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Division of
Market Oversight

CFTC letter No. 07-06
May 24, 2007
No-Action
Division of Market Oversight

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35 W. Wacker Drive
Chicago, IL 60601-9703

Re: Request for No-Action Relief from Sections 5 and 5a of the Commodity Exchange Act, as amended, and the Regulations promulgated thereunder relating to contract markets and derivatives transaction execution facilities

Dear Mr. Philipp:

This is in response to your letter dated March 13, 2007 to the Division of Market Oversight (Division) of the Commodity Futures Trading Commission (CFTC or Commission).[1] By this correspondence, you request, on behalf of the Dubai Mercantile Exchange Limited (DME or Exchange), a company established in the Dubai International Financial Centre (DIFC)[2] located in the UAE, that the Division issue a no-action letter confirming that it will not recommend enforcement action to the Commission against DME or its members[3] or guaranteed customers[4] if DME does not seek designation as a contract market (DCM) or registration as a

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[1] Letter from Michael M. Philipp, Esq., Winston & Strawn LLP, to Richard Shilts, Director, Division of Market Oversight, Commodity Futures Trading Commission (March 13, 2007).

[2] The DIFC is a Financial Free Zone, established in accordance with United Arab Emirates (UAE) Federal Law and by Dubai Law.

[3] For the purposes of this letter and the relief provided herein, the term "member" shall include floor members, off-floor members and clearing members of the DME. Furthermore, references herein to members shall include the affiliates of such members, to the extent that such affiliates are granted direct access by members to DME Direct. An "affiliate" of a member means any person, as the term is defined in Section 1a(28) of the Act, that: (i) owns 50% or more of a member (ii) is owned 50% or more by the member; or (iii) is owned 50% or more by a third person that also owns 50% or more of a member. DME represents that to the extent a member permits an affiliate to have direct access to DME Direct, such affiliate will be required to comply with all of DME's Rules relating to trading on DME Direct and the DME member shall ultimately be responsible to DME for ensuring such compliance.

[4] For the purposes of this letter and the relief provided herein, the term "guaranteed customer" means a non-member of the DME who is permitted by a clearing member to have direct access to DME Direct in accordance with DME Rules and whose transactions on DME are financially guaranteed by the DME clearing member. You represent that guaranteed customers are subject to all relevant DME Rules and must agree, in writing, to be bound by DME Rules. Further, because retail customers are not permitted to trade on DME, no guaranteed customer may be a retail customer.

derivatives transaction execution facility (DTEF) pursuant to Sections 5 and 5a, respectively, of the Commodity Exchange Act (CEA or Act) or comply with any other section of the Act or Commission regulations relating specifically to DCMs or DTEFs in connection with the installation and direct access[5] use of the DME's electronic trading and order matching system known as DME Direct[6] in the United States[7] by members, seat lessees[8] and guaranteed customers. (No-action request).

Specifically, DME wishes to make DME Direct available to:

(1) DME members and guaranteed customers in the U.S. who wish to trade for their own accounts through direct access to DME Direct;

(2) DME members and guaranteed customers who are registered with the Commission as futures commission merchants (FCMs) or who are exempt from such registration pursuant to Commission Regulation 30.10 (Rule 30.10 Firms)[9] and who wish to submit orders from or on behalf of U.S. customers[10] for transmission through direct access to DME Direct;

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[5] For the purpose of this letter and the relief granted herein, the term "direct access" refers to the explicit grant of authority by the DME to a member or a guaranteed customer to enter orders directly into DME Direct.

[6] DME Direct is the brand name of the electronic trading system employed by DME for accessing DME products traded through the NYMEX ClearPort® Trading Services (CPT).

[7] For purposes of this letter and the relief provided herein, the term "United States" shall include the U.S., its territories and possessions.

[8] As defined in the DME Rulebook, a "seat lessee" is a person to whom a floor member has leased a seat. According to DME Rules, a seat lessee may trade either on the account of the floor member or on its own account held with a clearing member, but not on both, and may not accept or enter orders for a customer account.

[9] Rule 30.10 permits a person affected by the requirements contained in Part 30 of the Commission's rules to petition the Commission for an exemption from such requirements. Appendix A to the Part 30 rules provides an interpretative statement that clarifies that a foreign regulator or self-regulatory organization (SRO) can petition the Commission under Rule 30.10 for an order to permit firms that are members of the SRO and subject to regulation by the foreign regulator to conduct business from locations outside of the United States for United States persons on non-United States boards of trade without registering under the Act, based upon the person's substituted compliance with a foreign regulatory structure found comparable to that administered by the Commission under the Act.

Among the issues considered by the Commission in determining whether to grant Rule 30.10 relief to a foreign regulatory or self-regulatory authority are the authority's: (1) requirements relating to the registration, authorization, or other form of licensing, fitness review, or qualification of persons through whom customer orders are solicited and accepted; (2) minimum financial requirements for those persons that accept customer funds; (3) minimum sales practice standards, including risk disclosures, and the risk of transactions undertaken outside of the United States; (4) procedures for auditing compliance with the requirements of the regulatory program, including recordkeeping and reporting requirements; (5) standards for the protection of customer funds from misapplication; and (6) arrangements for the sharing of information with the United States. Interpretative Statement with Respect to the Commission's Exemptive Authority Under § 30.10 of its Rules, 17 C.F.R. Part 30, Appendix A (2006).

[10] For purposes of this letter and the relief provided herein, the term "United States customers" shall have the same meaning as the term "foreign futures or foreign options customers" as it is defined in Rule 30.1 (c). Because no retail customer (defined as any person who does not meet the definition of "client" and discussed below) will be permitted to trade directly or indirectly on DME, no U.S. customer may be a retail customer. DME Rules prohibit

(3) DME members and guaranteed customers who are registered with the Commission as Commodity Pool Operators (CPO) or Commodity Trading Advisors (CTA), or who are exempt from such CPO or CTA registration pursuant to Commission Regulation 4.13 or 4.14, and who wish to submit orders on behalf of U.S. pools they operate or U.S. customer accounts for which they have discretionary authority, respectively, for transmission through direct access to DME Direct, provided that an FCM or a Rule 30.10 Firm acts as clearing firm with respect to all activity conducted by such CPOs and CTAs through the submission of orders on DME Direct; and/or

(4) DME members or guaranteed customers who are registered with the Commission as FCMs or who are Rule 30.10 Firms and who wish to accept orders for U.S. customers transmitted via automated order routing systems (AORS)[11] for submission to DME Direct.

As you know, the Commission, on October 27, 2006, issued a policy statement that affirmed the use of the no-action process to permit foreign boards of trade to provide direct access to their electronic trading systems from the U.S. (Policy Statement).[12] The Division has reviewed DME's No-action request and the materials submitted in support thereof in accordance with the Policy Statement and the June 2, 1999, Commission Order (June 2 Order) which first directed the Commission staff to consider requests from foreign exchanges for interim no-action relief to allow them to provide direct access to their trading systems from the U.S.[13]

In connection with its No-action request, DME has forwarded the following information to the Division:

- General information regarding DME (*e.g.*, its location and organization);
- DME Rules;
- DME Ethics Guidelines;
- Dubai Financial Services Authority (DFSA) Conduct of Business (COB) Rules;

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members from opening an account for, or entering into an Exchange contract with, a retail customer. This prohibition applies to clearing members when holding accounts for both guaranteed customers as well as all other customers who have access to DME through a member. The prohibition on retail customers independently applies to guaranteed customers under DME Rules.

[11] For the purposes of this letter, the term "AORS" shall mean any system of computers, software or other devices that allows entry of orders through another party who has been granted direct access to DME Direct, (a DME member or guaranteed customer) for transmission to DME Direct, where without substantial human intervention, trade matching or execution takes place.

[12] Boards of Trade Located Outside of the United States and No-Action Relief from the Requirement to Become a Designated Contract Market or Derivatives Transaction Execution Facility, 71 Fed. Reg. 64443 (November 2, 2006).

[13] Order of the CFTC Withdrawing Proposed Rules Regarding Access to Automated Boards of Trade, 64 Fed. Reg. 32829, 32830 (June 18, 1999).

- DFSA Authorization (AUT) Rules;
- DFSA General (GEN) Rules;
- DFSA Recognition (REC) Rules;
- DFSA Anti-Money Laundering (AML) Rules;
- Regulatory Law (DIFC Law No. 1 of 2004), as amended (RL 2004);
- Markets Law (DIFC Law No. 12 of 2004) (ML2004);
- Clearing Services Agreement, DME – NYMEX, dated September 1, 2005 (CSA);
- General Services Agreement, DME – NYMEX, dated September 1, 2005 (GSA);
- Software Licensing and Maintenance Agreement, DME – NYMEX, dated September 1, 2005 (SLMA);
- DFSA Recognized Jurisdiction Notice (table of recognized [Tier One] jurisdictions), dated April 18, 2006;
- Brochure, "Doing Business in the Dubai International Financial Centre" (DIFC);
- Certification of authorized representative of DME as to the truth and completeness of the material facts set forth in the request for no-action relief; and
- Undertaking of authorized representative of DME to notify Commission staff if, prior to the issuance of no-action relief requested in letter dated March 13, 2007, any material representation made in such request for no-action relief ceases to be true and complete.

Representations made by DME regarding the structure of DME, DME's activities in the U.S., DME's membership criteria, the electronic trading and order matching system known as DME Direct, the relevant regulatory regime in Dubai in the UAE, and the information-sharing arrangements applicable to DME and its regulator are summarized in Sections I - VI below. For purposes of its response to the No-action request, the Division has relied upon DME's representations and information provided by DME and has not conducted an independent review to confirm their accuracy.[14]

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[14] As stated below, the no-action relief provided herein is contingent upon the accuracy of the representations made by DME in support of its No-action request. Any materially different, changed, or omitted facts or circumstances may render the no-action relief void or cause the Division, in its discretion, to condition further, modify, suspend, terminate, or otherwise restrict the relief.

I. GENERAL INFORMATION REGARDING DME

DME is directly owned by DME Holdings Limited (DME Holdings), a joint venture between NYMEX Holdings, Inc. (NYMEX Holdings), and Tatweer, Inc. (Tatweer),[15] that is incorporated in Bermuda.[16] DME was incorporated in the DIFC, located in the UAE, on September 29, 2005 as a private limited company under the DIFC Companies Law (No. 2 of 2004), as amended. Since its establishment, DME has operated in the DIFC. DME represents that it does not maintain a representative office in the U.S., nor does it provide investment advice, solicit orders or direct trading from the U.S.

DME has been licensed by the DFSA[17] as an Authorized Market Institution (AMI) to operate an exchange within the DIFC pursuant to Article 45 of the RL 2004. Initially, DME has made the following contracts available for electronic trading on DME Direct: Oman Sour Crude futures contract, West Texas Intermediate (WTI) - Oman Financial Spread futures contract, and Brent - Oman Financial Spread futures contract.[18] The DME also plans to list later in 2007 a Middle East-based jet fuel futures contract.

Certain of the Exchange's operations are outsourced to its affiliate, the New York Mercantile Exchange, Inc. (NYMEX),[19] pursuant to a Software License and Maintenance Agreement (SLMA) and a General Services Agreement (GSA) executed between Tatweer, NYMEX Holdings and DME Holdings[20] covering technology hosting, market surveillance and other services. In addition, the clearing department of NYMEX (NYMEX Clearing), a CFTC-regulated DCO, provides clearance and settlement services to DME pursuant to a Clearing Services Agreement (CSA) executed between NYMEX and DME.

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[15] Tatweer was incorporated in Dubai in October 2004 as part of the Dubai Holding Group. Dubai Holding Group plays a role in developing and managing major projects aimed at promoting and developing Dubai and the region as an international venue for commerce, finance and tourism.

[16] On November 20, 2006, the Sultanate of Oman's Ministry of Finance (MOF) and the DME reached an agreement for MOF to acquire a [ ] percent equity stake in the DME. When the transaction is completed, the Oman Investment Fund will own approximately [ ] percent of DME Holdings while NYMEX Holdings and Tatweer will each own approximately [ ] percent.

[17] As discussed further below, the DFSA, created under DIFC Law No. 9 of 2004, is the regulator responsible for the authorization, licensing and registration of institutions and individuals who wish to conduct financial and ancillary services in or from the DIFC. The DFSA also supervises regulated participants and monitors their compliance with applicable laws, regulations and rules.

