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]

**BILLING CODE 6351–01–U**

## 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:**

## I. Background

The Commission is proposing to amend its Part 35 exemption to expand and to clarify its operation, including the availability of clearing for these transactions. These proposed amendments would provide greater legal certainty to the OTC markets and reduce systemic risk. The Commission was encouraged in this undertaking by the other Federal financial regulators that comprise the President's Working Group on Financial Markets [1] and by the chairmen of the Commission's Congressional oversight committees.

The proposed amendments to part 35 respond to changes that have occurred in the over-the-counter (OTC) markets since the Commission adopted its Swaps Policy Statement in 1989, and its subsequent part 35 swaps exemption in 1993. In the intervening years, the OTC derivatives markets have experienced dramatic and sustained growth. During this period, OTC financial derivatives have developed into global markets having outstanding contracts with a total notional value of over $80 trillion. OTC derivatives have transformed finance, increasing the range of financial products available for managing risk.

## II. Legal Certainty for Bilateral OTC Transactions

The Commission is proposing to amend its part 35 swaps exemption in a number of ways. First, it is proposing to delete specific reference to ''swaps'' within the exemption itself. Instead, the rule would refer to a ''contract, agreement or transaction'' that meets the requisite exemptive conditions. This is being proposed to clarify that an instrument's denomination as a ''swap'' was not, and is not, an independent condition of the exemption. Moreover, as suggested by the PWG Report, the Commission has also proposed to delete the requirement that exempt transactions not be fungible or standardized and has made clear that insofar that such exempt transactions may be cleared, creditworthiness of the counterparty is not a condition of the exemption. PWG Report at 17–18. In addition, the Commission is proposing, through an exemption from the private right of action provision of section 22 of the Act, that transactions entered into in reliance on the part 35 swaps exemption would not be subject to a claim for rescission solely due to a violation of the exemption's requirements. See Id. at 18.

The Commission has proposed these changes to its part 35 swaps exemption in order to enhance the legal certainty for such instruments. These changes would in no way call into question any transaction undertaken under the part 35 rules as currently drafted. Moreover, in recognition of its continuing vitality and to assist the public in locating it, the Commission is proposing to incorporate by reference its 1989 Swaps Policy Statement as Appendix A to part 35.[2] Moreover, the Commission is not proposing any changes to its energy interpretation (55 FR 39188) and energy exemption (58 FR 21286) and affirms their continued applicability.

A condition of the part 35 exemption is that such transactions not be entered into and traded on or through a ''multilateral transaction execution facility'' (MTEF). The Commission is proposing to define MTEF in amendments to part 36 of its rules included in a companion release published in this edition of the **Federal Register**. The Commission is proposing to define MTEF as ''an electronic or non-electronic market or similar facility through which persons, for their own accounts or for the accounts of others, enter into, agree to enter into or execute binding transactions by accepting bids or offers made by one person that are open to multiple persons conducting business through such market or similar facility.'' This definition highlights the essential nature of an MTEF as a place or facility through, or on, which traders have the ability to execute agreements or contracts. It does not, however, require that every trader have access to every transaction offered through the facility. The definition as proposed does not, and is not intended to, ''preclude participants from engaging in privately negotiated bilateral transactions, even where these participants use computer or other electronic facilities, such as 'broker screens,' to communicate simultaneously with other participants so long as they do not use such systems to enter orders to execute transactions.'' See, 58 FR 5587, 5591 (Jan. 22, 1993). Accordingly, the proposed definition makes clear that it does not include facilities merely used as a means of communicating bids or offers nor does it include markets in which a single party offers to enter into bilateral transactions with multiple counterparties who may not transact with each other.

As proposed, the Commission would not make any determination that the exempted transactions are or are not subject to its jurisdiction. When it adopted Section 4(c) in 1992, the Conferees of the Congress stated:

> The Conferees do not intend that the exercise of exemptive authority by the Commission (under section 4(c)) would require any determination beforehand that the agreement, instrument, or transaction for which an exemption is sought is subject to the Act. Rather, this provision provides flexibility for the Commission to provide legal certainty to novel instruments where the determination as to jurisdiction is not straightforward.[3]

## III. Section 4(c) Findings

These proposed rule amendments are being proposed under section 4(c) of the Act, which grants the Commission broad exemptive authority. Section 4(c) of the Act provides that, in order to promote responsible economic or financial innovation and fair competition, the Commission may by rule, regulation or order exempt any class of agreements, contracts or transactions, either unconditionally or on stated terms or conditions. To grant such an exemption, the Commission must find that the exemption would be consistent with the public interest, that the agreement, contract, or transaction to be exempted would be entered into solely between appropriate persons and that the exemption would not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act.[4]

As explained above, the proposed exemption for bilateral transactions is available only to appropriate persons. Moreover, these amendments to part 35 will promote financial innovation and reduce systemic risk. The Commission further finds that these proposed amendments would have no adverse effect on any of the regulatory or self-regulatory responsibilities imposed by the Act. The Commission specifically

---

[1] Recognizing the importance of the OTC derivatives markets, the Chairmen of the Senate and House Agriculture Committees requested that the President's Working Group on Financial Markets (PWG) conduct a study of OTC derivatives markets. After studying the existing regulatory framework for OTC derivatives, recent innovations, and the potential for future developments, the PWG on November 9, 1999, reported to Congress its recommendations. See Over-the-Counter Derivative Markets and the Commodity exchange Act, Report of the President's Working Group. The PWG report focused on promoting innovation, competition, efficiency, and transparency in OTC derivatives markets and in reducing systemic risk.

