposes of making this attestation when filing a financial report with the Commission electronically, the use of a personal identification number ("PIN") will be deemed to be the equivalent of

a manual signature.<sup>1</sup> The Commission also is amending Rule 1.10(c) to account for the possibility that registrants may choose to file certain financial reports electronically using a Commission issued PIN rather than filing such reports in paper form with the regional office of the Commission nearest the principal place of business of the registrant. Rule 1.10(c) will permit electronic filing of financial reports that are not required to be certified by an independent public accountant provided that the Commission obtains the means to read and process the electronically transmitted data.<sup>2</sup> The Commission also is adding Rule 1.10(b)(2)(iii) to clarify that certified financial reports may not be filed electronically.

In addition, the Commission is amending Rules 1.10(g) and 31.13(m) to clarify that certain portions of the financial reports will be deemed public and other portions nonpublic, and to eliminate the requirement that firms filing financial reports need to separately bind portions of such reports generally treated as nonpublic in order for such portions of the reports to be accorded nonpublic treatment.

**EFFECTIVE DATE:** April 7, 1997.

**FOR FURTHER INFORMATION CONTACT:** Lawrence B. Patent, Associate Chief Counsel, or Lawrence T. Eckert, Attorney Adviser, Division of Trading and Markets, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington D.C. 20581. Telephone (202) 418-5450.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

On October 25, 1996, the Commission published for comment proposed amendments to Rule 1.10 (the "Proposals"),<sup>3</sup> which sets forth the financial reporting requirements for futures commission merchants ("FCMs") and independent introducing brokers ("IBIs").<sup>4</sup> Rule 1.10 requires

<sup>1</sup> Commission Rule 1.10(h) permits registrants that are also registered as securities broker-dealers with the Securities and Exchange Commission to file a copy of their Financial and Operational Combined Uniform Single Report ("FOCUS") with the Commission in lieu of Form 1-FR. The amendments discussed herein are intended to apply equally to registrants who file Form 1-FR or FOCUS with the Commission.

<sup>2</sup> The Commission currently is involved in discussions with the Chicago Mercantile Exchange ("CME") to obtain the electronic filing software co-developed by CME and the Chicago Board of Trade ("CBT") and used by CME, CBT and their members.

<sup>3</sup> 61 FR 55235.

<sup>4</sup> Approximately two-thirds of introducing brokers enter into a guarantee agreement with an FCM and thus are not required to raise their own regulatory capital or file financial reports.