[18] The Oman Sour Crude futures contract is physically settled with one delivery point in Mina Al Fahal, Oman. The WTI - Oman Financial and the Brent - Oman Financial spread contracts are cash-settled contracts.

[19] NYMEX is wholly owned by its parent company, NYMEX Holdings. NYMEX has been designated by the Commission as a DCM and registered as a Derivatives Clearing Organization (DCO).

[20] The outsourcing arrangements also provide for NYMEX to assist DME in its trading floor operations, including technology and compliance assistance, on an on-going basis.

DME is overseen by a Board of Directors (Board) which is comprised of eight directors including four independent directors[21] and an equal number of representatives of NYMEX Holdings and Tatweer. The Board has overall responsibility for ensuring that DME complies with its obligations under the DFSA regulatory framework, including its obligations as a DFSA authorized body, and for approving strategic decisions. The Board has the power to appoint the members of several committees to assist in the governance of DME, including the disciplinary, appeal, compliance review, product advisory, governance and membership committees.[22] The day-to-day management of the Exchange is the responsibility of the DME Chief Executive Officer (CEO) and the executive management team. The CEO is, in particular, responsible for helping to develop Exchange strategy and business plans and for implementing the Board's strategy. He is assisted by a full-time staff, including a compliance department.[23] In the event of an emergency, each DME Board member and the DME CEO and CCO have the right, under DME Rules, to order a suspension of trading for such period as in their judgment is necessary.[24]

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[21] The 50 percent independent directors requirement is an ongoing requisite of the AMI license. Under DFSA AMI Guidance, the DFSA will consider a director to be "independent" if the director is found, on the reasonable determination by the Governing Body (*i.e.*, Board), to: (1) be independent in character and judgment; and (2) have no relationships or circumstances which are likely to affect or could appear to affect the director's judgment in a manner other than in the best interests of the AMI. The Guidance also identifies a number of factors that the Governing Body should consider in determining the independence of a director.

[22] The Board's Corporate Governance Committee (Governance Committee) is charged with reviewing and assessing the DME's corporate structure and standards for integrity and professionalism. The Governance Committee is also charged with reviewing the DME's risk management process and to keep the Board apprised of such issues. DME has adopted Ethics Guidelines setting out fundamental ethical principles for all DME Members, directors, committee members, and employees with respect to DME business, including principles relating to conflicts of interest.

[23] DME has a staff of approximately 80 people. The Compliance Department is staffed with seven people, including the Chief Compliance Officer (CCO) and an administrative assistant. Reporting directly to the CCO are the Director of Membership Surveillance, the Manager of Market Surveillance, and the Senior Manager of Risk. Reporting to the Director of Membership Surveillance are a Membership Surveillance Analyst and a Trainee-Membership Surveillance Analyst. As explained in more detail below, the Membership Surveillance function is responsible for the monitoring of business systems and controls at member firms, guaranteed customers, seat lessees, and applicants for membership. Reporting to the Manager of Market Surveillance will be a Market Surveillance Analyst, a NYMEX market surveillance analyst who will be seconded to the DME. The Market Surveillance function is responsible for monitoring, oversight and investigation of daily market activities and market irregularities. Finally, the Senior Manager of Risk is responsible for review and analysis of the financial regulation within the jurisdictions where the DME has trading terminals, a physical presence or a license. The Senior Manager of Risk is also responsible for management of the overseas regulator database, operational risk, resolution of audit points and resolution of customer complaints.

[24] Under DME Rules, an emergency includes, but is not limited to, the following circumstances: (1) where any manipulative activity or attempted manipulative activity is suspected; (2) any actual, attempted or threatened corner, squeeze, congestion or undue concentration of positions; (3) any circumstance or circumstances that may materially affect the performance of futures or options contracts traded on the Exchange; (4) any action taken by or against the UAE government, the Government of the Emirate of Dubai, the DIFC Authority, any foreign government, any local government, authority or agency, or by any other exchange, or trade association, whether foreign or domestic, which action may have a direct impact on trading on the Exchange; (5) any circumstances that may have a severe, adverse effect on the physical functions of the Exchange, including a physical emergency; (6) any other unusual, and unforeseeable adverse circumstance.

II. MEMBERSHIP AND GUARANTEED CUSTOMERS

A. Members

Any individual, corporate body, partnership or unincorporated association may apply for membership of DME as long as the applicant meets the specific requirements set out in the DME Rules. DME has the following categories of membership: floor members, off-floor members, and clearing members. DME Rules require members to comply with all applicable rules and regulations, including DFSA requirements.

Floor members have the right to access and to trade on DME Direct on the Exchange trading floor (Exchange Floor).[25] Initially, DME will issue 50 seats, which confer on the floor members an equity interest in the Exchange, as well as lower Exchange fees and the right to occupy a seat on the Exchange Floor. A floor member's trading privileges are exercised on the Exchange Floor by individuals who are employees or representatives of that floor member. An applicant for floor membership must, among other things, (1) be a body corporate, partnership or unincorporated association; (2) be established and carrying on its business in the DIFC; (3) be Authorized (discussed below) or otherwise permitted by the DFSA to conduct the activities which it intends to conduct while trading on the DME and must provide evidence to the DME of such regulatory status; or (4) have, in the opinion of the Board, good character, commercial standing and business experience. If the applicant intends to trade as principal or agent on the account of any customer or to trade as agent on account of any of its affiliates or of any other member, it must also comply with all applicable DFSA or other regulatory capital requirements and have net capital of not less than $1,000,000 or its equivalent in any other currency.[26]

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[25] Despite being a fully electronic exchange, DME will also allow traders to operate from trading hubs and individual trading stations on the Exchange Floor. The Exchange Floor is not an open-outcry pit trading facility and all orders will be executed through DME Direct.

[26] An applicant must also (1) provide such evidence as requested by the Exchange as to its legal status and organization and as to its ability to become a floor member without breaching applicable laws, regulations and rules; (2) provide the following in the prescribed form or in form agreed to by the Exchange:

> (i) a copy of a resolution, duly certified by the secretary or other authorized officer or partner of the applicant, designating agents for service of process in the DIFC concerning and limited to the Exchange-related activities and business of the applicant and/or employees of the applicant;(ii) a copy of a resolution, duly certified by the secretary or other authorized officer or partner of the applicant, or by the governing body of the applicant, authorizing the application for floor membership and the execution of the documents referred to above and all other documents relating to the applicants floor membership; and(iii) with respect to partnerships, a statement describing the business in which it is engaged and a certified copy of its current partnership agreement. The applicant shall also file certified copies of any and all documents filed with the DIFC authorizing the partnership to conduct business in the DIFC;

(3) agree to be bound by the DME Rules; (4) designate an officer, employee or partner as the Exchange liaison, whom the Exchange may contact in order to obtain additional information or documentation in connection with any matter whatsoever provided in these Rules; (5) do or submit such other things or documents as the Board may stipulate from time to time; (6) if not also a clearing member, have entered into an agreement with at least one clearing member for the clearing of the applicant's trading on the Exchange and provide the Exchange with a copy

Off-floor memberships do not confer equity rights in the Exchange or provide seats on the Exchange Floor, but do provide for lower Exchange fees. Off-floor members have the right to access and to trade on DME Direct off the Exchange Floor – whether from inside or outside the DIFC. Initially, DME will offer 50 off-floor memberships for sale. An applicant for off-floor membership must satisfy the membership criteria set out for floor membership, except that the applicant need not be a body corporate, partnership or unincorporated association or be established and carrying on its business in the DIFC. An applicant for off-floor membership must satisfy the Exchange that it is Authorized, Recognized (discussed below) or otherwise permitted by the DFSA to engage in the activities it intends to conduct while trading on the Exchange and must provide the Exchange evidence of such regulatory status.

Clearing memberships are only available to NYMEX clearing members. Although all NYMEX clearing members are eligible to become DME clearing members, they will not automatically become DME clearing members and need to apply separately to DME for such membership. An applicant for clearing membership must satisfy the clearing member requirements of NYMEX Clearing, must satisfy the DME membership criteria established for off-floor memberships, and must also satisfy the Exchange that is authorized, recognized or otherwise permitted by the DFSA to engage in the activities it intends to conduct while trading on the Exchange and must provide the Exchange evidence of such regulatory status.

B. Authorization and Recognition

The Financial Services Prohibition of the RL 2004 prohibits carrying on financial services in the DIFC unless those engaged in such activities are "Authorized" or "Recognized" by the DFSA. The Financial Services Prohibition is deemed to apply to, among others, the following financial activities when carried on in or from the DIFC: (1) dealing in investments as principal; (2) dealing in investments as agent; (3) arranging credit or deals in investments; (4) managing assets; (5) advising on financial products or credit; and (6) operating a collective investment fund. If a DME member (floor member, off-floor member or clearing member) is physically present in the DIFC, it is required to be authorized by the DFSA. If a DME member has no physical presence in the DIFC, such member must be Recognized by the DFSA.[27] In addition to the DFSA authorization or recognition requirement, DME requires that floor members and off-floor members maintain an account with a clearing member, *i.e.*, they must be guaranteed by a clearing member.

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of each such agreement; (7) provide evidence of its experience and competence; and (8) provide satisfactory evidence to enable DME to comply with its obligations under the applicable AML Requirements.

[27] DFSA regulations include some exclusions to the authorization requirement. One such exclusion is that the DFSA does not require that a commercial trade user who intends to trade only for its own account be Authorized. Seat lessees, being physically present in the DIFC, must be Authorized to the extent that they trade for other than their own account. Their transactions, whether for their own account or the account of a floor member, must be financially guaranteed by a DME clearing member. Seat lessees are bound by the DME Rulebook.

With respect to authorization, RL 2004 requires the DFSA to ensure that any firm applying for DFSA authorization satisfy, and continue to satisfy, the authorization conditions that pertain to all of the financial services for which it has or will have a license. Among the most important authorization requirements are those regarding the suitability of the applicant to carry on the financial service activities for which it has applied, *i.e.*, an applicant for authorization must satisfy the DFSA that it is fit and proper to carry on those activities. In determining whether an applicant is fit and proper, the DFSA may take into account, among other things, an applicant's: (1) integrity (including absence of convictions or civil liabilities); (2) honesty; (3) competence; and (4) financial soundness. The DFSA requires applicants to submit detailed financial and business information in conjunction with an application for authorization to ensure compliance with DFSA's capital requirements.

An applicant must submit a detailed personal information form for its employees engaged in a licensed function, including the Senior Executive Officer, Licensed Director, Licensed Partner, Finance Officer, Compliance Officer, Senior Manager, Money Laundering Reporting Officer, Licensed Representative and Responsible Officer. The form requires disclosure of, among other things, past experience, license or authorization refusals, convictions, disciplinary actions, investigations, and insolvencies.[28] Firms must also seek DFSA approval for certain employees who perform certain key functions with respect to the firm's financial services activities. The application process also requires the firm to inform the DFSA of any person or persons who have control of the firm (Controller).[29] Authorized firms are required to have adequate arrangements in place to ensure that employees are suitable, adequately trained and properly supervised.

The DFSA imposes financial resource requirements upon all Authorized Firms and all applicants for Authorization must demonstrate on-going compliance with the prescribed levels of capital to ensure that there is no significant risk that the member's liabilities cannot be met as they fall due. The financial resources requirements are contained in various regulatory modules and depend on the type of institution, nature, size and complexity of its business (*e.g.*, investment firms, banks, etc.). The primary module applicable to firms incorporated in the DIFC and Authorized by the DFSA in relation to physical commodities is the Prudential Investment, Insurance Intermediation and Banking Business Module, which includes complex rules governing the financial resources requirements applicable to various types of firms or institutions. The financial resources must be of the kinds and amounts specified in, and calculated in accordance with, the applicable DFSA Rule.

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[28] No Authorized person may employ an individual to whom the DFSA has issued an order under RL 2004 indicating that such person is not a fit and proper individual to perform functions relating to financial services activities carried on by that Authorized person or Authorized persons generally.

[29] Generally, a Controller is any person who holds 10 percent or more of the share capital of a firm, or is otherwise entitled to exercise or control the exercise of 10 percent or more of the voting rights at a general (shareholders) meeting of the firm. Once Authorized, a firm must notify the DFSA of, and in many cases seek the DFSA's prior approval to, any change in the identity of its Controllers and the level of control held by them.