Although specific recommendations about the regulatory structure applicable to exchange-traded futures were beyond the scope of its report, the PWG suggested that the Commission review existing regulatory structures (particularly those applicable to markets for financial futures) to determine whether they were appropriately tailored to serve valid regulatory goals.

[2] The Swaps Policy Statement is found at 54 FR 30694 (July 21, 1989).

[3] H.R. Rep. No. 978, 102d Cong., 2d Sess. 82–83 (1992).

[4] See 7 U.S.C. 6(c).

requests the public to comment on these findings.

**IV. 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. Information of the type that would be required under the proposed rule does not involve any small organizations.

*B. Paperwork Reduction Act*

The Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3507(d)), which 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 does not apply to this rule. The Commission believes the proposed amendments to this rule do not contain information collection requirements which require the approval of the Office of Management and Budget. The purpose of these proposed rule amendments is to provide greater legal certainty for the specified OTC transactions.

**List of Subjects in 17 CFR Part 35**

Commodity futures, Commodity Futures Trading Commission.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act and, in particular, sections 2, 4, 4(c), and 8a thereof, 7 U.S.C. 2, 6, 6c, and 12a, the Commission hereby proposes to amend Chapter I, Part 35 of Title 17 of the Code of Federal Regulations as follows:

## PART 35—EXEMPTION OF BILATERAL AGREEMENTS

1. The authority citation for Part 35 continues to read as follows:

**Authority:** 7 U.S.C. §§ 2, 6, 6c, and 12a.

2. The heading of part 35 is proposed to be revised as set forth above.

3. Section 35.1 is proposed to be amended by revising paragraph (b) to read as follows:

**§ 35.1 Scope and definitions.**

* * * * *

(b) *Definition.* As used in this part, ''eligible participant'' means, and shall be limited to, the following persons or classes of persons:

(1) A bank or trust company (acting on its own behalf or on behalf of another eligible participant);

(2) A savings association or credit union;

(3) An insurance company;

(4) An investment company subject to regulation under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, provided that such investment company or foreign person is not formed solely for the specific purpose of constituting an eligible participant;

(5) A commodity pool formed and operated by a person subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, provided that such commodity pool or foreign person is not formed solely for the specific purpose of constituting an eligible participant and has total assets exceeding $5,000,000;

(6) A corporation, partnership, proprietorship, organization, trust, or other entity not formed solely for the specific purpose of constituting an eligible participant:

(i) Which has total assets exceeding $10,000,000, or

(ii) The obligations of which under the agreement are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by any such entity referenced in this paragraph (b)(6)(i) of this section or by an entity referred to in paragraph (b)(1), (2), (3), (4), (5), (6) or (8) of this section; or

(iii) Which has a net worth of $1,000,000 and enters into the agreement in connection with the conduct of its business; or which has a net worth of $1,000,000 and enters into the agreement to manage the risk of an asset or liability owned or incurred in the conduct of its business or reasonably likely to be owned or incurred in the conduct of its business;

(7) An employee benefit plan subject to the Employee Retirement Income Security Act of 1974 or a foreign person performing a similar role or function subject as such to foreign regulation with total assets exceeding $5,000,000, or whose investment decisions are made by a bank, trust company, insurance company, investment adviser subject to regulation under the Investment Advisers Act of 1940 (15 U.S.C. 80a–1 *et seq.*), or a commodity trading advisor subject to regulation under the Act;

(8) Any governmental entity (including the United States, any state, or any foreign government) or political subdivision thereof, or any multinational or supranational entity or any instrumentality, agency, or department of any of the foregoing;

(9) A broker-dealer subject to regulation under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible participant: Provided, however, that if such broker-dealer is a natural person or proprietorship, the broker-dealer must also meet the requirements of either paragraph (b)(6) or (11) of this section;

(10) A futures commission merchant, floor broker, or floor trader subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible participant: Provided, however, that if such futures commission merchant, floor broker, or floor trader is a natural person or proprietorship, the futures commission merchant, floor broker, or floor trader must also meet the requirements of paragraph (b)(6) or (b)(11) of this section; or

(11) Any natural person with total assets exceeding at least $10,000,000.

