

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Part 18

RIN 3038-AC22

### Maintenance of Books, Records and Reports by Traders

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed rules.

**SUMMARY:** Commission Regulation 18.05 requires that a person holding or controlling a futures or option position in a commodity above a certain level (reportable position) on a designated contract market or registered derivatives transaction execution facility (reporting markets) must retain books and records and make available to the Commission upon request any pertinent information with respect to other positions, transactions or activities in the commodity in which the trader has a reportable position. The Commission is proposing to amend Regulation 18.05 in two respects: To make it explicit that persons holding or controlling reportable positions on a reporting market must retain books and records and make available to the Commission upon request any pertinent information with respect to all other positions and transactions in the commodity in which the trader has a reportable position, including positions held or controlled or transactions executed over-the-counter and/or pursuant to Sections 2(d), 2(g) or 2(h)(1)–(2) of the Commodity Exchange Act (Act) or Part 35 of the Commission's regulations, on exempt commercial markets operating pursuant to Sections 2(h)(3)–(5) of the Act, on exempt boards of trade operating pursuant to Section 5d of the Act, and on foreign boards of trade (hereinafter referred to collectively as non-reporting transactions); and to make the regulation clearer and more complete with respect to hedging activity. The purpose of the amendments is to enhance the

Commission's ability to deter and prevent price manipulation or any other disruptions to the integrity of the regulated futures markets, to ensure the avoidance of systemic risk, and to clarify the meaning of the regulation.

**DATES:** Comments must be received by July 23, 2007.

**ADDRESSES:** Comments should be sent to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581, attention: Office of the Secretariat. Comments may be sent by facsimile to 202-418-5521, or by e-mail to [secretary@cftc.gov](mailto:secretary@cftc.gov). Reference should be made to "Regulation 18.05."

Comments may also be submitted to the Federal eRulemaking Portal: <http://www.regulations.gov>.

#### FOR FURTHER INFORMATION CONTACT:

Duane C. Andresen, Special Counsel, Division of Market Oversight, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Telephone 202-418-5492; e-mail [dandresen@cftc.gov](mailto:dandresen@cftc.gov). This document is also available at [www.regulations.gov](http://www.regulations.gov).

#### SUPPLEMENTARY INFORMATION:

#### I. Purpose of Regulation 18.05 and Statutory Basis

Section 3(b) of the Commodity Exchange Act (Act)<sup>1</sup> declares that the purpose of the Act is to, among other things, deter and prevent price manipulation or any other disruptions to market integrity and to ensure the financial integrity of all transactions subject to the Act and the avoidance of systemic risk.<sup>2</sup> Section 4i of the Act<sup>3</sup>

<sup>1</sup> 7 U.S.C. 5(b) (2006).

<sup>2</sup> Section 3(b) of the Act provides in full that it is the purpose of this chapter to serve the public interests described in subsection (a) of this section through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission. To foster these public interests, it is further the purpose of this chapter to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this chapter and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.

<sup>3</sup> 7 U.S.C. 6i (2006). Section 4i of the Act provides that it shall be unlawful for any person to make any contract for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility if such person shall directly or indirectly

requires persons holding futures or option positions at designated contract markets (DCM) or registered derivatives transaction execution facilities (DTEF) at or above certain levels to keep books and records of all:

(1) Transactions and positions in the exchange-traded commodity,

(2) transactions and positions in any such commodity traded on or subject to the rules of any other board of trade, and

(3) cash or spot transactions in, and inventories and purchase and sale commitments of such commodity.

Such books and records must be open at all times for inspection by any representative of the Commission or the Department of Justice.

Section 8a(5) of the Act<sup>4</sup> provides explicit authority to the Commission to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the Act. In order to accomplish the purposes of Sections 3(b) and 4i set forth above, the Commission has promulgated regulations creating market and large trader reporting

make such contracts with respect to any commodity or any future of such commodity during any one day in an amount equal to or in excess of such amount as shall be fixed from time to time by the Commission, and if such person shall directly or indirectly have or obtain a long or short position in any commodity or any future of such commodity equal to or in excess of such amount as shall be fixed from time to time by the Commission, unless such person files or causes to be filed with the properly designated officer of the Commission such reports regarding any transactions or positions described in clauses (1) and (2) hereof as the Commission may by rule or regulation require and unless, in accordance with rules and regulations of the Commission, such person shall keep books and records of all such transactions and positions and transactions and positions in any such commodity traded on or subject to the rules of any other board of trade, and of cash or spot transactions in, and inventories and purchase and sale commitments of such commodity. Such books and records shall show complete details concerning all such transactions, positions, inventories, and commitments, including the names and addresses of all persons having any interest therein, and shall be open at all times to inspection by any representative of the Commission or the Department of Justice. For the purposes of this section, the futures and cash or spot transactions and positions of any person shall include such transactions and positions of any persons directly or indirectly controlled by such person.