With respect to recognition, recognized member status allows firms that are carrying out financial services activities in compliance with their home jurisdictions' requirements to undertake such activities within the DIFC without becoming fully Authorized by the DFSA. This Recognized status allows the DFSA to have certain oversight and enforcement rights with respect to the Recognized member. In determining whether a financial services regulator is satisfactory to the DFSA, the DFSA undertakes a due diligence inquiry of the caliber of regulation and considers whether there are adequate arrangements in place for cooperation between the DFSA and the other regulator. Recognized member status is readily available to firms in Tier 1 jurisdictions[30] including, among others, the U.S. and United Kingdom. Recognized member status is also available to firms in non-Tier 1 jurisdictions upon DFSA approval, on a firm by firm basis, following DFSA review of the financial regulation in the home jurisdiction, so long as the activities the firm will undertake in the DIFC are regulated in the firm's home jurisdiction to a standard acceptable to the DFSA. Thus, many members who wish to trade on DME without having a physical presence in the DIFC will be regulated by a regulator in their home jurisdiction rather than by the DFSA. Notably, DFSA Recognized members must comply with their home jurisdiction regulators' financial requirements.

Upon receipt of a Recognized member application, the DFSA initially researches the applicant and confirms with the DME that the firm is genuinely interested in DME membership. Upon confirmation and satisfaction of the firm's initial due diligence, the DFSA contacts the applicant's home regulator and, to determine if the same activities fall within the scope of the applicant's license in its home jurisdiction, identifies to the home regulator the activities the applicant wishes to undertake in the DIFC. In the case of Recognized member applicants located in the U.S., the DFSA contacts the NFA to obtain confirmation of: (1) the regulatory status of the firm, and (2) any past, present or known future disciplinary record of the firm.

C. Guaranteed Customers

Pursuant to DME Rules, guaranteed customers are permitted to have direct access to DME Direct. Each guaranteed customer is required to maintain an account with a clearing member who financially guarantees the guaranteed customer's transactions. Retail customers are not permitted to trade on DME, and accordingly, no guaranteed customer may be a retail customer or enter orders for retail customers for whom it is authorized to trade.[31] DFSA requires

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[30] Pursuant to the Collective Investment Law No. 1 of 2006, the DFSA has issued a Recognised Jurisdictions Notice that identifies, among other things, countries and territories that have been accorded Recognized status. The DFSA has advised the DME to use the Recognised Jurisdiction Notice as guidance in determining acceptable jurisdictions, also known as Tier 1 jurisdictions.

[31] Any person who does not meet the definition of client as set forth in DFSA COB Rules 3.2.2 is a retail customer. In general, a client is a person who has been determined by a member to be:

(1) an individual who: (i) has at least $1 million in liquid assets and has provided the member written confirmation of this fact; (ii) has sufficient financial experience and understanding to participate in financial markets; and (iii) has consented in writing to being treated as a client;

(2) an individual who: (i) is an employee of the member; and (ii) meets the conditions in (1)(ii) and (iii);

(3) an entity which has had, or any of whose holding companies or subsidiaries has had, in the last two years, called up share capital or net assts of at least $5 million. In case of a limited liability partnership calculated without deducting loans owning to any of the partners;

guaranteed customers physically present in the DIFC to be Authorized unless their activities in the DIFC fall within an exclusion. Guaranteed customers not present in the DIFC are not required to be either Authorized or Recognized. However, all guaranteed customers are subject to all relevant DME Rules and must agree, in writing, to be bound by DME Rules. In addition, DME Rules expressly applicable to guaranteed customers mandate that each guaranteed customer shall observe high standards of integrity, fair dealing and market conduct as reflected in the DFSA Rulebook and any guidance published by the DFSA.

III. OVERVIEW OF THE DME TRADING SYSTEM

At the outset, the Division notes that the description of DME Direct set forth herein is based upon representations made by DME or its representatives. The Division has not performed an independent assessment of the security or soundness of DME Direct in connection with this request. Nonetheless, it should also be noted that DME Direct is the brand name of the electronic trading system employed by DME for accessing DME products traded through the NYMEX ClearPort® Trading Services (CPT), which has previously been reviewed by the Commission staff. On January 16, 2003, the Division acknowledged the self-certified submission by NYMEX of proposed new and amended rules in support of the launch of CPT and the Division has not, to date, recommended any alteration in its trading procedures. In addition, Commission staff has previously described CPT in connection with the granting of direct access no-action relief to NYMEX Europe Limited.[32]

A. Introduction

DME Direct is a flexible internet-based electronic trading system developed, maintained and enhanced by NYMEX on the CPT platform in New York.[33] Under the SLMA, NYMEX has provided DME with a license to use the CPT for the trading of DME products on DME Direct. NYMEX, through the NYMEX Customer Service Call Center (NCSCC), provides back-up services including, among other things, resolution of clearing and trading systems issues. The

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(4) a trustee of a trust or pension fund which has had in the last two years assets of at least $5 million calculated by aggregating the value of cash and the investments forming part of the trust's or fund's assts, but before deducting liabilities;
(5) a properly constituted government, government agency, central bank or other national monetary authority of any country or jurisdiction;
(6) a public authority or state investment body;
(7) a supranational organization whose members are either countries, central banks or national monetary authorities;
(8) an Authorized Firm or Regulated Financial Institution;
(9) an Authorized Market Institution, regulated exchange or regulated clearing house;
(10) an entity which is a holding company or subsidiary of an entity listed in (8) or (9) with that entity's consent;
(11) a body corporate whose shares are listed or admitted to trading on any regulated exchange of an IOSCO member country; or
(12) a collective investment fund or special purpose vehicle.

[32] CFTC Staff Letter No. 05-24 (December 16, 2005).

[33] DME anticipates that it will, at some point, transfer the matching engine for DME Direct to the DIFC.

DME Direct trading week commences at 6:00 PM New York time each Sunday (2:00 AM Monday Dubai time) and ends at 5:15 PM New York time each Friday (1:15 AM Saturday Dubai time). DME Direct is closed daily for 45 minutes between 5:15 PM and 6:00 PM New York time. The Board has the discretion to adjust the trading hours to take into account religious holidays in the UAE.

DME Direct, supported by core components, sends and receives messages in FIX formats, stores order and trade data in database tables, matches orders and communicates market data to traders and vendors. The NYMEX Clearing 21 system (C21®) is used to clear DME trades. C21® performs the following functions: (1) calculating margin requirements; (2) producing DME large trader reports; (3) producing regulatory reports; (4) interfacing with clearing members; (5) managing cash transfers for margin calls; and (6) contract administration. C21® produces daily contract facts sheets that list key contract information including open interest, volume, and historical highs and lows.

1. Trading Host and Connecting to DME Direct

The systems supporting DME's trading operations are hosted by servers located in the U.S. and operated and maintained by NYMEX. The systems hosted by NYMEX in New York include: (1) Trade Management System (TMS), used for capturing DME Trades; (2) Price Reporting System (PRS), used for the dissemination of price information from the market; (3) TXN, a computerized surveillance system; and (4) C21®. DME Direct has an "open architecture" through which software application programming interfaces enable market participants to connect DME Direct with their own proprietary system or a system provided by an ISV. Members and guaranteed customers may connect directly to DME Direct via a managed network solution or manage their own direct network connection access via the internet. There are two standard interfaces to DME Direct: NYMEX Order Routing FIX API, used to authenticate and configure orders and receive confirmations, and FIX Market Data API, the interface for real-time market prices.

Every member, seat lessee and guaranteed customer with direct access to DME Direct must register at least one individual with the DME as an Authorized Terminal User (ATU).[34] The ATUs must be trained in the use of DME Direct and serve as contact persons for the Exchange in the event of any problems with DME Direct systems involving the member, seat lessee or guaranteed customer, or if the Exchange has any questions regarding business conducted through a particular DME Direct connection assigned to that member, seat lessee or guaranteed customer. DME Rules set out the requirements for each ATU and provide that ATUs are bound by DME and DFSA Rules.

2. Order Entry and Audit Trail

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[34] As defined in DME Rules, an ATU is a person whom the member, seat lessee or guaranteed customer has designated to serve as terminal operator or otherwise authorized to access the trading platform and whom the member, seat lessee or guaranteed customer has so notified to the Exchange.

Under DME Rules, members, seat lessees and guaranteed customers must promptly make a record of the receipt of a customer order, including information as set out in Conduct of Business (COB) Rules. Immediately upon receipt, all customer orders must be entered into the DME Direct database and programs that accept, match and report execution of orders in DME (Matching System).

DME Direct supports the limit and stop limit order types with the following order duration qualifiers: Day (Single Session), GTC (Good Till Cancelled), and GTD (Good Till specified Date). The following core data is part of each DME order record: commodity; contract month; purchase or sale; account number (or certification that the order is for multiple accounts to be allocated later); quantity; limit price; the clearing member who holds the account for the relevant customer or the member, seat lessee or guaranteed customer if trading on its own account or for the account of affiliates or on an omnibus account basis; strike prices, put or call (for options); and times of order entry and order execution or cancellation. Each order entered on DME Direct must also contain a Customer Type Indicator (CTI), which is used for reporting and compliance analysis and distinguishes for whom and on what type of account the trades are being placed.

All relevant data entered into DME Direct are passed from DME Direct to the post-trade systems and retained by NYMEX in New York for a minimum of five years.[35] All members are required to maintain, for at least six years, records relating to all orders and transactions to which they are a party or which they have executed, forwarded for execution, transferred or assigned, including details of the persons for whom the trade was executed, the parties to it, and the manner in which it was fulfilled, discharged, terminated or executed. Members are required to maintain all such records in permanent hard copy or permanent and readily-retrievable electronic form, unless they are required to keep them in another form by the rules and regulations of any regulatory body to which they are subject.

3. Order Matching Algorithm

The DME Direct matching algorithm utilizes price and time priority, *i.e.*, all orders at the best price level will be filled according to time priority. Because the algorithm utilizes time priority, any order modifications results in the modified order moving to the bottom of the priority list for orders at the same price level. DME Direct also incorporates implied pricing functionality, which integrates bids and offers in spreads and their underlying contracts, to generate additional liquidity and provide the opportunity for price improvement. DME Rules provide that trades in DME Direct are formed at the time of matching in the matching system.

4. Data Dissemination

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[35] DME Direct allows orders entered to be modified and deleted. Some, but not all, data fields can be changed. Order quantity, price, time in force, the specified price for a stop limit order, and expiration date can be altered. The account, symbol, side, order type, and compliance ID data fields cannot be changed. The audit trail captures the times of all order modifications.

NYMEX distributes DME market data to vendors that have signed the standard DME market data distribution agreement. DME products are uniquely identified by the ITC2 (Inter-Exchange Technical Committee) exchange code "DM" and product symbols. Each price change is reported on a real-time basis to market data vendors.

5. System Support

As provided in the SLMA, the NCSCC is operated by NYMEX on behalf of DME. The NCSCC will be available 24 hours each day from Sunday 6:00 PM New York time (2:00 AM Monday Dubai time) until Friday 6:00 PM New York time (2:00 AM Saturday Dubai time) to assist traders with issues regarding electronic trading and clearing. The NCSCC generally has three to five staff members available at any time to field questions and communicate with market participants and provide market support services.

NCSCC provides DME customer support and problem management to members and guaranteed customers designated by clearing members. In order to be designated and eligible for DME Direct support, a guaranteed customer must register with the DME. Upon receipt by the NCSCC of notice from the DME that the DME is satisfied that a guaranteed customer meets the criteria set out in DME Rules, NCSCC allocates passwords to allow the guaranteed customer access.

The DME trade cancellation policy authorizes the NCSCC to mitigate market disrupting events caused by the improper or erroneous use of DME Direct, or by system defects, by adjusting trade prices or canceling ("busting") trades. NCSCC may also adjust trade prices or cancel any trade if the NCSCC determines that failure to do so may have a material adverse effect on the integrity of the market. The decision of the NCSCC is final.