4. Section 35.2 is proposed to be revised to read as follows:

**§ 35.2 Exemption.**

A contract, agreement or transaction is exempt from all provisions of the Act and any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to such agreement, is exempt for such activity from all provisions of the Act (except in each case the provisions enumerated in § 35.3(a)) provided the following terms and conditions are met:

(a) The contract, agreement or transaction is entered into solely between eligible participants;

(b) The contract, agreement or transaction is not entered into and traded on or through a multilateral transaction execution facility as defined in § 36.1 of this chapter; and

(c) Except for those contracts, agreements or transactions submitted for clearance or settlement to a clearinghouse as provided under paragraph (d)(3) of this section, the creditworthiness of any party having an actual or potential obligation under the contract, agreement or transaction would be a material consideration in entering into or determining the terms of the contract, agreement or transaction, including pricing, cost, or credit enhancement terms.

(d) The provisions of paragraphs (b) and (c) of this section shall not be deemed to preclude:

(1) Arrangements or facilities between parties to such contracts, agreements or transactions that provide for netting of payment obligations resulting from such contracts, agreements or transactions;

(2) Arrangements or facilities among parties to such contracts, agreements or transactions, that provide for netting of payments resulting from such contracts, agreements or transactions;

(3) The submission of such contracts, agreements or transactions for clearance and/or settlement to a clearing organization which is authorized under § 39.2 of this chapter; or

(4) The use of an electronic or non-electronic market or similar facility used solely as a means of communicating bids or offers by market participants or the use of such a market or facility by a single counterparty to offer to enter into or to enter into bilateral transactions with multiple counterparties.

(e) Any person may apply to the Commission for exemption from any of the provisions of the Act (except section 2(a)(1)(B)) for other arrangements or facilities, on such terms and conditions as the Commission deems appropriate, including but not limited thereto, the applicability of other regulatory regimes.

5. Section 35.3 is proposed to be added to read as follows:

**§ 35.3 Enforceability.**

(a) Notwithstanding the exemption in § 35.2, sections 2(a)(1)(B), 4b, and 4o of the Act, § 32.9 of this chapter as adopted under section 4c(b) of the Act, § 32.13 of this chapter, and sections 6(c) and 9(a)(2) of the Act to the extent that they prohibit manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, continue to apply to transactions and persons otherwise subject to those provisions.

(b) A party to a contract, agreement, or transaction that is with an eligible participant (or counterparty reasonably believed by such party to be an eligible counterparty) shall be exempt from any claim, counterclaim or affirmative defense by such counterparty under section 22(a)(1) of the Act or any other provision of the Act:

(1) That such contract, agreement, or transaction is void, voidable or unenforceable; or

(2) to rescind or recover any payment made in respect of such contract, agreement, or transaction, based solely on the failure of such party or such contract, agreement, or transaction to comply with the terms or conditions of the exemption under this part or from the terms or conditions of the Statement of Policy Concerning Swap Transactions in appendix A to this part 35.

(c) A party to a contract, agreement or transaction that qualifies under the Statement of Policy Concerning Swap Transactions in appendix A to this part 35 or the Statutory Interpretation Concerning Hybrid Instruments, as the same may be revised by the Commission from time to time, shall be exempt from any claim under Section 22(a)(1) of the Act or any other provision of the Act:

(1) That such contract, agreement or transaction is void, voidable, or unenforceable; or

(2) to rescind or recover any payment made in respect of such contract, agreement or transaction, based solely on the failure of such party, or such contract, agreement or transaction, to comply with any provision of the Act or Commission rules, excluding, in the case of this paragraph, any claim for manipulation or fraud arising under a provision of the Act or Commission rules applicable by its terms to a contract, agreement or transaction that is not otherwise subject to regulation under the Act.

6. Part 35 is proposed to be amended by adding new Appendix A to read as follows:

**Appendix A to Part 35—Policy Statement Concerning Swap Transactions**

*(a) Background*

(1) Section 2(a)(1)(A) of the Commodity Exchange Act (CEA or Act) grants the Commission exclusive jurisdiction over ''accounts, agreements (including any transaction which is of the character of * * * an 'option' * * *), and transactions involving contracts of sale of a commodity for future delivery traded or executed on a contract market * * * or any other board of trade, exchange, or market. * * *'' 7 U.S.C. 2. The CEA and Commission regulations require that transactions in commodity futures contracts and commodity option contracts, with narrowly defined exceptions, occur on or subject to the rules of contract markets designated by the CFTC.[1] In several recent releases [2] and in response to requests for case-by-case review of various proposed offerings,[3] the Commission has addressed the applicability of the Act and Commission regulations to various forms of commodity-related instruments offered and sold other than on designated contract markets. An overview of off-exchange transactions and issues was commenced by issuance in December 1987 of an Advance Notice of Proposed Rulemaking (Advance Notice). The Advance Notice requested comment concerning, among other things, a proposed no-action position concerning certain commercial transactions, which, as described, would have extended to certain categories of swap transactions.

(2) Based upon careful review of the comments received in response to the Advance Notice, indicating generally a need for greater clarity in this area, representations from market users, and consultations with other federal regulators concerning the issues raised by swap transactions, the Commission is issuing this policy statement to clarify its view of the regulatory status of certain swap transactions. This statement reflects the Commission's view that at this time most swap transactions, although possessing elements of futures or options contracts, are not appropriately regulated as such under the Act and regulations. This policy statement is intended to recognize a non-exclusive safe harbor for transactions satisfying the requirements set forth herein.