<sup>4</sup> 7 U.S.C. 12a(5) (2006).

requirements.<sup>5</sup> Included among these regulations is a requirement that persons holding futures or option positions at DCMs or DTEFs (reporting markets)<sup>6</sup> at or above reportable levels (reportable positions)<sup>7</sup> are identified to the Commission under the large trader reporting system (LTRS).

The LTRS, which requires that clearing members, futures commission merchants (FCM) and foreign brokers file daily reports with the Commission, enables the Commission to assess an individual trader's activities and potential market power and to enforce the Commission or DCM-set limits on speculative positions.<sup>8</sup> Once a trader holds a reportable position, the trader is subject to Commission Regulation 18.05,<sup>9</sup> which requires that the trader

keep books and records showing all details concerning:

(1) All positions and transactions for future delivery in the commodity on all reporting markets;

(2) all positions and transactions in the commodity option;

(3) all positions and transactions in the cash commodity, its products and byproducts; and

(4) commercial activities that the trader hedges in the commodity underlying the futures contract in which the trader is reportable.<sup>10</sup>

A reportable trader is required to furnish to the Commission, upon request, any pertinent information concerning these positions, transactions or activities.<sup>11</sup> Traders who do not hold reportable positions do not have obligations under Regulation 18.05.

## II. Proposed Amendments

### A. Introduction

In order to enhance its ability to detect and prevent manipulation of regulated markets and products and to ensure the avoidance of systemic risk, as well as to clarify the meaning of the regulation and bring it up to date, the Commission proposes, for the reasons discussed below, to amend Regulation 18.05 in the following respects:

1. To make it explicit that persons holding or controlling reportable positions on a reporting market must retain books and records and make available to the Commission upon request pertinent information with respect to all non-reporting transactions, i.e., all positions and transactions in the commodity in which the trader is reportable, including transactions executed over-the-counter and/or pursuant to Sections 2(d), 2(g) or 2(h)(1)–(2) of the Act or Part 35 of the Commission's regulations, on exempt commercial markets operating pursuant to Sections 2(h)(3)–(5) of the Act (ECM),

on exempt boards of trade operating pursuant to Section 5d of the Act (EBOT), and on foreign boards of trade (FBOT); and

2. to make the regulation clearer and more complete with respect to hedging activity.

### B. Amendments Related to Recordkeeping and Reporting

There is a close relationship among transactions conducted on reporting markets and non-reporting transactions. In view of this, it is sometimes necessary to determine all transactions and positions with respect to the commodity in which the trader is reportable in order to more effectively detect and prevent manipulation of regulated markets and products and to ensure the avoidance of systemic risk.<sup>12</sup> Just as it is critical that the LTRS permits staff to aggregate related accounts to assess an individual trader's activities and potential power in a market, so is it critical that staff be able to assess the reportable trader's overall position in the same commodity in non-reporting transactions in order to see the complete picture of the reportable trader's positions in the commodity. This is particularly important in light of the growing volume of trading on, and participation in, the non-reporting markets, the close relationship among the various products and markets, the increasing globalization of the futures markets, and the growth of trading on electronic exchanges and on foreign boards of trade.<sup>13</sup>

Regulation 18.05 explicitly requires that a trader that is reportable because of futures or option positions in a futures or option contract traded on a DCM or DTEF keep books and records and provide to the Commission, upon request, pertinent information with respect to positions and transactions in the underlying commodity. For example, a reportable trader in the Natural Gas futures contract on the New York Mercantile Exchange, Inc., (NYMEX) must keep books and records and provide to the Commission, upon request, pertinent information with respect to positions and transactions in

<sup>5</sup> The Commission's market and large trader reporting rules are contained in Parts 15 through 21 of the Commission's regulations.

<sup>6</sup> Pursuant to Commission Regulation 15.00(m), a reporting market means a designated contract market and, unless determined otherwise by the Commission with respect to the facility or a specific contract listed by the facility, a registered derivatives transaction execution facility.