6. System Reliability and Failure Recovery

a. Duplication of Key Components

NYMEX uses the Storage Library System from Digital Equipment Corporation for tape management and has a predetermined schedule for incremental and full back-ups. NYMEX maintains a back-up facility for all of its IT systems at NYMEX's established disaster recovery (DR) facility, which is on a separate power, water, and telecommunication grid from NYMEX's headquarters at the World Financial Center. The main facility and the back-up facility are linked with multiple redundant fiber optics lines, providing completely synchronized communication. NYMEX audits its back-up facilities on a quarterly basis. In adherence to the tape rotation policy, all previous weekday tapes are off-sited to a vaulting facility. Tape retention policy is seven years for all full backups and 60 days for all incremental backups. All backup tapes are retained at NYMEX's main business address and at the DR facility.

NCSCC also performs back-up functions. At the end of the trading day, trade volume summary screens and trade detail screens (Trade Book and Order Book) are accessed by a NCSCC staff member within DME Direct. The screen details are copied and pasted into a spreadsheet to create a daily repository on the LAN of trade activities for use the next trading

day so as to address customer inquiries about alleged errant and/or missing trades. Access to the LAN directory is restricted to NCSCC staff and management. The LAN is backed up nightly. In essence, every trade record is copied and stored on a spreadsheet, by trade date, for eventual retrieval by the NCSCC staff should it be necessary to review the trade details.

b. Failure Detection

NYMEX measures and monitors the availability and performance of applications and host systems on a 24-hour basis. Diagnostic systems software notifies IT personnel through alerts as soon as a problem is detected. IT personnel process and correlate the diagnostic software data with other information to analyze the potential problem. The diagnostic system is installed in the Operations Room, where operators observe critical systems via dedicated monitors at all times. In addition, NYMEX uses job-scheduling software to create system application logs for monitoring actual batch submissions and processing, including: (1) jobs scheduled for execution; (2) actual job start and completion times; (3) any abnormal conditions during the execution; and (4) whether jobs were run to normal completion.

NYMEX also has in place systems and procedures for maintaining business continuity in the event of system or network failure. If a serious systems event occurs at NYMEX's primary New York site, the systems for DME Direct can be managed remotely to continue to provide support to DME. In the event that DME cannot be supported, a crisis management team will assess the situation and notify DME of the event. If the problem occurs intra-session and results in discontinuation (or the threat of discontinuation) of trading, the crisis management team will seek to halt markets, notify the DFSA, and monitor the event until it is resolved.

c. Failure and Recovery

NYMEX provides all reasonable assistance to DME in developing, maintaining and implementing an appropriate disaster recovery and business continuity plan to ensure that DME continues to meet the legal, regulatory and accounting requirements and standards applicable to it. NYMEX is required to maintain a business continuity plan for the equipment, systems and power supply, including backup arrangements for both processing and communications resources.

B. Limitation of Liability

DME Rules generally provide (except where liability results from a person's willful misconduct) that none of the Exchange, NYMEX, or their affiliates and any of their respective officers, directors, employees, agents, consultants, information providers, independent contractors or subcontractors, licensors, members and clearing members, shall be liable to any person for any losses, damages, costs or expenses (including but not limited to, lost profit, loss of use, and direct, special, indirect, incidental or consequential damages) arising from: (1) any failure or malfunction, including any liability to enter or cancel orders on DME Direct or delay being able to do so; (2) any failure or malfunction or fault in delivery, delay, omission, suspension, inaccuracy, interruption in connection with furnishing of the Exchange's systems, data made available through those systems or DME services; or (3) any unauthorized access to

the Exchange's systems, service or facilities or use of DME Direct; or any person using DME Direct without training or if he or she fails to follow the instructions for use. The same limitations on the liability of DME and NYMEX apply if DME or NYMEX employees, including NCSCC employees, provide services on behalf of NYMEX or DME to members, seat lessees, guaranteed customers, and ATUs. In addition, DME makes no express or implied warranties and does not guarantee continuous, uninterrupted and secure access to DME Direct.

C. Adherence to IOSCO Principles

You represent that, in providing DME Direct to its members, seat lessees and guaranteed customers, DME adheres to the Principles for the Oversight of Screen-Based Trading Systems for Derivative Products developed by the Technical Committee of the International Organization of Securities Commissions (IOSCO) (as adopted by the Commission on November 21, 1990).[36] You represent that DFSA is aware of DME's commitment to the IOSCO principles.

IV. CLEARING AND SETTLEMENT PROCESSES

All contracts executed on DME Direct are submitted for clearing to NYMEX Clearing pursuant to the CSA between NYMEX and DME. As noted earlier, NYMEX is registered with the CFTC as a DCM and as a DCO. In addition, NYMEX is a Recognized Body pursuant to DIFC regulatory law and the Recognition Module of the DFSA Rulebook to operate a Clearing House for a DFSA Authorized Market Institution and to offer electronic access to its exchange products within the DIFC.[37] The CSA specifies clearing and settlement services and service levels and includes escalation procedures to enable DME staff to address any issues concerning the services on a timely basis. NYMEX Clearing clears all trades initiated on DME on essentially the same basis as it clears trades executed on NYMEX.

A. Trade Registration

Each contract executed on DME is a contract between the two DME clearing members to whose accounts the matching positions have been allocated and, on acceptance for clearing by NYMEX Clearing, is replaced by two contracts with NYMEX Clearing: one between the buying clearing member and NYMEX Clearing as seller, and another between the selling clearing member and NYMEX Clearing as buyer. This structure both substantially reduces counterparty credit risk and entirely eliminates the need for traders to make individual credit determinations with respect to potential counterparties before entering into a trade.

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[36] The Commission adopted the IOSCO Principles as a statement of regulatory policy for the oversight of screen-based trading systems for derivative products. Policy Statement Concerning the Oversight of Screen-Based Trading Systems, 55 Fed. Reg. 48670 (Nov. 21, 1990).

[37] NYMEX Clearing is under the jurisdiction of the NYMEX Board of Directors, which is advised by the Clearing House Committee. The Clearing House Committee is co-chaired by two members of the NYMEX Board of Directors and is comprised of twenty five clearing member firm representatives. The Clearing House Committee meets at least monthly, and periodically evaluates the adequacy of the NYMEX Clearing's financial resources. NYMEX Clearing provides clearing services to both the NYMEX and COMEX trading divisions of NYMEX and to DME.

NYMEX Clearing does not have any direct contractual relationship with DME members other than those with which it already has a contractual relationship as NYMEX clearing members. Under the terms of a clearing member qualification, a clearing member must accept financial responsibility for all trades executed as a result of orders entered through the use of the DME Direct password protected system for which it is responsible. Accordingly, NYMEX Clearing is not liable for any obligations of a DME member who is not also a clearing member of NYMEX, or for any obligation of a clearing member to a DME member or customer, or for any obligation of a clearing member to another clearing member for whom the former is acting as broker. Furthermore, NYMEX Clearing is not be liable to customers of DME members to make or take deliveries or otherwise.

B. Clearing Process

NYMEX Clearing conducts clearing through its C21® system, developed jointly with the Chicago Mercantile Exchange (CME) and introduced in 1999. This system is highly flexible and is expected to support any anticipated growth in volume or business expansion over the next five to ten years. The C21® system was upgraded in autumn 2001 to permit clearing member access via the internet, as well as to accommodate an enhanced product base, including the clearing of OTC contracts. It enables NYMEX to perform functions relating to banking, settlement, asset management, delivery management, position management and margins. C21® was upgraded at the beginning of 2006 and improved its functionality by moving into a Windows environment, making it more efficient and flexible. C21® covers contracts executed at all NYMEX trading venues, including the New York trade floor and electronic trading platforms, including DME Direct.

C. Settlement Prices

Daily settlement prices for contracts traded on DME are determined by the DME pursuant to procedures set forth in its Rules that closely parallel NYMEX's price settlement procedures, including the use of an average weighted price for contracts meeting certain liquidity thresholds.[38] Under DME Rules, the Exchange must notify NYMEX Clearing of the daily settlement price determined by the Exchange and NYMEX Clearing uses the settlement price in the calculation of original and variation margin, unless NYMEX Clearing reasonably believes that it is clearly erroneous, in which case it notifies the Exchange with a view to agreeing on an appropriate daily settlement price or, in the absence of such agreement, it notifies the Exchange of the settlement price it will use.

D. Margin and Banking Arrangements

NYMEX Clearing collects both original margin and variation margin with respect to clearing members on a daily basis. Original margin is collected at least once daily, at noon New York time, based on open positions as of 10:00 AM New York time. Variation margin is

[38] In practice, NYMEX determines the daily settlement prices on DME's behalf.

collected at least twice daily: at 10:00 AM New York time based on open positions as of 7:00 PM New York time the previous day and the previous day's settlement price and intra-day based on market prices as of 11:00 AM New York time. The original margin requirement is a function of a clearing member's open positions and the margin rate. The margin rate is set by NYMEX Clearing using Standard Portfolio Analysis of Risk (SPAN), developed by the CME and used by commodity clearing houses worldwide. Variation margin is calculated as being the difference between the trade price and the settlement or market price used for the particular variation margin call. In accordance with the standards set out in the CSA, the Financial Surveillance & Risk Management Division of the NYMEX Compliance Department conducts, on a daily basis, a detailed review of each clearing member's variation margin, earmarking stress thresholds and making inquiries if needed. NYMEX Clearing Rules allow clearing members to post original margin using cash, various securities (subject to a haircut) and certain money market mutual funds. All variation margin must be posted in cash.

NYMEX Clearing acts as a fiscal transfer agent, transferring money from the customer or proprietary settlement accounts of its clearing members who have experienced net losses in either of those account origins to the customer or proprietary settlement accounts of those members who have generated net gains in either account origin. As required by the CFTC, NYMEX Clearing segregates margin deposited by clearing members from their customer accounts from margin received from their house accounts.[39] Pursuant to a Section 4d order issued by the Commission on May 23, 2007, NYMEX holds DME customer positions and NYMEX customer positions in the same customer segregated accounts. NYMEX Clearing verifies, on a daily basis, that the cash it maintains is sufficient to cover its obligations to clearing members in accordance with the CFTC's segregation rules.

E. NYMEX Financial Resources

NYMEX, is AA+ credit rated by Standard & Poor's and, as of June 30, 2006, was holding performance bond (margin) totaling $20.7 billion, of which $15.7 billion was customer segregated funds and $5.0 billion was house funds. NYMEX maintains a Guaranty Fund which, as of July 1, 2006, had a minimum balance of $200 million.[40] In addition, NYMEX maintains a $115 million default insurance policy with AA rated Radiance Asset Assurance, Inc., for losses in excess of $200 million and, if there is a shortfall in the Guaranty Fund, NYMEX has limited powers to assess its clearing members to replenish the fund. The maximum assessment permitted is the lesser of: (1) 40 percent of the clearing members' regulatory capital; or (2) $30 million. The maximum total assessment power as of June 30, 2006 was approximately $1 billion. NYMEX is currently finalizing the terms of a $60 million short-term liquidity facility, the primary purpose of which is to provide immediate funding to meet daily settlement

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[39] NYMEX Clearing requires clearing members to collect margin from their customers at set percentages in excess of the clearing members' requirement.

[40] Each clearing member must contribute to the Guaranty Fund in an amount based on a hybrid formula of clearing member risk and volume, calculated quarterly, with a minimum clearing member contribution of $2 million. Contributions can be made in cash, U.S. government securities, or shares of approved money-market mutual funds.

requirements in the event of a clearing member default. Access to the facility will allow time for an orderly liquidation, if necessary, of the non-cash assets maintained in the Guaranty Fund.

Currently there are 40 clearing member firms which guarantee the performance to NYMEX Clearing of non-clearing members and customers. All NYMEX clearing members must own a minimum of two NYMEX memberships, must hold and maintain the related shares of common stock in NYMEX Holdings, and must have a minimum of $5 million in working capital (or adjusted net capital in the case of FCMs). The aggregate regulatory capital of the clearing members, which represents a potential financial resource to support NYMEX's clearing operations, was $110.6 billion as of May 31, 2006.[41]

In addition, NYMEX imposes capital-based position limits on each clearing member. The position limits are based upon the "modified capital" of a clearing member, which may be higher or lower than regulatory capital. A clearing member with a parent guaranty or letter of credit can have a modified capital level that is higher than regulatory capital, subject to a cap of $1 billion, which may be waived in circumstances where the clearing member is a subsidiary of a highly capitalized and highly rated financial institution. These capital-based position limits are applied as follows: "position risk" (*i.e.*, the SPAN performance bond requirement for the net positions carried by the clearing member) is limited to 200 percent of a firm's modified capital for the customer account; 100 percent for the house account; and 250 percent on a combined basis. If a clearing member exceeds these limits, it must deposit "super margin" on the excess, provided that a clearing member may not exceed 300 percent of modified capital for the customer account, 150 percent for the house account and 350 percent on a combined basis.