---

[1] 7 U.S.C. 6(a), 6c(b), 6c(c). Section 4(a) of the CEA provides, *inter alia,* that it is unlawful to enter into a commodity futures contract that is not made ''on or subject to the rules of a board of trade which has been designated by the Commission as a 'contract market' for such commodity.'' 7 U.S.C. 6(a). This prohibition does not apply to futures contracts made on or subject to the rules of a foreign board of trade, exchange or market. 7 U.S.C. 6(a). The exchange trading requirement reflects Congress's view that such an environment would control speculation and promote hedging. H.R. Rep. No. 44, 67th Cong., 1st Sess. 2 (1921). See also 7 U.S.C. 5 (Congressional findings concerning necessity for regulation of futures and commodity option transactions). Pursuant to Sections 4c(b) and 4c(d), 7 U.S.C. 6c(b) and 6c(d), of the CEA, the Commission has authority to permit transactions in commodity options which do not take place on contract markets. Currently, only two narrow categories of such option transactions exist: trade options (in which the offeree is a ''commercial user'' of the underlying commodity) and dealer options (in which the grantor fulfills the criteria of Section 4c(d)(1) of the CEA). See also 54 FR 1128 (January 11, 1989) (Proposed Rules Concerning Regulation of Hybrid Instruments); Final Rules Concerning Regulation of Hybrid Instruments, published elsewhere in this issue.

[2] 52 FR 47022 (December 11, 1987) (Advance Notice of Proposed Rulemaking); 54 FR 1139 (January 11, 1989) (Statutory Interpretation Concerning Certain Hybrid Instruments); 54 FR 1128 (January 11, 1989) (Proposed Rules Concerning Regulation of Hybrid Instruments). See also 50 FR 42963 (October 23, 1985) (Statutory Interpretation and Request for Comments Concerning Trading in Foreign Currencies for Future Delivery).

[3] The Commission staff's Task Force on Off-Exchange Instruments has addressed a number of proposed offerings of hybrid instruments in a series of published ''no-action'' letters. See, *e.g.,* CFTC Advisory No. 39–88, June 23, 1988 [Interpretative Letter No. 88–10, June 20, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,262] (notes indexed to dollar/Yen exchange rate); CFTC Advisory No. 45–88, July 19, 1988 [Interpretative Letter No. 88–11, July 13, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,284] (notes indexed to dollar/Yen exchange rate); CFTC Advisory No. 48–88, July 26, 1988 [Interpretative Letter No. 88–12, July 22, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,285] (notes indexed to dollar/foreign currency exchange rate); CFTC Advisory No. 58–88, August 30, 1988 [Interpretative Letter No. 88–16, August 26, 1988, 2 Com. Fut. L. Rep. (CCH) ¶ 24,312] (federally-chartered corporation issuing notes indexed to nationally disseminated measure of inflation published by a U.S. government agency); CFTC Advisory No. 63–88, September 21, 1988 [Interpretative Letter No. 88–17, September 6, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,320] (fixed-rate debentures with additional payments indexed to the price of natural gas over an established base price); CFTC Advisory No. 66–88, September 23, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,321 (certificates of deposit with interest payable at maturity indexed in part to the spot price of gold). See also CFTC Advisory No. 18–19, March 17, 1989 (letter dated November 23, 1988, concerning proposed sale of hay for delayed delivery).

*(b) Safe Harbor Standards*

(1) In determining whether a transaction constitutes a futures contract, the Commission and the courts have assessed the transaction ''as a whole with a critical eye toward its underlying purpose.'' [4] Such an assessment entails a review of the ''overall effect'' of the transaction as well as a determination as to ''what the parties intended.'' [5] Although there is no definitive list of the elements of futures contracts, the CFTC and the courts recognize certain elements as common to such contracts.[6] Futures contracts are contracts for the purchase or sale of a commodity for delivery in the future at a price that is established when the contract is initiated, with both parties to the transaction obligated to fulfill the contract at the specified price. In addition, futures contracts are undertaken principally to assume or shift price risk without transferring the underlying commodity. As a result, futures contracts providing for delivery may be satisfied either by delivery or offset.

(2) In addition to these necessary elements, the CFTC and the courts also recognize certain additional elements common to exchange-traded futures contracts, including standardized commodity units, margin requirements related to price movements, clearing organizations which guarantee counterparty performance, open and competitive trading in centralized markets, and public price dissemination.[7] These additional elements facilitate the trading of futures contracts on exchanges and historically have developed in conjunction with the growth of organized contract markets. The presence or absence of these additional elements, however, is not dispositive of whether a transaction is a futures contract.[8]

(3) In general, a swap may be characterized as an agreement between two parties to exchange a series of cash flows measured by different interest rates, exchange rates, or prices with payments calculated by reference to a principal base (notional amount).[9] Commenters have described the swap market as one in which the customary large transaction size effectively limits the market to institutional participants rather than the retail public.[10] Market participants also have noted that swaps typically involve long-term contracts, with maturities ranging up to twelve years.[11] In addition to these characteristics, many comparisons between swaps and futures contracts have stressed the tailored, non-standardized nature of swap terms; the necessity for particularized credit determinations in connection with each swap transaction (or series of transactions between the same counterparties); the lack of public participation in the swap markets; and the predominantly institutional and commercial nature of swap participants. Other commenters have stressed that, despite these distinctions in the manner of trading of swaps and exchange products, the economic reality of swaps nevertheless resembles that of futures contracts.