<sup>7</sup> Pursuant to Commission Regulation 15.00(l), reportable position means: for reports specified in parts 17, 18 and § 19.00(a)(2) and (a)(3) of this chapter any open contract position that at the close of the market on any business day equals or exceeds the quantity specified in § 15.03 of this part in either: any one future of any commodity on any one reporting market, excluding future contracts against which notices of delivery have been stopped by a trader or issued by the clearing organization of a reporting market; or long or short put or call options that exercise into the same future of any commodity, or long or short put or call options for options on physicals that have identical expirations and exercise into the same physical, on any one reporting market. For the purposes of reports specified in § 19.00(a)(1) of this chapter, any combined futures and futures-equivalent option open contract position as defined in part 150 of this chapter in any one month or in all months combined, either net long or net short in any commodity on any one reporting market, excluding futures positions against which notices of delivery have been stopped by a trader or issued by the clearing organization of a reporting market, which at the close of the market on the last business day of the week exceeds the net quantity limit in spot, single or in all-months fixed in § 150.2 of this chapter for the particular commodity and reporting market.

<sup>8</sup> The Commission also uses large-trader reporting information as a means to ensure the avoidance of systemic risk in that such information enables Commission staff to determine which FCMs carrying accounts might have exposure in particular markets.

<sup>9</sup> Regulation 18.05 states in full that every trader who holds or controls a reportable futures or option position shall keep books and records showing all details concerning all positions and transactions for future delivery in the commodity on all reporting markets, all positions and transactions in the commodity option, and all positions and transactions in the cash commodity, its products and byproducts and, in addition, commercial activities that the trader hedges in the commodity underlying the futures contract in which the trader is reportable, and shall upon request furnish to the Commission any pertinent information concerning such positions, transactions or activities.

<sup>10</sup> In describing the requirements of Regulation 18.05 in 1981, the Commission stated that the regulation requires reportable traders to maintain books and records of futures positions and transactions in the commodity in which they are reportable and all positions and transactions in the cash commodity and its products and byproducts. \* \* \* [T]he Commission wishes to underscore its view that the book and recordkeeping requirements and inspection provision contained therein are essential to accomplish the purposes of the Act and within the Commission's authority to adopt pursuant to section[s] 4i and 8a(5) of the Act. These requirements have always applied to the traders who hold or control a reportable position, and have not been restricted in any way. "Reporting Requirements for Contract Markets, Futures Commission Merchants, Members of Exchanges and Large Traders," 46 FR 59,960, 59,963 (December 8, 1981) (footnote omitted).

<sup>11</sup> The Commission currently requests such information an average of three times per year.

<sup>12</sup> Sections 6(c), 6c, 6(d) and 9(a)(2) of the Act authorize the Commission to bring enforcement actions against any person who is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity.

<sup>13</sup> For instance, since 1999, Commission staff, through foreign terminal no-action letters, has allowed 18 FBOTs to make their trading systems available by direct access to members and other participants in the U.S. without requiring the FBOTs to register as DCMs or DTEFs.

Natural Gas on all DCMs and DTEFs, in the commodity option, in the cash commodity, its products and byproducts, and commercial activities that the trader hedges in the commodity underlying the Natural Gas futures contract. Information with respect to positions and transactions in the virtually identical Natural Gas contracts on the IntercontinentalExchange (ICE), an ECM, also is important to the Commission's ability to conduct effective market surveillance of the NYMEX Natural Gas contracts and to determine the degree of a trader's exposure in both the NYMEX and ICE natural gas markets. Similarly, if a trader is reportable because of futures or option positions in the Light Sweet Crude Oil contract on the NYMEX, the trader's books and records with respect to non-reporting positions and transactions in the West Texas Intermediate (WTI) Light Sweet Crude Oil futures or option contracts on ICE Futures,<sup>14</sup> a foreign board of trade,<sup>15</sup> are relevant to effective surveillance and supervision of the reporting NYMEX market.

The Act provides ample authority to require keeping books and records and providing pertinent information with respect to non-reporting transactions. Section 4i explicitly encompasses non-reporting transactions on "any other board of trade" (such as FBOTs, ECMs operating pursuant to Sections 2(h)(3)–(5) of the Act, and EBOTs operating pursuant to Section 5d of the Act) and in the form of cash or spot transactions, inventories, and purchase and sale commitments. Further, Section 3(b) of the Act declares that the purpose of the Act is to, among other things, deter and prevent price manipulation or any other disruptions to market integrity and to ensure the avoidance of systemic risk. Section 8a(5) of the Act authorizes the Commission to promulgate such regulations as, in its judgment, are reasonably necessary to accomplish any of the purposes of the Act. Making it explicit that Regulation 18.05 requires the reportable trader to keep books and records showing all details concerning non-reporting transactions in the reportable commodity is reasonably necessary to accomplish the purposes of Section 3(b) of the Act.