F. Default Arrangement

The Exchange's arrangements for dealing with a defaulting member are based on the DFSA Default Rules requirements and complement the NYMEX Clearing arrangements. Under the Default Rules, designed to protect the actions taken by market authorities to deal with the consequences of the default or insolvency of one or more market participants, an AMI must have rules that allow it to close-out open positions by discharging the appropriate rights and liabilities of transactions which a person granted access to its facilities cannot, or may not, be able to fulfill. Market authorities are not required to wait for formal insolvency proceedings to commence before making a declaration that a member is in default, so long as they believe, in good faith, that the member will be unable to meet future obligations under market contracts. All actions taken by AMIs in good faith under their respective default rules are protected and not open to challenge by liquidators or other insolvency officials.

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[41] Clearing members are required to submit regulatory capital calculations and financial statements to NYMEX on a regular and timely basis. FCMs electronically file financial statements, including a balance sheet, income statement, change in ownership and segregated funds report, on a monthly basis. Non-FCM clearing members file similar information quarterly. NYMEX conducts a formal analysis of all filings. In addition, NYMEX conducts an audit, at least annually, of all clearing members for which it acts as the designated self-regulatory organization. If a clearing member's financial condition weakens, or it takes on excess risk, NYMEX may require additional margin to be posted and/or restrict the member's trading.

The NYMEX default rules, rather than DME default rules, apply to contracts to which NYMEX Clearing is a party. If, therefore, a clearing member were to default, NYMEX Clearing default rules would apply to the registered contracts, while DME Rules would apply to the back-to-back contracts between the defaulting clearing member on the one hand and clients and/or non-clearing members for which the defaulting clearing member clears on the other hand. If a non-clearing member were to default, only DME Rules would apply as NYMEX would have no contractual nexus with such defaulting member.

Pursuant to NYMEX's Rules, in the event of a clearing member default, the President of NYMEX, with the approval of NYMEX's Board of Directors, may close out all or any part of the clearing member's positions in the best interest of NYMEX and the defaulting clearing member. In addition, NYMEX Clearing may apply against the defaulting clearing member's obligations the clearing member's: (1) margin on deposit, (2) deposit in the NYMEX Guaranty Fund, and (3) any other assets of the defaulter under the control of NYMEX. NYMEX Clearing may apply these assets based on the type of default by the clearing member, as follows: (1) for defaults in the customer segregated account, NYMEX Clearing may use all assets of the defaulting clearing member; and (2) for defaults in the clearing member's house account and or customer non-regulated accounts, NYMEX Clearing may use that portion of the assets held in the defaulter's house and/or customer non-regulated accounts. If these assets are not sufficient, NYMEX Clearing Rules provide that NYMEX will utilize other substantial financial resources (discussed above), such as its Guaranty Fund and default insurance, to meet the obligations of the defaulting clearing member. In addition, NYMEX may obtain funds from any guarantee provided by a parent company of the defaulting clearing member (if applicable) and from a sale of the defaulted clearing member's equity in NYMEX.

V. OVERVIEW OF THE REGULATORY STRUCTURE IN THE DIFC

A. Introduction

The DIFC was created and vested under UAE federal law with the authority to create a legal and regulatory framework for all civil and commercial matters conducted within the DIFC. Responsibility for Financial Services[42] legislation and broad policy lies with the DIFC President,[43] with the assistance of the DFSA. As prescribed by RL 2004, the DFSA regulates all financial and ancillary activities undertaken in or from the DIFC. Under this mandate, the responsibility for authorizing persons to conduct investment business, and the regulation of those persons, rests with the DFSA.

The DFSA fulfills its regulatory responsibilities within the framework established by the RL 2004 and DIFC regulations and orders. In addition, DFSA has promulgated a Rulebook

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[42] The term "Financial Services" is defined by the DFSA and refers to specified activities carried on in relation to categories of investments as set out in the DFSA Rules. Financial services include dealing in, arranging deals in, advising on and certain other kinds of business in various types of securities, derivatives and other investment products.

[43] The President of the DIFC is His Highness Sheikh Mohammed Bin Rashid Al Maktoum, Ruler of Dubai.

governing activities in the DIFC. The Rulebook is composed of modules covering several subject areas, with each specifying its scope and to whom it applies. The modules include the General Module (GEN), Conduct of Business Module (COB), Authorization Module (AUT) and Enforcement Module (ENF). Although DFSA regulates all financial activities within the DIFC, some of the modules rules only apply to entities physically present in the DIFC (Authorized Firms), while others apply to all entities that undertake financial activities in the DIFC. For instance, the GEN Rules dealing with general provisions, financial services and information sharing requirements with the DFSA apply to Authorized and Recognized members and provide for the jurisdiction of the DFSA as defined by the financial services it regulates. Similarly, the ENF rules also apply to Recognized members to enable the DFSA to enforce its oversight over such members. Recognized members, however, are not subject to the COB because, as previously noted, Recognized members are located outside the DIFC and are expected to comply with the applicable conduct of business rules of their home jurisdiction regulator.

B. Investor Protection

In addition to RL 2004, the ML 2004 contains statutory investor protection measures that prohibit any person in the DIFC, any person outside the DIFC whose conduct affects the DIFC markets, or users of the DIFC markets, from: (1) engaging in fraud and market manipulation; (2) making misleading or untrue statements; (3) engaging in misleading or deceptive conduct; (4) making misleading or deceptive statements; (5) making statements about future matters; (6) inducing persons to deal in investments by, among other things, making false statements or concealing material facts; (7) engaging in insider dealing;[44] and (8) providing inside information.

The DFSA is required to enforce these investor protection measures and has incorporated these provisions within its Rulebook. Some of the DFSA Rules relating to investor protection are included in the COB and are only applicable to Authorized firms. However, the DFSA has broader enforcement powers under the ENF, which is applicable to both Recognized and Authorized firms and, therefore, the DFSA can act if it suspects any possible violations of ML 2004. In addition, DME Rules mandate that, whether or not a member is an Authorized firm, each member shall observe high standards of integrity, fair dealing and market conduct as reflected in the DFSA Rulebook and any guidance published by the DFSA.

The DFSA does not have the authority to intervene in the DME market and direct the actions of DME market participants, but it does have the power to direct the DME to intervene.[45]

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[44] While not termed insider trading ("insider dealing" in DIFC law and "undeclared information which might affect price" in UAE Federal law), this conduct is prohibited in both the DIFC and on other UAE exchanges. However, in broad terms, the prohibition only relates to securities and not commodities investments, and as such trading in DME products is excluded from the DFSA and UAE insider dealing rules.

[45] Article 9 of ML 2004 Law provides as follows: (1) Without limiting the application of the Regulatory Law, the DFSA may by written notice direct an AMI to do or not do specified things that the DFSA considers are necessary or desirable to comply with the Law or ensure the integrity of the financial services industry in the DIFC, including but not limited to directions: (a) requiring compliance with any duty, requirement, prohibition, obligation or responsibility applicable to an AMI; or (b) requiring an AMI to act in a specified manner in relation to transactions conducted on or through the facilities operated by an AMI, or in relation to a specified class of transactions.

The DFSA monitors market activity to ensure compliance with the market conduct standards set out in ML 2004 and, if it identifies any potential market misconduct, it may direct the DME, as an AMI under the DFSA's jurisdiction, to take appropriate measures.

C. Conduct of Business

Under the RL 2004, the DFSA must establish conduct of business and other rules and monitor compliance with those rules. Accordingly, the DFSA has adopted detailed rules applicable to Authorized firms, including rules relating to: (1) the handling and recording of customer complaints; (2) the responsibility of a firm for its employees and agents; (3) solicitation, advertising and publishing, including detailed restrictions on cold-calling; (4) risk and product information disclosure; (5) contents of customer agreements, including provisions for discretionary accounts; (6) "know your customer" and suitability of investment products of customers; (7) disclosure of material interests; and (8) disclosure of charges and other remuneration. The DFSA has also established Principles for Business (Principles)[46] which articulate standards for Authorized firms in areas such as integrity, skill, care and diligence, management, systems and controls, resources, market conduct, information and interests, conflicts of interest, suitability, customer assets and money and relationship with regulators.

D. Treatment of Customer Funds and Property

All Authorized firms (including all Authorized members) who receive or hold money from or on behalf of clients in the course of providing financial services are required to comply with the DFSA's Client Money Rules set forth in the COB. This requires client money to be protected in the event of the insolvency of the Authorized firm.[47] Authorized firms must comply with the Client Money Rules if they hold and control money for: (1) a client who is an individual (other than an individual who has opted out of Client Money Rules by written consent); (2) any client in connection with discretionary investment management services; and (3) any other client to whom the Authorized firm has agreed to provide the protections conferred under DFSA Client Money Rules. Such clients are referred to as segregated clients.

COB Rules require Authorized firms to keep client money in a separate client account and not to mix the client money of segregated clients with the Authorized firm's monies.[48] Detailed requirements relating to client money include the requirement to reconcile client accounts at least once every 25 days.[49] An Authorized firm must: (1) reconcile the individual

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[46] *See* note 51.

[47] Client money is defined as money which, in the course of carrying on investment business, a firm holds in respect of any investment agreement entered into, or to be entered into, with or for a client, or which a firm treats as client money in accordance with the Client Money Rules (*e.g.*, money not immediately due and payable to the firm for its own account).

[48] A client account is defined as an account which: (1) is held with a third party agent; (2) is established to hold client assets; (3) is maintained in the name of; (i) if a domestic firm, the Authorized firm; or (ii) if a non-domestic firm, a nominee company controlled by the authorized firm; and (4) includes the words "Client Account" in its title.

[49] The reconciliation must include: (1) a full list of individual segregated client credit ledger balances, as recorded by the Authorized firm; (2) a full list of individual segregated client debit ledger balances, as recorded by the Authorized firm; (3) a full list of unpresented checks and outstanding deposit; (4) a full list of client account cash

credit ledger balances, client account cash book balances, and the third party agent client account balances; (2) check that the balance in the client accounts as at the close of business on the previous day was at least equal to the aggregate balance of individual credit ledger balances as at the close of business on the previous day; and (3) ensure that all shortfalls, excess balances and unresolved differences, other than differences arising solely as a result of timing differences between the accounting systems of the third party agent and the Authorized firm, are investigated and, where applicable, corrective action taken as soon as possible.[50]

The treatment of non-cash collateral in the event of the insolvency of the Authorized firm depends on the terms on which it has been deposited with that firm (and on the terms that the Authorized firm has deposited it with others, such as a custodian or clearing house). COB Rules impose detailed custody requirements of customers' investments, to include giving the member the responsibility for safekeeping documents of title and certificates and requiring the registration of investments in the customer's name or in another appropriate manner to safeguard client investments. A number of disclosures must also be made to the customer in certain circumstances so that the customer understands the custody arrangements. These include: (1) the basis of any terms governing the manner in which the collateral will be held, including any rights which the firm may have to dispose of the collateral; (2) if applicable, that the collateral will not be registered in that client's own name (from which it follows that there is no requirement that the collateral will be so registered); (3) if applicable, that the firm proposes to return to the client collateral other than the original collateral or original type of collateral; and (4) in the event of insolvency, any excess collateral will be sold and the resulting funds will be distributed in accordance with the DFSA Client Money Distributions Rules.

E. Market Integrity

COB Rules prohibit Authorized members from trading accounts that are the subject of investment research until customers have had an opportunity to act upon such research. COB Rules also prohibit Authorized members from churning contracts. They also require strict recordkeeping of each transaction so that a full audit trail is established. In addition, ML 2004 makes it an offense to make a misleading or untrue statement, or to refrain from disclosing a fact that is necessary to make the statement not misleading, which significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of investments.