(4) The Commission recognizes that swaps generally have characteristics, such as individually-tailored terms, predominantly commercial and institutional participants, and expectation of being held to maturity, rather than offset during the term of the agreement, that may warrant distinguishing them from futures contracts. The criteria set forth below identify certain swaps for which regulation under the CEA and Commission regulations is unnecessary. These safe harbor standards are consistent with policies reflected in the CEA's jurisdictional exclusion for forward contracts,[12] the Treasury Amendment,[13] and the trade option exemption,[14] and are otherwise consistent with Section 2(a)(1)(A) of the CEA. Although these jurisdictional and exemptive or exclusionary provisions are not sufficiently broad to provide clear exemptive boundaries for many swaps, they reflect policies relevant to the safe harbor policy set forth herein and may encompass certain swap transactions.[15]

---

[4] *CFTC* v. *Co. Petro Marketing Group, Inc.*, 680 F.2d 573, 581 (9th Cir. 1982).

[5] *CFTC* v. *Trinity Metals Exchange,* No. 85–1482–CV–W–3 (W.D. Mo. January 21, 1986] [citing *CFTC* v. *National Coal Exchange, Inc.* [1980–1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,424 at 26,046 (W.D. Tenn. 1982)].

[6] See generally, 52 FR 47022, 47023 (December 11, 1987) (citing In the Matter of First National Monetary Corp., [1984–1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,698 (CFTC 1985)); Letter to the Honorable Patrick Leahy and the Honorable Richard Lugar, Committee on Agriculture, Nutrition and Forestry, United States Senate, from Wendy L. Gramm, Chairman, Commodity Futures Trading Commission, dated May 16, 1989 (Attachment at 7–8). The Commission has explained that this does not mean that ''all commodity futures contracts must have all of these elements * * *'' In re Stovall, [1977–1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941 (CFTC 1979). To hold otherwise would permit ready evasion of the CEA.

[7] E.g., Advance Notice, 52 FR at 47023; Letter to the Honorable Patrick Leahy and the Honorable Richard Lugar, Committee on Agriculture, Nutrition and Forestry, United States Senate, from Wendy L. Gramm, Chairman, Commodity Futures Trading Commission, dated May 16, 1989 (Attachment at 8); OGC Statutory and Regulatory Interpretation (Regulation of Leverage Transactions and Other Off-Exchange Future Delivery-Type Instruments), 50 FR 11656, 11657, n.2 (March 25, 1985); *CFTC* v. *Co Petro Marketing Group, Inc.*, 680 F.2d 573 (9th Cir. 1982).

[8] In addition, the Commission and the courts have consistently recognized that ''the requirement that a futures contract be executed on a designated contract market is what makes the contract legal, not what makes it a futures contract.'' In the Matter of First National Monetary Corp., [1984–1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,698 at 30,975 (CFTC 1985); In re Stovall, [1977–1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941 at 23,776 (CFTC 1979). See, also, Interpretative Statement, ''The Regulation of Leverage Transactions and Other Off-Exchange Future Delivery Type Investments-Statutory Interpretation,'' 50 FR 11656 (March 25, 1985).

[9] See generally, Bank for International Settlements, Recent Innovations in International Banking at 37–60 (April 1986); S. K. Henderson, ''Swap Credit Risk: A Multi-Perspective Analysis,'' 44 Business Lawyer 365 (1989). Interest rate swaps have been described as having three primary forms: coupon swaps (fixed rate to floating rate swaps); basis swaps (swap of one floating rate for another floating rate); and cross-currency interest rate swaps (swaps of fixed rate payments in one currency to floating rate payments in another currency). Currency swap transactions involve agreements between two parties providing for exchanges of amounts in different currencies which are calculated on the basis of a pre-established interest rate, a specified exchange rate, and a specified notional amount. Commodity swaps generally include swap transactions similar in structure to interest rate swaps, except that payments are calculated by reference to the price of a specified commodity, such as oil.

[10] The average notional amount for swaps has been estimated at $24 million. Letter from the New York Clearing House to CFTC, dated April 6, 1989, commenting on Proposed Rule and Statutory Interpretation Concerning Certain Hybrid and Related Instruments.

[11] E.g., Letter to CFTC from the International Swap Dealers Association, Inc., dated April 8, 1988, concerning Advance Notice; letter to CFTC from Morgan Guaranty Trust Company of New York, dated April 11, 1988, concerning Advance Notice.