<sup>14</sup> ICE Futures is a UK registered investment exchange which permits direct access to its trading system from the U.S. pursuant to a foreign terminal no-action letter issued by Commission staff. CFTC Staff Letter No. 99–69 (November 12, 1999), as amended, originally issued to the International Petroleum Exchange (IPE).

<sup>15</sup> Section 1a of the Act defines the term board of trade as any organized exchange or other trading facility without regard to location.

Although non-reporting transactions themselves generally are not subject to most regulatory provisions of the Act, the futures or option transactions executed and maintained on a DCM or DTEF that result in a reportable position are subject to such provisions and, pursuant to Section 3(a) of the Act, are affected with a national public interest. It is the purpose of the Act pursuant to Section 3(b) that the Commission prevent price manipulation of all commodities traded on these regulated markets. To accomplish this purpose, it is necessary that the Commission have the ability to review all activities in commodities traded on these markets, regardless of where the transactions are executed. By taking a position on a regulated market, a trader agrees to abide by the rules of the market and the Commission, including prohibitions against manipulation. To enhance its ability to detect and deter manipulation and other threats to market integrity, the Commission requires persons holding reportable positions to maintain books and records of transactions that could impact the regulated market and related cash market, including non-reporting transactions.<sup>16</sup>

Commission staff has interpreted Regulation 18.05 to include position and transaction data for non-reporting transactions and has received such information in response to requests made pursuant to the Regulation. Consistent with the Act and Commission practice, the Commission is proposing to amend Regulation 18.05 to make explicit that a trader with a reportable position must keep books and records showing all details concerning all non-reporting transactions in the same commodity and provide pertinent information to the Commission upon request.

#### *C. Amendments Related to Clarity and Completeness*

The Commission notes two issues that arise in connection with the Regulation 18.05 requirement that traders keep books and records showing all details concerning "commercial activities that the trader hedges in the commodity underlying the futures contract in which the trader is reportable." First, the phrase has led to some confusion. Originally inserted into the paragraph as "commercial activities that the trader hedges in the futures commodity in which the trader is reportable," its purpose was to require that, "in

<sup>16</sup> As previously stated, traders who do not hold reportable positions on reporting markets do not have obligations under Regulation 18.05's recordkeeping and reporting requirements.

addition to books and records of positions or transactions in a cash commodity, a reportable trader must also maintain records of commercial activities which the trader hedges."<sup>17</sup> Second, reportable positions can be option positions, as well as futures positions, but it is not clear that the current language also addresses commercial activities that the trader hedges in the commodity underlying any option contract in which the trader is reportable.

The Commission proposes to amend the regulation to revert to the original approach and include hedges in the option contract in which the trader is reportable. By modifying the phrase to read "commercial activities that the trader hedges in the futures or option contract in which the trader is reportable," Regulation 18.05 would capture information with respect to hedges in other than the cash commodity, its products or byproducts (i.e., a trader with a reportable position in gold futures that is a hedge of a cash position in silver would be required to comply with the Regulation 18.05 requirements with respect to the silver position).

### **III. Related Matters**

#### *A. Cost Benefit Analysis*

Section 15(a) of the Act requires the Commission to consider the costs and benefits of its action before issuing a new regulation or order under the Act. By its terms, Section 15(a) does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the proposed regulation outweigh its costs. Rather, Section 15(a) simply requires the Commission to "consider the costs and benefits" of its action.

Section 15(a) further specifies that the costs and benefits of the proposed rule or order shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. Accordingly, the Commission may, in its discretion, give greater weight to any one of the five enumerated areas of concern and may, in its discretion, determine that, notwithstanding its costs, a particular rule or order is necessary or appropriate to protect the public interest or to effectuate any of the

<sup>17</sup> 46 FR 42463, 42466 (August 21, 1981).

provisions or to accomplish any of the purposes of the Act.

The proposed amendments would make it explicit that persons holding or controlling reportable positions on a reporting market must also retain books and records and make available to the Commission upon request any pertinent information with respect to non-reporting transactions in the commodity in which the trader is reportable, and make the regulation clearer and more complete with respect to hedging activity. These amendments would enable the Commission to better carry out its responsibilities under Section 3(b) of the Act by enhancing the Commission's ability to deter and prevent price manipulation or any other disruptions to the integrity of the regulated futures markets and help to ensure the avoidance of systemic risk.