The power to initiate prosecutions for these offenses lies with the DFSA, which also has the power to obtain injunctions to prevent violations of RL 2004 provisions. The maximum fines for these offenses are potentially unlimited. ML 2004 provides for various market abuse offenses and allows the DFSA to impose unlimited fines on any regulated or unregulated firm or other person for certain types of behavior occurring with respect to various investments,

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book balances; and (5) formal statements from third party agents showing account balances as at the date of reconciliation.

[50] An Authorized firm must perform the reconciliations within 10 days of the date to which the reconciliation relates. A member firm may agree with any client to opt out of the client money rules as long as there is written consent from that client.

including: (1) fraud or market manipulation, (2) misleading or deceptive conduct, and (3) inducing a person to deal under false statements or promises or forecasts.

F. Other Customer Protections and Standards of Conduct

In addition to the COB Rules, the DFSA has set out a number Principles that must be followed by Authorized firms.[51] Firms must also comply with DFSA Rules of general application, such as those contained in the GEN and Anti-Money Laundering Module (AML). The COB and AML Rules include: (1) a requirement to identify your customer; (2) a best execution requirement; (3) a prohibition on churning; (4) rules on disclosure of material interests; (5) rules regulating customer order priority; (6) rules on aggregation and allocations; (7) rules designed to ensure suitability; (8) a requirement to maintain compliance procedures; and (9) rules requiring that confirmation of transactions and periodic statements be provided to customers.[52]

The DFSA Rules comport with and complement UAE federal laws, in particular Federal Law No. 4 of 2002, which criminalizes money laundering in the UAE,[53] and Federal Law No. 1 of 2004 regarding anti-terrorism within the UAE. DFSA Rules specifically require firms to establish and verify the identity of any customer with or for whom the firm acts or proposes to act. In establishing and verifying a customer's true identity, a firm must obtain sufficient and satisfactory evidence on a risk-based approach. The membership section of the DME Rulebook sets out specific requirements for members to comply with to ensure compliance with the DFSA

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[51] These Principles are articulated as follows: Principle 1 — Integrity: An Authorized firm must observe high standards of integrity and fair dealing; Principle 2 — Due skill, care and diligence: In conducting its business activities an Authorized firm must act with due skill, care and diligence; Principle 3 — Management, systems and controls: An Authorized firm must ensure that its affairs are managed effectively and responsibly by its senior management. An Authorized firm must have adequate systems and controls to ensure, as far as is reasonably practical, that it complies with legislation applicable in the DIFC; Principle 4 — Resources: An Authorized firm must maintain and be able to demonstrate the existence of adequate resources to conduct and manage its affairs. These include adequate financial and system resources as well as adequate and competent human resources; Principle 5 — Market conduct: An Authorized firm must observe proper standards of conduct in financial markets; Principle 6 — Information and interests: An Authorized firm must pay due regard to the interests of its customers and communicate information to them in a way which is clear, fair and not misleading; Principle 7 — Conflicts of interest: An Authorized firm must take all reasonable steps to ensure that conflicts of interest between itself and its customers and between one customer and another are identified and then prevented or managed in such a way that the interests of a customer are not adversely affected; Principle 8 — Suitability: An Authorized firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for customers who are entitled to rely upon its judgement; Principle 9 — Customer assets and money: Where an Authorized firm has control of or is otherwise responsible for assets or money belonging to a customer which it is required to safeguard, it must arrange proper protection for them in accordance with the responsibility it has accepted; Principle 10 — Relations with regulators: An Authorized firm must deal with regulators in an open and co-operative manner and keep the DFSA promptly informed of significant events or anything else relating to the Authorized firm of which the DFSA would reasonably expect to be notified.

[52] Authorized firms are also required to take reasonable steps to ensure that communication of information and marketing material is clear, fair and not misleading. The contents of documentation provided by an Authorized firm to a customer are also regulated under COB Rules.

[53] Article 3(1) of Federal Law No. 8 of 2004 explicitly provides that UAE Law No. 4 of 2002 applies to all activities within the DIFC.

Rules, UAE Law and DME internal requirements relating to customer identity. Records of verification evidence must be maintained by the member, as required, for at least 6 years after termination of the relevant membership.

G. Regulation of DME as an AMI

DME is an AMI under the DFSA pursuant to RL 2004. RL 2004 established a principle-based framework for the licensing and supervision of AMIs and for taking regulatory action against those institutions. This framework is supplemented by supervisory powers and other requirements relating to AMIs specified in ML 2004. Based on RL 2004 and ML 2004, DFSA promulgated the AMI Module of the DFSA Rulebook regulating the activities of the AMIs.

To be licensed as an AMI, and to maintain that status, an exchange must satisfy the DFSA, on an ongoing basis, that it meets the requirements set out in the DFSA's AMI Module. The AMI Module requires an exchange to ensure that business conducted on its facilities is conducted in an orderly manner so as to afford proper protection to market participants. Furthermore, the exchange is required to have in place adequate systems and controls concerning the transmission of information, the assessment and management of risks to the performance of the exchange's functions and the effecting and monitoring of transactions executed on or through the exchange. The exchange is also required to provide, or to make arrangements for a third party to provide, clearing and settlement of exchange transactions.

An exchange is required to monitor compliance with and enforce its rules, which is generally achieved through disciplinary action against members for non-compliance.[54] The exchange is also required to cooperate with other regulatory bodies, by the sharing of information or otherwise, to maintain high standards and prevent abuse. An exchange must ensure that satisfactory arrangements are in place for securing the timely discharge of the rights and liabilities of the parties to transactions conducted on or through its facilities. To that end, DME has chosen to outsource the provision of some of these services to NYMEX, a Recognized Body under the DFSA Rules.

RL 2004 makes AMIs accountable for their actions to the DFSA and gives the DFSA the powers of direction over AMIs. The DFSA exercises this oversight in a number of ways, the central element of which is an ongoing assessment of whether an AMI's rules, procedures and practices are adequate for the protection of investors and the maintenance of an orderly market. To this end, the DME is required by the RL 2004 to report the conduct of and the performance of the Exchange's regulatory functions.[55] The DME is also required, by the AMI Module, to

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[54] Sanctions available to the DME pursuant to its Disciplinary Rules include censure, fines of no more than $1,000,000, and suspension of membership rights and privileges.

[55] As an AMI, DME is required to have effective arrangements for the investigation and resolution of complaints in connection with the performance, or failure to perform, any of its regulatory functions. Accordingly, DME Rules require the Exchange to investigate and resolve such complaints. Among other things, the Rules require objective consideration of the complaint, a timely response thereto, a fair and impartial investigation and preparation of a report.

consult with and gain prior approval from the DFSA for any amendment to its business rules.[56] DME is also required to consult with the DFSA regarding the introduction of new products and trading mechanisms.

The DFSA carries out risk assessments of the DME on at least an annual basis. This assessment helps to identify any regulatory risks that DFSA perceives may exist and to communicate those identified risks to DME. The DFSA expects DME to put into place a plan to ensure that the risks are acknowledged and either eliminated or mitigated to the satisfaction of the DME's governing body and the DFSA. The DFSA has produced formal guidance setting out what it considers the AMI license requirements to mean in practice, including guidance on "proper markets" with respect to on-exchange business.

H. Regulation by DME

1. Introduction

Under the DME's regulatory regime, all members and guaranteed customers, regardless of their presence in DIFC, DFSA status, or home jurisdiction, are governed by DME Rules. The construction of DME Rules or disputes arising thereunder is governed by DIFC law, with the exception of those Rules governing the terms of the contracts to be traded on the Exchange. Rules relating to contract terms are governed by the same law that governs the contract itself.[57] Issues relating to whether a contract exists are determined by DIFC law pursuant to DME Rules. NYMEX Rules, including default rules and margin requirements, which are governed by New York law, apply to NYMEX clearing members and to any default by a clearing member on DME contracts, once they have been accepted by NYMEX for clearing.

Under DME Rules, any claim, dispute, grievance or controversy arising out of DME Rules, or out of or in connection with market contracts,[58] falls under the exclusive jurisdiction of DIFC courts (whether applying English or DIFC law). However, DME has discretion to take proceedings in any competent jurisdiction. In addition, DME Rules create an exception to the above and provide that any federal or state court located in New York, New York shall have exclusive jurisdiction to settle any dispute, claim, grievance or controversy involving NYMEX arising out of, or in connection with DME Rules.

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[56] In urgent cases, the DFSA may, on written application by the AMI, dispense with prior consultation requirements.

[57] Pursuant to DME Rules, English law governs the DME's Oman Sour Crude futures contract, West Texas Intermediate versus Oman Financial Spread futures contract, and Brent versus Oman Financial Spread futures contract. Any obligations associated with delivery of the underlying commodity under the contract are also governed by English law.

[58] A market contract is defined as "a contract in the terms of an Exchange Contract entered into by a Member or Designated Non-Member which is either: (i) a contract made on the Exchange; (ii) a contract made on an exchange to whose undertaking the Exchange has succeeded whether by amalgamation, merger or otherwise; or (iii) a contract in the making which the Member or Designated Non-Member was subject to the Rules."

DME Rules provide for mandatory arbitration for disputes between members if the dispute arises out of transactions executed on the DME or relates to the business of such member on the Exchange. In disputes between members and customers that arise out of transactions subject to DME Rules, arbitration is mandatory upon the election of the customer. The location of any arbitration proceeding under DME Rules will be London, England, and any proceeding will be conducted subject to English law, specifically the Arbitration Act of 1996.

2. Trading on DME

Modeled after NYMEX trading rules, notably NYMEX's trade practice rules relating to trading standards, DME Trading Rules govern trading on the Exchange. DME contracts are competitively traded via DME Direct.[59] Market participants may also negotiate exchange of futures for swaps (EFS) or exchange of futures for physicals (EFP) transactions in designated DME contracts off of the Exchange pursuant to DME Rules and post an EFS or EFP transaction to NYMEX through NYMEX ClearPort Clearing (CPC).

3. Market Integrity and Investor Protection

DME has implemented a monitoring and surveillance program that includes floor surveillance, member monitoring, trade practice surveillance, market surveillance, and financial and risk management. This program covers the activities of members and all other participants who have direct access to DME Direct, including seat lessees, guaranteed customers and ATUs. On a day to day basis, DME's CCO, supported by the Director of Membership Surveillance and the Manager of Market Surveillance, is responsible for ensuring the effectiveness of the monitoring and surveillance programs. The performance of financial surveillance of members is aided by NYMEX and, under the terms of the GSA, NYMEX also assists the DME in performing trade practice surveillance, market surveillance and financial surveillance. DME, however, maintains overall control of the monitoring and surveillance programs.

With respect to floor surveillance, the DME's Member Surveillance Department (MSD) routinely observes traders engaged in electronic trading from hubs and individual trading stations on the Exchange Floor at random times during the trading day and when and if special market conditions exist. Among other things, floor surveillance is used to: (1) determine affiliations between members and users, (2) identify unusual trading patterns for particular members or other users, and (3) monitor members' activities on the floor. DME compliance staff also has the ability to conduct audio surveillance and monitor the telephone conversations of floor members if the need arises.

Under DME Rules, members must afford the DME CCO access to documents, information, premises and personnel. MSD monitors members for compliance with DME Rules by reviewing documents and materials provided by members, visiting member premises and

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[59] DME Rules provide that no ATU shall make any purchase or sale, or enter an order through the trading platform, to affect a trade that has been pre-arranged. DME Rules provide a limited exception for trades effected through pre-execution discussions.

interviewing member personnel. The member monitoring program covers areas such as order handling, audit trails, client documentation of terms of business and customer agreements, business conduct, member's own surveillance programs and back office processes. The MSD reviews member order handling procedures for consistency with DME Rules and such COB requirements as prevention of market misconduct. MSD also reviews member recordkeeping procedures to ensure the audit trail complies with DME Rules requiring an accurate and comprehensive audit trail of member activities in DME products.

The DME CCO is responsible for detection and investigation of potential abuses in trading on DME and for enforcement against such abuses. MSD, DME Market Surveillance Department (MktSD), NYMEX Trading Practice Division (NYMEX TPD) and NYMEX Market Surveillance Division (NYMEX MSD) provide support to the CCO. The MSD conducts electronic trade practice surveillance to protect and detect breaches of DME Rules and applicable law in the DIFC relating to market misconduct and anti-money laundering. NYMEX TPD, with the assistance of NYMEX MSD, conducts computerized trade practice monitoring and surveillance. NYMEX uses its computerized surveillance program, TXN, to detect possible trading violations and to assist in the investigation of trade practice abuses. TXN permits analysts to select default or customized parameters to create reports that focus on particular types of trading violations, members, or suspected patterns of violations. Specifically, TXN is used to detect practices such as trading ahead, pre-arranged trading, "unfair" fill prices, fraudulent trading activity on day trading accounts, and abusive cross trades.

