

**Securities Industry Association**

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April 22, 1998

Jean A. Webb  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

**Re: Rule Proposal Regarding Requests for Exemptive, No-Action and Interpretative Letters**

Dear Ms. Webb:

The OTC Derivative Products Committee (the "Committee") of the Securities Industry Association (the "SIA")<sup>1</sup> is submitting this comment in response to the release published by the Commodity Futures Trading Commission (the "Commission" or "CFTC") on January 22, 1998 (the "Release")<sup>2</sup> regarding the proposed adoption of new Rule 140.99 under the Commodity Exchange Act (the "Act"). Proposed Rule 140.99 would establish procedures for the filing of requests for the issuance of exemptive, no-action and interpretative letters by the Commission's staff.

As described in the Release, Proposed Rule 140.99 is intended (i) to assure that request letters include a focused presentation of the guidance sought, the issues raised thereby and the relevant precedents, (ii) to elicit from the outset the information that the staff will need to evaluate a request and (iii) to minimize staff resources expended in seeking additional information.

The Committee supports the Commission's objectives and welcomes the opportunity to comment on the Commission's proposed rulemaking.

### **Summary**

The staff no-action, interpretative and exemptive relief ("staff relief") processes are extremely important regulatory tools. The Committee agrees with the Commission that it is important for that process to operate in a manner that is resource-efficient. Subject to the comments noted below, the Committee believes that the Commission's proposed framework has the potential to contribute to an efficient use of staff resources. However, the Committee is concerned that

certain ancillary elements of the Commission's rule proposal would, if implemented, have a chilling effect on the use of the staff relief process. Certain of these elements of the proposal would also likely undermine the very goals of enhanced efficiency sought to be achieved by the Commission.

The Committee is particularly concerned that the Commission's proposed limitations on withdrawal of requests for staff relief would inappropriately and unnecessarily restrict market conduct that would otherwise be permissible under the CEA. The Committee is also concerned that Proposed Rule 140.99 would impose unnecessary internal procedural constraints on Commission staff, such as the prohibition against the submission of draft requests, that have the potential to increase inefficient expenditure of staff and petitioner resources. Finally, the Committee is concerned that the establishment of a continuing affirmative obligation to notify the Commission of changed facts would create an unnecessary and burdensome obligation.

Each of these could have a chilling effect on use of the staff relief process to the detriment of the Commission and market participants and, in the Committee's view, would not further the public interest.

### **Benefits of the Staff Relief Process**

By facilitating the informal exchange of information between the Commission and market participants, the staff relief process has become a vital component of the regulatory process. In relation to more formal regulatory processes, the staff relief process offers several important benefits both to regulators and to market participants.

The staff relief process, and more informal staff consultation, provide an important source of information to the staff and, indirectly, to the Commission regarding market conduct and trends. These processes simultaneously enable market participants to obtain both formal and informal staff guidance regarding the application of regulatory requirements in circumstances where a more formal rulemaking or petition is neither necessary nor appropriate.

The staff relief process is also a key component in the evolution of regulatory policy. It allows the Commission's regulatory policy to evolve on a case-by-case basis in response to concrete market practices and concerns. Because the staff relief process does not rely on abstract notions of market behavior and regulatory policy, it does not result in over-inclusive or under-inclusive rules of general application. It provides a concrete footing, and an incremental evolutionary framework, for the development of regulatory policy, and facilitates the process by which the law adapts to market developments (and vice versa). In so doing, the staff relief process also helps to avoid the promulgation of regulations that are over-inclusive or under-inclusive or that fail adequately to address actual market practices or concerns.

As a vehicle for communicating evolving regulatory policy, the staff relief process is also an effective tool for the Commission, through its staff, to influence the expectations and behavior of market participants prior to the formal codification of those policies.