The Commission believes that the proposed amendments would address the Section 15(a) enumerated areas of market and public concern in that they would further protect market participants and the public, enhance the financial integrity of futures markets, and promote sound risk management practices. The Commission believes that the costs arising from the proposed amendments would be of little or no consequence for three reasons: (1) The amendments to Regulation 18.05 make explicit existing Commission practice; (2) it is likely that the traders that would be affected by the proposed amendments' requirements (traders who have reportable positions) already keep books and records showing all details concerning their non-reporting transactions as demonstrated by the fact that Commission staff has received such information in response to requests made pursuant to the Regulation; and (3) the Commission anticipates that special calls for pertinent information relating to non-reporting transactions would continue to be made on an infrequent basis.

After considering these factors, the Commission has determined to propose the revisions to Regulation 18.05 as discussed above and set forth below. The Commission specifically invites public comment on its application of the criteria contained in Section 15(a) of the Act. Commenters are also invited to submit any quantifiable data that they may have concerning the costs and benefits of the proposed rule with their comment letters.

#### *B. The Regulatory Flexibility Act*

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.*, requires federal agencies, in proposing rules, to consider the impact of those rules on small

businesses. The Commission has previously determined that exchanges, futures commission merchants and large traders are not "small entities" for the purposes of the RFA.<sup>18</sup> The requirements related to the proposed amendments fall on large traders. Accordingly, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the actions proposed to be taken herein will not have a significant economic impact on a substantial number of small entities.

#### *C. The Paperwork Reduction Act*

When publishing proposed rules, the Paperwork Reduction Act (PRA)<sup>19</sup> imposes certain requirements on Federal agencies, including the Commission, in connection with conducting or sponsoring any collection of information as defined by the PRA. In compliance with the PRA, the Commission through these proposed rule amendments solicits comments to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including the validity of the methodology and assumptions used; (2) evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information including the validity of the methodology and assumptions used; (3) enhance the quality, utility, and clarity of the information to be collected; and (4) minimize the burden of the collection on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology. The Commission has submitted the proposed rule amendments and its associated information collection requirements to the Office of Management and Budget (OMB). The proposed rule amendments are a part of an approved collection of information. The estimated burden associated with and reporting obligations for traders with reportable positions (OMB Control No. 3038-0009) is as follows:

*Average Burden Hour Per Response:*  
1.5.

*Number of Respondents:* 6.

*Frequency of Response:* Upon special call.

Persons wishing to comment on the information which would be required by the proposed rule amendments should contact the Desk Officer, CFTC, Office of Management and Budget,

Room 10202, NEOB, Washington, DC 20503, 202.395.7340. Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street, NW., Washington, DC 20581, 202.418.5160. Copies of the OMB-approved information collection package associated with the rulemaking may be obtained from the Desk Officer, Commodity Futures Trading Commission, Office of Management and Budget, Room 10202, NEOB, Washington, DC 20503, 202.395.7340.

#### **List of Subjects in 17 CFR Part 18**

Commodity futures, Reporting and recordkeeping requirements.

In consideration of the foregoing, and pursuant to the authority contained in the Act, and, in particular, sections 3, 4, 4a, 4c, 4g, 4i, 5, 5a and 8a of the Act, the Commission hereby proposes to amend Chapter I of Title 17 of the Code of Federal Regulations as follows:

#### **PART 18—REPORTS BY TRADERS**

1. The authority citation for part 18 is revised to read as follows:

**Authority:** 7 U.S.C. 2, 4, 5, 6a, 6c, 6f, 6g, 6i, 6k, 6m, 6n, 12a and 19; 5 U.S.C. 552 and 552(b), unless otherwise noted.

2. Revise § 18.05 to read as follows:

#### **§ 18.05 Maintenance of books and records.**

Every trader who holds or controls a reportable futures or option position shall keep books and records showing all details concerning all positions and transactions in the commodity on all reporting markets, over the counter and/or pursuant to Sections 2(d), 2(g) or 2(h)(1)–(2) of the Act or Part 35 of this chapter, on exempt commercial markets operating pursuant to Sections 2(h)(3)–(5) of the Act, on exempt boards of trade operating pursuant to Section 5d of the Act, and on foreign boards of trade. Every such trader shall also keep books and records showing all details concerning all positions and transactions in the cash commodity, its products and byproducts, and all commercial activities that the trader hedges in the futures or option contract in which the trader is reportable. The trader shall upon request furnish to the Commission any pertinent information concerning such positions, transactions or activities in a form acceptable to the Commission.

Issued in Washington, DC, this 18th day of June, 2007, by the Commission.

**Eileen A. Donovan,**

*Acting Secretary of the Commission.*

[FR Doc. E7-12045 Filed 6-21-07; 8:45 am]

**BILLING CODE 6351-01-P**

<sup>18</sup> 47 FR 18618, 18618–21 (April 30, 1982).

<sup>19</sup> Public Law 104–13 (May 13, 1995).