MktSD conducts market surveillance for DME, including monitoring of futures and cash market prices, market news, volume and open interest and data on positions in each DME contract. For price monitoring, analysts monitor market developments, changes in futures and cash prices, and spread relationships in the DME market. MktSD uses third-party data providers such as the Bloomberg News Service, which provides real-time news, cash market prices and the ability to chart historical price relationships for the DME markets. Research concerning market participants is conducted on the Nexis computer database. Analysts also consult with a computerized record of historical Exchange prices, the data sheet, and review trade publications. MktSD also monitors volume and open interest, reviewing the previous day's trading volume and open interest for DME contracts on a daily basis. Volume data for DME contracts is available online and can be sorted by contract and trade date. Open interest data can be obtained from Daily Open Interest Reports generated by NYMEX. Exception reports generated by the NYMEX Large Trade Reporting system enable the analysts to determine what percentage of open interest a reportable trader's position represents. NYMEX's Statistics Department provides historical data on price, volume, and open interest to MktSD analysts, who can also access intra-day volume data through TMS and a daily "snap shot" of positions of any NYMEX clearing member.

NYMEX Clearing rules require clearing members, omnibus accounts and foreign brokers to provide NYMEX and the CFTC with close of business position data for all accounts which exceed reportable levels. These NYMEX Clearing rules apply to DME contracts and, thus, any DME member or other market participant whose positions exceed reportable levels reports to NYMEX required information on a daily basis. NYMEX in turn makes DME large trader

reporting data available to the CFTC for financial surveillance purposes.[60] To enhance detection of breaches of DME Rules, DME consults with NYMEX on a weekly basis to review all large trader exception reports.

DME will receive assistance with respect to financial surveillance and risk management from NYMEX, which has extensive surveillance and compliance operations and procedures to monitor and enforce compliance with the NYMEX Clearing rules and DME Rules pertaining to the trading, position sizes and financial condition of members. NYMEX Clearing has extended its daily, weekly, monthly and periodic surveillance operations to trades entered into on DME pursuant to the GSA. Under the GSA, NYMEX conducts ongoing financial surveillance and risk management and analysis of members to ensure they comply with DME and NYMEX financial rules.

4. Disciplinary Arrangements

DME monitors compliance with its Rules and settlement arrangements through a combination of its own resources and those of NYMEX. DME's Disciplinary Rules provide that enforcement of such compliance is the responsibility of DME's Compliance Department. NYMEX provides further support, particularly in relation to information sharing and investigative assistance. The CCO takes the lead on all investigations and disciplinary matters (other than certain summary action).

DME's Disciplinary Rules are largely the same as those at NYMEX, but they have been adapted to comply with the requirements of the DFSA. Pursuant to its Rules, DME has procedures to deal effectively with complaints about the conduct of its members and guaranteed customers. Such complaints and any potential rule violations uncovered as a result of its surveillance regime are investigated promptly and rigorously by the Compliance Department. The investigative process itself is subject to careful review by the Disciplinary Committee, comprised of a chairman, four committee members (including one person who is not a director, officer or employee of any member or of any affiliate of any member), and an alternate (who must be a person who is not a director, officer or employee of any member or of any affiliate of any member). If the Compliance Department and Disciplinary Committee are satisfied that there is a reasonable basis to conclude that a rule violation has occurred, disciplinary action is taken. Potential rule violations may also be referred to other regulatory authorities for action as appropriate.

The Disciplinary Rules provide for a respondent's case to be heard and decided fairly and impartially, within a reasonable time, and for a respondent to be penalized appropriately if found to have breached a Rule. Possible sanctions include censure, fines of not more than one million dollars, orders of restitution and suspension of, or expulsion from, membership or access to DME's facilities (or some combination of these sanctions), and reflect the seriousness of the

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[60] In connection with large position monitoring, NYMEX retains the data in a data bank known as the Large Trader Reporting system which generates various reports that both DME and NYMEX use, including the Customer Position Ranking Report and the Futures Open Exception Report.

offense.[61] In all disciplinary cases, DME's decision may be appealed to an independent and impartial Appeal Committee composed of three members. The chairman and alternate must be lawyers by profession, with at least ten years practice, who have relevant experience and who are not a director, officer or employee of any member or any affiliate of any member. The procedures for hearing such appeals are designed to ensure that an appellant's case is dealt with promptly and fairly.

VI. INFORMATION-SHARING

The DFSA mandates that an AMI must be able and willing to co-operate with the DFSA or other appropriate regulatory authorities with regard to regulatory matters when required. In obtaining Authorization from the DFSA, DME has satisfied the DFSA of its ability and willingness to do so. DFSA guidance states that in assessing this cooperation, the DFSA may have regard to the extent to which the constitution and rules of the AMI enable it to obtain information from members and to disclose otherwise confidential information to the DFSA and other appropriate bodies and whether the AMI participates in appropriate international forums. You represent that DME has taken steps to enter into agreements to fulfill this information sharing obligation and has various Rules to facilitate such cooperation.[62]

As set forth more fully below, pursuant to the terms and conditions of the no-action relief provided herein, the Division will be entitled to receive certain specified information regarding DME, DME Direct and DME's market participants directly from DME. Additional information relevant to DME and DME's market participants will be available to the Commission and its staff under the terms of certain information-sharing arrangements to which both the CFTC and the DFSA are parties. The arrangements include, without limitation, the *IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMOU)* dated October 16, 2003, the *Protocol Concerning Mutual Assistance, Information Sharing and Cooperation* signed by the CFTC and DFSA on December 1, 2005, and the *Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations*, as amended March 1998 (commonly known as the Boca Declaration). By letter dated February 13, 2007, the DFSA confirmed that the information-sharing arrangements would extend to information requested by the Commission in connection with the activities conducted pursuant to any no-action relief granted by the Commission, or any Division

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[61] DME also has the power to suspend members and to terminate access to its facilities on the occurrence of specified default events.

[62] You represent that DME is currently seeking to sign the companion memorandum of understanding to the Boca Declaration, the Exchange *International Information Sharing Memorandum of Understanding and Agreement*, which provides for the sharing of information between market authorities upon the occurrence of certain triggering events, and that NYMEX, on behalf of DME, has initiated steps with the Inter Market Surveillance Group (ISG) for the DME to become a member of the ISG. Pursuant to the GSA, NYMEX has agreed to share all information relevant to DME trades with DME. DME may pass on any information it deems appropriate to the regulatory authorities for the purposes of prevention or detection of financial crime.

thereof, in connection with the placement in the U.S. of electronic facilities providing access to a DFSA-regulated market or products traded through a DFSA-regulated market.[63]

VII. CONCLUSION

Consistent with the Commission's Policy Statement and the June 2 Order, the Division has reviewed and considered DME's No-action request and the information and documentation forwarded to the Division in support thereof. Among other things, the materials furnished by DME indicate that DME and its Authorized members and guaranteed customers present in the DIFC are subject to oversight in the DIFC by a regulatory regime that is based upon regulatory objectives that generally are equivalent to those in the U.S.; that the regulatory regime provides basic protections for customers trading on DME's market and for the integrity of the market itself; that DME and its regulatory authority employ surveillance, compliance and enforcement mechanisms designed to ensure compliance with statutes and DME's and DFSA's rules and regulations; that DME adheres to the IOSCO Principles; and that adequate information-sharing arrangements applicable to the activities of DME are in place. The materials furnished by DME also indicate that its Recognized members are subject to oversight by a regulatory regime that is based upon regulatory objectives that generally are equivalent to those in the U.S. and that all members and guaranteed customers must comply with DME Rules and applicable DFSA Rules.[64]

Based specifically upon these and other representations made by DME in support of its No-action request, the Division has determined that granting no-action relief to DME and its members and guaranteed customers would not be contrary to the public interest. Accordingly, subject to compliance with the terms and conditions stated herein, the Division will not recommend that the Commission institute enforcement action against DME or its members or guaranteed customers if DME does not seek designation as a DCM or registration as a DTEF pursuant to Sections 5 and 5a, respectively, of the Act or comply with any other section of the Act or Commission regulations relating specifically to DCMs or DTEFs if: (1) DME members and guaranteed customers in the U.S. trade for their own accounts through direct access to DME Direct; (2) DME members and guaranteed customers who are registered with the CFTC as FCMs or who are Rule 30.10 Firms submit orders from or on behalf of U.S. customers for transmission through direct access to DME Direct; (3) DME members and guaranteed customers who are registered with the CFTC as CPOs or CTAs, or who are exempt from such CPO or CTA registration pursuant to Commission Regulation 4.13 or 4.14, submit orders on behalf of U.S. pools they operate or U.S. customer accounts for which they have discretionary authority, respectively, for transmission through direct access to DME Direct, provided that an FCM or Rule 30.10 Firm acts as clearing firm with respect to all activity conducted by such CPOs and

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[63] Letter from David Knott, Chief Executive, DFSA, to Reuben Jeffery III, Chairman, Commodity Futures Trading Commission (February 13, 2007).

[64] The Division notes that the foregoing is not intended to be an exhaustive list of the factors relevant to its decision to grant the no-action relief requested by DME nor of the factors that the Division might consider when analyzing no-action requests from other exchanges. No-action requests, by their nature, require case-by-case evaluation and the Division's conclusion regarding any particular no-action request will be based upon the facts and circumstances presented at the time of its review of that request.

CTAs through the submission of orders on DME Direct; and/or (4) DME members and guaranteed customers who are registered with the CFTC as FCMs or who are Rule 30.10 Firms accept orders for U.S. customers transmitted via AORS for submission to DME Direct.

The Division's no-action position shall become effective immediately with respect to the following DME contracts:

- Oman Sour Crude futures,
- West Texas Intermediate (WTI) - Oman Financial Spread futures, and
- Brent - Oman Financial Spread futures.

If additional futures and option contracts become available for trading through DME Direct, DME may make such futures and option contracts available for trading by direct access from the U.S. in accordance with the provisions of the Commission's Notice of Revision of Commission Policy Regarding the Listing of New Futures and Option Contracts by Foreign Boards of Trade that have Received Staff No-Action Relief to Provide Direct Access to their Automated Trading Systems from Locations in the United States.[65]

The scope of the Division's no-action position is restricted to providing relief from the requirement that DME obtain DCM designation or DTEF registration pursuant to Sections 5 and 5a, respectively, of the Act and regulatory requirements that flow specifically from the DCM designation and DTEF registration requirements if the above-referenced contracts are made available in the U.S. for trading through DME Direct in the manner set forth herein. The Division's no-action position does not extend to any other provision of the Act, any other Commission regulations or orders, or to any registered futures association rules and does not excuse DME or its members from compliance with any applicable requirements thereunder. Nor does the no-action position alter, restrict, or expand the coverage of existing Commission exemptions for particular products.

The Division specifically notes that its no-action position does not alter the general requirement that a firm operating pursuant to the no-action relief provided herein must be appropriately registered or exempt from such registration to engage in the offer or sale of a foreign futures contract or a foreign option transaction for or on behalf of a U.S. customer. For example, nothing in this letter is intended to alter current Commission rules that require that any foreign firm that clears trades on a fully-disclosed basis on behalf of U.S. persons (including where the U.S. person is a non-clearing member of a foreign board of trade trading solely for its own account) be a registered FCM or a Rule 30.10 Firm.[66] However, if a foreign firm solely

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[65] 71 Fed. Reg. 19877 (April 18, 2006); corrected at 71 Fed. Reg. 21003 (April 24, 2006). The Notice of Revision does not apply to broad-based stock index futures and option contracts that are covered by Section 2(a)(1)(C) of the Act. Foreign boards of trade are required to seek and receive written supplemental no-action relief from Commission staff prior to offering or selling such contracts through U.S.-located trading systems.

