

or rendered unenforceable as a result of:

(a) A violation by the designated contract market of the provisions of section 5 of the Act or this part 38; or

(b) Any Commission proceeding to alter or supplement a rule, term or condition under section 8a(7) of the Act, to declare an emergency under section 8a(9) of the Act, or any other proceeding the effect of which is to alter, supplement, or require a designated contract market to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

#### APPENDIX A TO PART 38—GUIDANCE ON COMPLIANCE WITH DESIGNATION CRITERIA

This appendix provides guidance on meeting the criteria for designation under Sections 5(b) and 6 of the Act and this part, both initially and on an ongoing basis. The guidance following each designation criterion is illustrative only of the types of matters an applicant may address, as applicable, and is not intended to be used as a mandatory checklist. Addressing the issues and questions set forth in this appendix would help the Commission in its consideration of whether the application has met the criteria for designation. To the extent that compliance with, or satisfaction of, a criterion for designation is not self-explanatory from the face of the contract market's rules (as defined in §40.1 of this chapter), the application should include an explanation or other form of documentation demonstrating that the applicant meets the designation criteria of Section 5(b) of the Act.

Designation Criterion 1 of section 5(b) of the Act: *IN GENERAL—To be designated as a contract market, the board of trade shall demonstrate to the Commission that the board of trade meets the criteria specified in this appendix.*

A board of trade preparing to submit to the Commission an application for designation as a contract market is encouraged to contact Commission staff for guidance and assistance in preparing an application. Applicants may submit a draft application for review and feedback prior to the submission of an actual application without triggering the application review procedures of §38.3.

Designation Criterion 2 of section 5(b) of the Act: *PREVENTION OF MARKET MANIPULATION—The board of trade shall have the capacity to prevent market manipulation through market surveillance, compliance, and enforcement practices and procedures, including methods for conducting real-time monitoring of*

*trading and comprehensive and accurate trade reconstructions.*

A designation application should demonstrate a capacity to prevent market manipulation, including that the contract market has trading and participation rules deterring abuses and a dedicated regulatory department, or an effective delegation of that function.

Designation Criterion 3 of section 5(b) of the Act: *FAIR AND EQUITABLE TRADING—The board of trade shall establish and enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and the capacity to detect, investigate, and discipline any person that violates the rules. The rules may authorize—(A) transfer trades or office trades; (B) an exchange of—(i) futures in connection with a cash commodity transaction; (ii) futures for cash commodities; or (iii) futures for swaps; or (C) a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization.*

(a) Establishing and enforcing trading rules to ensure fair and equitable trading on a contract market, among other things, includes providing to market participants, on a fair, equitable and timely basis, information regarding, prices, bids and offers, as applicable to the market.

(b) Such trading rules should be designed with adequate specificity.

(c) A contract market that authorizes transfer trades or office trades; an exchange of futures for physicals or futures for swaps; or any other non-competitive transactions, including block trades, should have rules particularly authorizing such transactions and establishing appropriate recordkeeping requirements.

Designation Criterion 4 of section 5(b) of the Act: *TRADE EXECUTION FACILITY—The board of trade shall—(A) establish and enforce rules defining, or specifications detailing, the manner of operation of the trade execution facility maintained by the board of trade, including rules or specifications describing the operation of any electronic matching platform; and (B) demonstrate that the trade execution facility operates in accordance with the rules or specifications.*

(a) An application of a board of trade to be designated as a contract market should include the system's trade-matching algorithm and order entry procedures. An application involving a trade-matching algorithm that is based on order priority factors other than price and time should include a brief explanation of the algorithm.

(b) A designated contract market's specifications on initial and periodic objective

testing and review of proper system functioning, adequate capacity and security for any automated systems should be included in its application. A board of trade should submit in the contract market application, information on the objective testing and review carried out on its automated system. The Commission believes that the guidelines issued by the International Organization of Securities Commissions (IOSCO) in 1990 (which have been referred to as the "Principles for Screen-Based Trading Systems"), and adopted by the Commission on November 21, 1990 (55 FR 48670), as supplemented in October, 2000, are appropriate guidelines for an electronic trading facility to apply to electronic trading systems. Any program of objective testing and review of the system should be performed by a qualified independent professional (but not necessarily a third-party contractor).

Designation Criterion 5 of section 5(b) of the Act: *FINANCIAL INTEGRITY OF TRANSACTIONS—The board of trade shall establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into by or through the facilities of the contract market, including the clearance and settlement of the transactions with a derivatives clearing organization.*

(a) A designated contract market should provide for the financial integrity of transactions by setting appropriate minimum financial standards for members and non-intermediated market participants, margining systems, appropriate margin forms and appropriate default rules and procedures. Absent Commission action pursuant to its exemptive authority under section 4(c) of the Act, transactions executed on the contract market (other than stock futures products), if cleared, must be cleared through a derivatives clearing organization registered as such with the Commission. The Commission believes ensuring and enforcing the financial integrity of transactions and intermediaries, and the protection of customer funds should include monitoring compliance with the contract market's minimum financial standards. In order to monitor for minimum financial requirements, a contract market should routinely receive and promptly review financial and related information.

(b) A designated contract market should have rules concerning the protection of customer funds that address appropriate minimum financial standards for intermediaries, the segregation of customer and proprietary funds, the custody of customer funds, the investment standards for customer funds, related recordkeeping procedures and related intermediary default procedures.

Designation Criterion 6 of section 5(b) of the Act: *DISCIPLINARY PROCEDURES—The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or*

*market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.*

The disciplinary procedures established by a designated contract market should give the contract market both the authority and ability to discipline and limit or suspend a member's activities as well as the authority and ability to terminate a member's activities pursuant to clear and fair standards. The authority to discipline or limit or suspend the activities of a member or of a market participant could be established in a contract market's rules, user agreements or other means. An organized exchange or a trading facility could satisfy this criterion for a member with trading privileges but having no, or only nominal, equity, in the facility and for a non-member market participant by expelling or denying future access to such persons upon a finding that such a person has violated the board of trade's rules.

Designation Criterion 7 of section 5(b) of the Act: *PUBLIC ACCESS—The board of trade shall provide the public with access to the rules, regulations, and contract specifications of the board of trade.*

A designated contract market should provide information to the public by placing the information on its Web site.

Designation Criterion 8 of section 5(b) of the Act: *ABILITY TO OBTAIN INFORMATION—The board of trade shall establish and enforce rules that will allow the board of trade to obtain any necessary information to perform any of the functions described in this appendix, including the capacity to carry out such international information-sharing agreements as the Commission may require.*

A designated contract market should have the authority to collect information and documents on both a routine and non-routine basis including the examination of books and records kept by the contract market's members and by non-intermediated market participants. Appropriate information-sharing agreements could be established with other boards of trade or the Commission could act in conjunction with the contract market to carry out such information sharing.

[66 FR 42277, Aug. 10, 2001, as amended at 71 FR 1965, Jan. 12, 2006]

#### APPENDIX B TO PART 38—GUIDANCE ON, AND ACCEPTABLE PRACTICES IN, COMPLIANCE WITH CORE PRINCIPLES

1. This appendix provides guidance on complying with the core principles, both initially and on an ongoing basis, to maintain designation under Section 5(d) of the Act and this part. The guidance is provided in paragraph (a) following each core principle and it can be used to demonstrate to the Commission core principle compliance, under