[12] Section 2(a)(1)(A) of the CEA provides that the term ''future delivery'' does not include sales of any cash commodity for deferred shipment or delivery. 7 U.S.C. 2. Sales of cash commodities for deferred delivery, or forward contracts, generally have been recognized to be commercial, merchandising transactions in physical commodities entered into by commercial counterparties who have the capacity to make or take delivery of the underlying commodity but in which delivery ''may be deferred for purposes of convenience or necessity.'' 52 FR 47027; In re Stovall, [1977–1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941 at 23,777–78 (CFTC 1979). The forward contract exclusion may apply to certain types of swap transactions.

[13] The Treasury Amendment provides that ''[n]othing in this Act shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.'' 7 U.S.C. 2. See generally, 50 FR 42963 (October 23, 1985) (CFTC Statutory Interpretation). See also, *Commodity Futures Trading Commission* v. *American Board of Trade,* 473 F. Supp. 117 (S.D.N.Y. 1979), aff'd, 803 F.2d 1242 (2d Cir. 1986). The Treasury Amendment may apply to some types of transactions also characterized as swaps.

[14] The trade option exemption, which is set forth in Rule 32.4(a), 17 CFR 32.4(a) (1988), authorizes commodity option transactions, other than those on commodities specified in rule 32.2(a), that are not executed on a designated contract market and that are:

Offered by a person which has a reasonable basis to believe that the option is offered to a producer, processor, or commercial user of, or a merchant handling the commodity which is the subject of the commodity option transaction, or the products or byproducts thereof, and that such producer, processor, commercial user or merchant is offered or enters into the commodity option transaction solely for purposes related to its business as such.

It should be noted that under Rule 32.4(a), only the offeree of the trade option need qualify as a ''commercial user'' or ''merchant.'' Rule 32.4(a) is silent concerning which party to a trade option may be the option buyer of a put or call or ''long,'' and which party may be the option seller of a put or call or ''short.'' As a result, provided that the qualifying commercial offeree is entering the trade option transaction solely for non-speculative purposes demonstrably related to its commercial business in the commodity which is the subject of the option transaction, the requirements of Rule 32.4(a) are met.

[15] The forward contract inclusion facilitates commodity transactions within the commercial

Continued

(5) Consequently, the Commission has determined that a greater degree of clarity may be achieved through safe harbor guidelines establishing specific criteria for swap transactions to which the Commission's regulatory framework will not be applied. Swaps satisfying the requirements set forth below will not be subject to regulation as futures or commodity option transactions under the Act and regulations. This policy statement addresses only swaps settled in cash, with foreign currencies considered to be cash.[16]

(i) Individually-Tailored Terms

(A) Individual tailoring of the terms of swap agreements is frequently cited as indispensable to the operation of the swap market. Commenters have indicated that swap agreements are based upon individualized credit determinations and are tailored to reflect the particular business objectives of the counterparties. Tailoring occurs through private negotiations between the parties and may involve not only financial terms but issues such as representations, covenants, events of default, term to maturity, and any requirement for the posting of collateral or other credit enhancement. Such tailoring and counterparty credit assessment distinguish swap transactions from exchange transactions, where the contract terms are standardized and the counterparty is unknown. In addition, the tailoring of swap terms means that, unlike exchange contracts, which are fungible, swap agreements are not fully standardized.

(B) To qualify for safe harbor treatment, swaps must be negotiated by the parties as to their material terms, based upon individualized credit determinations, and documented by the parties in an agreement or series of agreements that is not fully standardized.[17] This requirement is intended to exclude from safe harbor treatment instruments which are fungible and therefore may be readily transferred and traded.

(ii) Absence of Exchange-Style Offset

(A) Exchange-traded futures contracts generally may be terminated by offset,[18] that is, liquidated through establishment of an equal and opposite position. For exchange-traded futures contracts, the universal counterparty to each cleared position is the clearing organization. Prior consent of the clearing organization, as counterparty, is unnecessary to offset.[19]

(B) In contrast, swap transactions have been described as transactions which create performance obligations terminable only with counterparty consent and which generally are expected to be maintained to maturity. A swap counterparty who seeks to eliminate the economic effect of a swap agreement may enter into a reverse swap agreement, that is, a second swap with the same maturity and payment requirements, with the same or a new counterparty, but in which the party seeking to eliminate its economic exposure assumes the reverse position (in this case the obligations of each party to both transactions continue to maturity). A swap counterparty who seeks to terminate, absent default, its obligations under a swap agreement may: (1) Undertake a swap sale in which, based upon consent of the counterparty, it assigns its rights and obligations under the swap to a third party; or (2) negotiate an early termination of the transaction, or swap ''closeout,'' in which it negotiates a lump-sum payment with its counterparty to terminate the swap.[20] In the latter two cases, termination of the obligations created by a swap is dependent upon consent of the counterparty.

(C) To qualify for safe harbor treatment, the swap must create obligations that are terminable, absent default, only with the consent of the counterparty. If consent to termination is given at the outset of the agreement and a termination formula or price fixed, the consent provision must be privately negotiated. This requirement is intended to confine safe harbor treatment to instruments that are not readily used as trading vehicles, that are entered into with the expectation of performance, and that are terminated as well as entered into based upon private negotiation.

