

exempt from registration because their clients are sophisticated investors. Exempt account managers, however, remain subject to the antifraud provisions of the Commodity Exchange Act and the Commission's regulations. The proposed rule would not apply to associated persons or Introducing Brokers exempt from Commission registration as CTAs pursuant to Rule 4.14(a)(3) and (6).⁶

The current rule allows foreign advisors to be eligible account managers only if they are subject to regulation by a foreign regulator or self-regulatory organization that has been granted an exemption pursuant to Rule 30.10⁷ or have entered into a Memorandum of Understanding or other arrangement with the Commission. As proposed, Rule 1.35(a-1)(5)(i)(D) would allow foreign advisors, who exercise discretionary trading authority over the accounts of non-United States persons, to be eligible account managers.⁸

The Commission, of course, would retain antifraud and antimanipulation authority. The Commission notes that foreign advisers under the proposed rule would be foreign brokers or foreign traders subject to Commission Rule 15.05, which makes the FCMs through which foreign advisers make or cause to be made trades the agents of the foreign advisers for purposes of communications from the Commission.⁹

As noted above, the proposal would expand the categories of entities permitted to bunch orders. The Commission requests comments on whether it is appropriate to permit these entities to be eligible account managers and whether the proposed protections are sufficient.

C. Disclosure

The Commission proposes to amend the disclosure requirement to be an

information availability requirement based upon the fact that the Commission does not generally require registrants to affirmatively disclose the mechanics of the process of trading.¹⁰

Current Rule 1.35(a-1)(5)(iii) specifies certain disclosure requirements that account managers must provide to customers. The proposal would replace these requirements with more general requirements that eligible account managers make certain information available to customers upon request. Account managers would be required to make the following information available to customers: (1) The general nature of the allocation methodology the account manager uses; (2) summary or composite data sufficient for that customer to compare its results with those of other relevant customers and, if applicable, any account in which the account manager has an interest; and (3) whether accounts in which the account manager may have any interest may be included with customer accounts in bunched orders eligible for post-execution allocation. The Commission is proposing to delete the requirement that account managers set forth the standard by which they will judge the fairness of the post-execution allocations as this essential requirement is provided by the description of the nature of the methodology and monitoring the account manager's post execution allocations for bias over time. More importantly, the Commission is proposing to retain the requirement that summary or composite data, sufficient to compare results with the results of other comparable customers, be made available to customers. In addition, the Commission proposes to add a requirement that summary or composite data about accounts in which the account manager has an interest be made available to customers.

The Commission invites comment on whether the proposal to change the disclosure requirement into an information availability requirement is appropriate.

D. Account Certification

Current Rule 1.35(a-1)(5)(iv) requires that account managers make certain certifications to FCMs. Both account managers and FCMs have claimed that this requirement is burdensome, an impediment to the use of current procedures and that it contributes to uncertainty regarding the relative responsibility of FCMs and account managers. Accordingly, the Commission is proposing to delete this requirement.

¹⁰ Registrants must provide such information if requested.

E. Allocation

The proposed rule would retain the essential requirement contained in the existing rule that the allocation must be fair and equitable and that no account or group of accounts may receive consistently favorable or unfavorable treatment. The proposal, however, would make several changes to the provisions governing allocation.

First, as noted above, the Commission is proposing to expand eligibility to all customers who have provided written discretion to an eligible account manager. Thus, the proposal would eliminate existing Rule 1.35(a-1)(5)(v)(A) that requires that allocations only be made among eligible customers. Second, to minimize end-of-trading session congestion, the Commission proposes to amend existing Rule 1.35(a-1)(5)(v) by requiring account managers to provide allocation information to FCMs in a time sufficiently before the end of the trading session during which the order is executed to ensure that clearing records identify the ultimate customer for each trade. Third, the Commission proposes to modify the provision addressing independent review of allocations. The proposed rule would retain the requirement that allocation methodology must be sufficiently objective and specific to permit independent verification of the fairness of the allocation.¹¹ The Commission, however, is deleting the requirement that appropriate allocation of a given trade should be verifiable because that requirement, along with the accompanying recordkeeping requirement in Rule 1.35(a-1)(vi) required an assessment of "appropriateness" on an order-by-order basis. Industry representatives have stated that requiring an assessment of the fairness on an order-by-order basis may not result in the most efficient allocation of trades entered by an account manager.¹² Therefore, and consistent with the recommendation of the Best Practices Study, the proposed rule would require that verification of fairness be judged over time rather than on an order-by-order basis.¹³

The proposal also would clarify the respective responsibilities of account

¹¹ Appendix C of part 1 contains examples of allocation methods. See, 17 CFR Part 1, Appendix C (2002), 62 FR 25470 (May 8, 1997). As noted in Appendix C, "the appropriateness of any particular method for allocating split and partial fills depends on the CTA's overall trading approach. For example, a daily rotation of accounts may satisfy the general standards for CTAs who trade on a daily basis but inappropriate for CTAs who trade less frequently."

¹² It is important to note that the standards for fair allocation of trades may shift over time.

¹³ Best Practices Study at 26.

⁶ 17 CFR 4.14(a)(3) (2002), 17 CFR 4.14(a)(6) (2002).

⁷ 17 CFR 30.10 (2002). Rule 30.10 permits any person to petition for an exemption from the Commission's Part 30 rules, which govern foreign futures and option trading by persons located in the United States. Commission orders issued pursuant to Rule 30.10 permit firms to solicit and accept orders for foreign futures and option contracts from United States customers without registering under the Commodity Exchange Act, based upon substituted compliance with the rules and regulations of the jurisdiction in which the firm is located.

⁸ 48 FR 35248, 35261 (August 3, 1983); see also, CFTC Staff Letter No. 76-2 [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,222 (August 15, 1976) (Commission staff would not recommend enforcement action for failure to register as a CPO where such persons are located outside the U.S. and operating a pool that accepts no United States participants and no funds from United States sources).

⁹ See 17 CFR 15.00(e) and 17 CFR 15.05 (2002).