[66] At this time, the Commission has not issued a Rule 30.10 order to DME permitting its members to conduct brokerage activities on behalf of U.S. persons without having to register as an FCM. However, DME members otherwise may qualify as a Rule 30.10 firm pursuant to other orders issued by the Commission pursuant to Rule 30.10. *See, e.g.*, 67 Fed. Reg. 30785 (May 8, 2002) (permitting firms authorized by Eurex Deutschland to solicit

carries accounts on behalf of U.S. customers that are the foreign firm's or any registered FCM's proprietary accounts (as defined in Rule 1.3(y)) or the foreign firm is either a member of the relevant foreign board of trade or is a foreign affiliate of a registered FCM and its sole contact with a U.S. customer is that it carries the FCM's omnibus account, then the firm need not register under Rule 30.4 nor confirm relief under Rule 30.10.

Moreover, the Division's no-action position does not amend, revise, or negate the obligations of CPOs, CTAs, FCMs and Rule 30.10 Firms under the Act, Commission regulations, or Rule 30.10 orders. For example, Rule 30.10 Firms continue to be prohibited from maintaining a presence in the U.S. Thus, Rule 30.10 Firms cannot provide direct access to DME Direct in the U.S. (although they would be permitted to accept orders overseas from customers located in the U.S. that submit such orders by telephone or through an AORS located in the U.S.). FCMs or Rule 30.10 Firms who solicit or accept orders from U.S. customers for trading on DME Direct remain responsible for, among other things, complying with risk disclosure, the handling and allocating of customer orders, and the segregation of customer funds.

The Division's no-action position does not affect the Commission's ability to bring appropriate action for fraud or manipulation. The Division specifically notes that the use of AORSs to transmit orders to DME Direct shall be subject to all existing Commission rules and regulations and to any future rules or guidance issued by the Commission or the Division. Finally, this letter does not address issues that might arise under the Securities Act of 1933, the Securities Exchange Act of 1934, or any other applicable federal securities law or rule promulgated thereunder.

The Division's no-action position is subject to compliance with the following conditions:

1. DME will, at all times, continue to satisfy the criteria for designation as an AMI under the applicable laws of the DIFC with respect to the transactions effected through DME Direct.

2. The DIFC laws, systems, rules, and compliance mechanisms applicable to DME will continue to require DME to maintain fair and orderly markets; prohibit fraud, abuse, and market manipulation; and provide that such requirements are subject to the oversight of the DFSA.

3. DME will continue to adhere to the IOSCO Principles for the Oversight of Screen-Based Trading Systems for Derivatives Products, as updated, revised, or otherwise amended to the extent consistent with U.S. and DIFC law.

4. Members and guaranteed customers will only have direct access (*i.e.*, not through an AORS) to DME Direct from the U.S. if a clearing member guarantees and assumes all financial responsibility for all activity conducted through the members' or guaranteed customers' direct access connection to DME Direct. DME will not provide, and will take reasonable steps to prevent third parties from providing, such access to DME Direct to persons other than DME

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and accept orders from U.S. persons for otherwise permitted transactions on all non-U.S. exchanges where such members are authorized to conduct business on behalf of customers pursuant to German law).

members and guaranteed customers that are guaranteed by a clearing member.[67]

5. All orders that are transmitted through DME Direct by a DME member or guaranteed customer that is operating pursuant to the no-action relief provided herein will be solely for the member's or guaranteed customer's own account unless (i) such member or guaranteed customer is registered with the CFTC as an FCM or is a Rule 30.10 Firm, or (ii) such member or guaranteed customer is registered with the CFTC as a CPO or CTA, or is exempt from such registration pursuant to Commission Regulation 4.13 or 4.14, provided that an FCM or Rule 30.10 Firm acts as clearing firm with respect to all activity conducted by such CPO or CTA through the submission of orders on DME Direct.

6. All orders for U.S. customers accepted through an AORS and transmitted by a member or guaranteed customer through DME Direct will be intermediated by a member that is either registered with the Commission as an FCM or is a Rule 30.10 Firm and all U.S. customers must qualify as Clients under DFSA COB Rule 3.2.

7. Prior to operating pursuant to the no-action relief provided herein, DME will require each current and prospective member that is not registered with the Commission as an FCM, a CTA or a CPO to execute and file with DME a written representation, executed by a person with the authority to bind the member, stating that as long as the member operates pursuant to the no-action relief provided herein, the member agrees to and submits to the jurisdiction of the Commission with respect to activities conducted pursuant to the no-action relief. DME will maintain the foregoing representations as long as the relevant member is operating pursuant to the no-action relief and shall make such representation available to the Commission upon the request of a Commission representative.

8. Prior to their operating pursuant to the no-action relief provided herein, DME will require each current and prospective member that is not registered with the CFTC as an FCM, a CTA or a CPO to execute and file with DME a valid and binding appointment of a U.S. agent for service of process in the U.S. pursuant to which the agent is authorized to accept delivery and service of "communications" issued by or on behalf of the Commission.[68] DME will maintain the foregoing appointments as long as the relevant member is operating pursuant to the no-action relief and shall make such appointments available to the Commission upon the request of a Commission representative.

9. Prior to their operating pursuant to the no-action relief provided herein, DME will require each current and prospective member that is not registered with the CFTC as an FCM, a CTA or a CPO to file with DME a written representation, executed by a person with the authority to bind the member, stating that as long as the member operates pursuant to the no-action relief provided

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[67] Members include those persons identified in footnote 3 for the purposes of this no-action letter and the conditions imposed upon the relief provided herein.

[68] For purposes of these conditions, "communications" is defined to include any summons, complaint, order, subpoena, request for information, or notice or any other written or electronic documentation or correspondence issued by or on behalf of the Commission.

herein, the member will provide, upon the request of the Commission, the U.S. Department of Justice and, if appropriate, the National Futures Association (NFA), prompt access to original books and records maintained at their United States offices as well as to the premises where DME Direct is installed or used in the U.S. DME will maintain the foregoing representations as long as the relevant member is operating pursuant to the no-action relief and shall make such representations available to the Commission upon the request of a Commission representative.

10. Prior to operating pursuant to the no-action relief provided herein, DME will file with the Division, and maintain thereafter as long as DME, its members, or DME Direct operates pursuant to the no-action relief, a valid and binding appointment of a U.S. agent for service of process in the U.S., pursuant to which the agent is authorized to accept delivery or service of "communications", as defined above, that are issued by or on behalf of the Commission.

11. DME will maintain the following updated information and submit such information to the Division on at least a quarterly basis, and at any time promptly upon the request of a Commission representative, in the format reflected in the attachment to this letter:

a. For each contract available to be traded through DME Direct, (i) the total trade volume originating from electronic trading devices providing access to DME Direct in the U.S., (ii) the total trade volume for such products traded through DME Direct worldwide, and (iii) the total trade volume for such products traded on DME generally; and

b. A listing of the names, NFA ID numbers (if applicable), and main business addresses in the U.S. of all DME members that have access to DME Direct in the U.S.

12. DME will request that the DFSA provide to the Division not later than July 1st of each year a letter or email confirming that DME retains its authorization in good standing as an AMI under the applicable laws of the DIFC or other exchange licensing methodology used in the UAE.

13. DME will promptly provide the Division with written notice of the following:

a. Any material change in the information provided in its No-action request, including any information contained in the documents submitted in support thereof;[69]

b. Any material change in DME's Rules or the laws, rules, and regulations in the DIFC relevant to futures and options;

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[69] The Division notes that "material" changes in the information provided to it in support of DME's No-action request would include, without limitation, a modification of: DME's membership criteria; the location of DME's management, personnel or operations (particularly changes that may suggest an increased nexus between DME's activities and the U.S.); the basic structure, nature, or operation of DME Direct; or the regulatory or self-regulatory structure applicable to DME members.

c. Any matter known to DME or its representatives that, in DME's judgment, may affect the financial or operational viability of DME, including, but not limited to, any significant system failure or interruption;

d. Any default, insolvency, or bankruptcy of any DME member or guaranteed customer known to DME or its representatives that may have a material, adverse impact upon the condition of DME, the Clearing House, or upon any U.S. customer or firm;

e. Any known violation by DME or any DME member or guaranteed customer of the terms or conditions of the no-action relief provided herein; and

f. Any disciplinary action taken by DME against any DME member or guaranteed customer operating pursuant to the no-action relief provided herein that involves any market manipulation, fraud, deceit, conversion or that results in suspension or expulsion and that involves the use of DME Direct to submit orders to DME and either (1) the DME member or guaranteed customer against whom the disciplinary action is taken is located or based in the U.S. or (2) the disciplinary action results, in whole or in part, from conduct that: (i) involves the use of DME Direct; (ii) involves a U.S. customer or firm or registered FCM; or (iii) might have a material, adverse impact upon any U.S. customer or firm.

14. A clearing member authorizing a guaranteed customer direct access to DME Direct must assist the DME in a timely manner in any investigation into potential violations of DME Rules, the Act, or the terms or conditions set forth in the no-action relief provided herein, including, but not limited to, requiring the guaranteed customer to provide documents and answer questions from the DME and/or to appear in connection with the investigation.

15. A clearing member authorizing a guaranteed customer direct access to DME Direct will suspend or terminate the guaranteed customer's direct access if DME determines that the actions of the guaranteed customer threaten the integrity or liquidity of any contract, violate any DME Rules, the Act, or the terms and conditions set forth in the no-action relief herein, or if the guaranteed customer fails to cooperate in an investigation.

16. Information-sharing arrangements satisfactory to the CFTC will be in effect between the Commission and the DFSA.

17. The Commission will be able to obtain sufficient information regarding DME and its members and guaranteed customers operating pursuant to the no-action relief provided herein. DME will provide directly to the Commission information necessary to evaluate the continued eligibility of DME or its members or guaranteed customers for the relief, to enforce compliance with the terms and conditions of the relief, or to enable the Commission to carry out its duties under the Act and Commission regulations and to provide adequate protection to the public or U.S. DCMs and DTEFs.

18. DME will employ reasonable procedures, to be determined by DME, for monitoring and

enforcing compliance with the terms and conditions of the no-action relief provided herein.

The no-action position taken herein is taken by the Division only and does not necessarily reflect the views of the Commission or any other unit or member of the Commission's staff. It is based upon the information and representations contained in DME's No-action request and the materials submitted in support thereof. Any materially different, changed, or omitted facts or circumstances may render this letter void. The Division specifically notes that it will examine the volume information submitted as a condition to the no-action relief provided herein as well as any changes in the nature or extent of DME's activities in the U.S. to ascertain whether DME's presence in the United States has increased to a level that might warrant reconsideration of the no-action relief. Finally, as with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

If you have any questions regarding this correspondence, please contact Duane C. Andresen, Special Counsel, at dandresen@cftc.gov or by phone at (202) 418-5492.

Very truly yours,

Richard A. Shilts
Director

cc: Gregory C. Prusik, Vice-President Compliance and Registration, NFA
Branch Chief, Audit and Financial Review Unit, Division of Clearing and Intermediary Oversight, Chicago Regional Office

Attachment

Attachment

Quarterly Trading Volume Report for Foreign Boards of Trade Granted No-Action Relief

Product[1]	Volume From All Terminals[2]	Volume From U.S. Terminals[3]	Percentage From U.S. Terminals[4]	Total Volume[5]
Contract 1				
Contract 2				
Contract 3				
Contract 4				
Totals				

[1] List each contract that is eligible to be traded through U.S.-based electronic trading terminals, including those contracts for which there was no trading volume during the reporting period.

[2] Include the total electronic trading volume worldwide for each contract that is eligible to be traded through U.S.-based trading terminals and, in the bottom row, enter the combined total volume worldwide for all such contracts.

[3] Include the total electronic trading volume originating from electronic trading devices in the U.S. for each eligible contract and, in the bottom row, enter the combined total volume originating from the U.S. for all such contracts.

[4] For each contract, and for all contracts combined, divide the numbers in the Volume From U.S. Terminals column by the numbers in the Volume From All Terminals column and enter the percentage from U.S. terminals.

[5] Include the total electronic and non-electronic trading volume worldwide for each contract that is eligible to be traded through U.S.-based trading terminals, including any trading volume that is not generated by trading on the electronic trading system. Numbers should include, as applicable, volume originated by open outcry trading as well as volume generated through Basis Trading Facilities, Block Trading Facilities, Asset Allocation Facilities, Against Actuals Facilities, Guaranteed Cross Facilities, and other such facilities. In the bottom row, enter the combined total volume worldwide for all such contracts.