(iii) Absence of Clearing Organization or Margin System

(A) As noted above, the necessity for individualized credit determinations has been described as a hallmark of swap transactions. A number of commenters have stressed both the dependence of the current swap market on such determinations and the absence of a multilateral ''credit support'' mechanism, such as a clearing organization, for swaps. In accordance with the concept of swaps as dependent upon private negotiation and individualized credit determinations as to the capacity of certain parties to perform, this safe harbor is applicable only to swap transactions that are not supported by the credit of a clearing organization and that are not primarily or routinely supported by a market-to-market margin and variation settlement system designed to eliminate individualized credit risk.[21] The ability to impose individualized credit enhancement requirements to secure either changes in the credit risk of a counterparty or increases in the credit exposure between two counterparties consistent with the above criteria would not be affected.

(iv) The Transaction is Undertaken in Conjunction With a Line of Business

(A) The absence of public participation in the swaps market has frequently been cited as a factor supporting different regulatory treatment of swaps and futures contracts. Swap market participants are predominantly institutional and commercial entities such as corporations, commercial and investment banks, thrift institutions, insurance companies, governments, and government-sponsored or chartered entities.[22]

(B) The safe harbor set forth herein is limited to swap transactions undertaken in conjunction with the parties' line of business.[23] This restriction is intended to preclude public participation in qualifying swap transactions and to limit qualifying transactions to those based upon individualized credit determinations. This restriction does not preclude dealer transactions in swaps undertaken in conjunction with a line of business, including financial intermediation services.

(v) Prohibition Against Marketing to the Public

Swap transactions eligible for safe harbor treatment may not be marketed to the public. This restriction reflects the institutional and commercial nature of the existing swap market and the Commission's intention to

---

merchandising chain. The trade option exemption similarly may be viewed as facilitating principal-to-principal transactions in which the offeree is a commercial party with respect to the underlying commodity. The Treasury Amendment reflects Congressional intent to avoid duplicative regulation of foreign currency transactions and other transactions in the interbank market supervised by bank regulatory agencies.

[16] As noted previously, certain categories of swap transactions may be subject to the forward contract exclusion, the Treasury Amendment and the trade option exemption. The safe harbor criteria set forth herein apply equally to options on swaps.

[17] Formation of swaps pursuant to a master agreement between two counterparties that establishes some or all contract terms for one or more individual swap transactions between those counterparties is not precluded by this requirement, provided that material terms of the master agreement and transaction specifications are individually tailored by the parties.

[18] In the context of exchange-traded futures, offset refers to the liquidation of a futures position through the acquisition of an opposite position. Availability of such offset, resulting in the liquidation of the position, typically is established by exchange rules governing exchange members' relationships with the clearing house. See, *e.g.,* Chicago Mercantile Exchange Rule 808 (''a clearing member long or short any commodity to the Clearing House as a result of substitution may liquidate the position by acquiring an opposite position for its principal''); Board of Trade Clearing Corporation Regulation 705.00 (''Where a member buys and sells the same commodity for the same delivery, and such contracts are cleared through the Clearing House, the purchases and sales shall be offset to the extent of their equality, and the member shall be deemed a buyer from the Clearing House to the extent that his purchases exceed his sales, or a seller to the Clearing House to the extent that his sales exceed his purchases''); New York Futures Exchange Rule 3–4 (''As between the Clearing Corporation and the original parties to futures contracts and option contracts, such contracts shall be binding upon the original parties until liquidated by offset, delivery, exercise or expiration, as the case may be''). Of course, the ability to offset in any given case depends upon the availability of a counterparty to enter into an offsetting transaction at an acceptable price.

[19] However, the ability to liquidate contractual positions through offset is established by clearing organization rules to which all clearing members consent.

[20] Swap parties may agree in advance upon a termination formula or price for the swap.

[21] Several commenters urged the Commission to adopt a safe harbor for swaps that would be conditioned upon, among other things, the absence of a credit support mechanism. See Letter to CFTC from Sullivan & Cromwell, dated April 8, 1988, concerning Advance Notice, at 41–42; Letter to CFTC from Manufacturers Hanover, dated April 11, 1988, concerning Advance Notice, at 4. The safe harbor standard is based upon individualized credit determinations at the outset and during the pendency of the contract.

[22] Letter dated April 8, 1988, to CFTC from International Swap Dealers Association, Inc. Concerning Advance Notice.

[23] Swap transactions entered into with respect to exchange rate, interest rate, or other price exposure arising from a participant's line of business or the financing of its business would be consistent with this standard.

restrict qualifying swap transactions to those undertaken as an adjunct of the participant's line of business.

(c) *Conclusion.* This policy statement is intended to clarify the regulatory treatment of certain transactions in order to facilitate legitimate market transactions in a field distinguished by innovation and rapid growth. Consequently, the Commission proposes to continue to review on a case-by-case basis transactions that do not meet the above criteria and that are not otherwise excluded from Commission regulation.

Issued in Washington, D.C., this 8th day of June, 2000, by the Commission.

**Jean A. Webb,**

*Secretary of the Commission.*

[FR Doc. 00–14917 Filed 6–21–00; 8:45 am]

BILLING CODE 6351–01–U

## COMMODITY FUTURES TRADING COMMISSION

## 17 CFR Parts 1, 3, 4, 5, 15, 20, 36, 37, 38, 39, 100, 140, 155, 166, 170, and 180

## A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of public meetings.

**SUMMARY:** Notice is hereby given that the Commodity Futures Trading Commission (''Commission'') will convene two public meetings at which interested members of the public may appear before it to give oral and written statements relating to the Commission's consideration of a new regulatory framework for multilateral transaction execution facilities, intermediaries and clearing organizations.

**DATES:** Tuesday, June 27, 2000, 10:00 a.m.–4:00 p.m. (multilateral transaction execution facilities); Wednesday, June 28, 2000, 10:00 a.m.–4:00 p.m. (intermediaries and clearing organizations).

**PLACE:** 1155 21st St., N.W., Washington, D.C. Lobby Level Hearing Room located at Room 1000. Status: Open.

**ADDRESSES:** Requests to appear and statements of interest should be mailed to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581, attention Office of the Secretariat; transmitted by facsimile at (202) 418–5521; or transmitted electronically to [secretary@cftc.gov]. Reference should be made to ''Regulatory Reinvention Meetings.''

**FOR FURTHER INFORMATION CONTACT:** Paul M. Architzel, Chief Counsel, or Nancy E. Yanofsky, Assistant Chief Counsel, Division of Economic Analysis, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581, (202) 418–5260, or electronically, [PArchitzel@cftc.gov] or [NYanofsky@cftc.gov].

**SUPPLEMENTARY INFORMATION:** In separate **Federal Register** releases published today, the Commission has proposed a new regulatory framework to apply to multilateral transaction execution facilities that trade derivatives, market intermediaries and clearing organizations. As explained in those **Federal Register** releases, the proposed framework contemplates far reaching and fundamental changes to modernize Federal regulation of the commodity futures and options markets.

The Commission is of the view that, in addition to the receipt of written comments, an opportunity for interested members of the public to appear before it will assist it in its consideration of the issues raised in the **Federal Register** releases and is in the public interest. Accordingly, the Commission will convene two public meetings, one on Tuesday, June 27, 2000 from 10:00 a.m. to 4:00 p.m. relating to the proposed framework as it applies to multilateral transaction execution facilities and one on Wednesday, June 28, 2000 from 10:00 a.m. to 4:00 p.m. relating to the proposed framework as it applies to market intermediaries and clearing organizations.

All individuals or organizations wishing to appear before the Commission should submit to the Commission at the above address, by June 23, 2000, a request to appear at either or both of the meetings, a concise statement of interest and qualifications as they relate to the particular meeting(s) and a brief summary or abstract of the content of his or her statement(s). The Commission will invite a representative number of individuals or organizations to appear at each meeting from those submitting such statements. A transcription of the meetings will be made and entered into the Commission's public comment files, which will remain open for the receipt of written comment until August 7, 2000.

Issued in Washington, D.C., this 8th day of June 2000.

By the Commodity Futures Trading Commission.

**Jean A. Webb,**

*Secretary of the Commission.*

**Concurring Statement of Commissioner Thomas J. Erickson**

I concur with the Commission's publication of this Notice of Public Hearing as well as with the simultaneous publication of the related proposed rulemakings entitled (1) Exemption for Bilateral Transactions; (2) A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations; (3) A New Regulatory Framework for Clearing Organizations; and (4) Rules Relating to Intermediaries of Commodity Interest Transactions.

Global derivatives markets are changing at a dramatic pace. Today's **Federal Register** releases represent an equally dramatic effort by Commission staff to modernize our regulatory scheme by accommodating new technologies and providing exchanges with some measure of regulatory relief. Accordingly, I agree with the publication of this and each related release and am hopeful that they will stir considerable thought and comment. With this concurrence—and in addition to the specific requests for comment in the proposed rules—I invite comment on certain aspects of this plan about which I have reservations. Specifically:

- Does the plan promote legal certainty for transactions by providing a regime that is based upon the voluntary submission of certain derivatives markets to Commission regulation?
- Are there enforceability and/or compliance concerns associated with a regulatory regime based on ''broad performance standards'' incorporated as core principles?
- Does the plan take adequate account of the public's interest in the Commission's ability to:
- Deter and detect fraud and manipulation?
- Deter and detect abusive trading practices?
- Ensure the financial integrity of industry participants?

I look forward to receiving comment and testimony that touch upon a full range of issues in addition to those few I have mentioned in this concurrence.

Dated: June 6, 2000.

**Thomas J. Erickson,**

*Commissioner.*

[FR Doc. 00–14918 Filed 6–21–00; 8:45 am]

BILLING CODE 6351–01–U