The staff relief process is an extremely flexible tool. For example, it enables the Commission to facilitate market conduct that is consistent with the Act and the public interest in cases where the surrounding circumstances are so specific to the petitioner, or otherwise of such limited general applicability, that a more formal rulemaking would be of limited utility and entail an inefficient use of resources. As important, where there exist statutory limitations on the

Commission's rulemaking or exemptive authority, the staff relief process may be an important avenue for communicating and implementing regulatory policy that the Commission has informed staff is consistent with the public interest and the objectives of the Act, notwithstanding limitations in the statute that the Commission has determined to have resulted in consequences unintended by Congress.

Finally, the staff relief process generally offers a much more resource-efficient means of exchanging information and communicating regulatory policy than more formal proceedings, which can be more costly and time-consuming, particularly when adversarial.

In light of these benefits both to the Commission and the public, it would be undesirable for the Commission to adopt procedural rules that would unnecessarily restrict the availability of the staff relief process in ways that are not required by the Act or administrative procedural law or that create unnecessary disincentives for market participants to seek staff relief. The Committee believes the Commission should avoid establishing binding procedural rules that unduly constrain the staff's ability to grant no-action relief. Such constraints would unnecessarily restrict the Commission's ability to implement substantive policies in the future, through staff relief, without providing any offsetting benefit today.

The Committee's concerns focus in particular on three elements of Proposed Rule 140.99 and the accompanying Release. These include: (1) limitations on the withdrawal of requests; (2) the requirement that all requests be submitted only in final form; and (3) the affirmative obligation to supplement factual information in a request. The Committee believes these elements of the Commission's proposal would, among other adverse impacts, unnecessarily undermine the benefits of the staff relief process by discouraging informal communication and desirable innovative behavior without producing a countervailing regulatory benefit.

## **Comments**

### **1. Limitations on Withdrawal of Requests**

Under paragraph (f) of the Proposed Rule 140.99, a requester who withdraws a request for staff relief would be prohibited from engaging in the conduct that was the subject of the initial request. The Committee regards this provision as misguided and unnecessary. By precluding a requester from withdrawing a request letter (unless the requester agrees not to proceed with the contemplated activity), the proposed rule risks imposing inappropriate substantive constraints on behavior that go beyond the Act. Indeed, because, as proposed, the requester must agree to refrain from the contemplated behavior in order to withdraw a request, such a withdrawal would impose a more binding constraint on the requester's future conduct than an outright denial of the requested relief would have imposed.

By dramatically expanding the risks to a requester of proceeding with a request for relief, this element of Proposed Rule 140.99 is likely to have a chilling effect on the use of the staff relief process to the detriment of the Commission's regulatory objectives.

#### **a. Inappropriate constraint on conduct**

There are many reasons why a requester may determine that it is preferable to withdraw a pending request for staff relief. For example:

- A requester may determine that intervening precedents have eliminated the

uncertainty that was of concern to the requester. Commission staff may or may not agree with the implications of the precedent, or may have other concerns that are not shared by the requester.

- Facts beyond the control of the requester may have changed in a way that has an impact on the petitioner's (although perhaps not the staff's) analysis of the legal questions at issue.
- The requester may determine that, by modifying certain of the elements of the factual background, or by proceeding in a slightly different way than initially proposed, it would be comfortable proceeding without staff relief.
- The requester may determine that the concerns of legal uncertainty that led to the initial request are outweighed by the negative effects of delay in the process or by conditions or limitations that the staff proposes to impose as a condition to relief.
- A requester may simply determine that it is prepared to assume the legal risks that initially led it to request staff relief.

Under any of the foregoing circumstances, including the last three cited, a requester should be permitted to withdraw its request. The Committee notes that paragraph (f)(1)(ii) includes an exception for requests that become "moot". However, the Committee does not believe that mootness establishes an appropriate standard or a standard on which a petitioner and staff will likely agree. The Committee also does not believe that it would be possible to construct a standard that would adequately distinguish between changed circumstances that would, and those that would not, justify a withdrawal, or that it is appropriate to establish such a standard. It is predictable that the requestor and the staff will not agree as to the import, applicability, significance or precedential effect of the relevant change in circumstance. The benefits of the staff relief process derive from its use as a channel for informal communication and indirect influence on market behavior, not as a surrogate for the Commission's enforcement or exemptive powers. For that reason, the Commission should not seek to penalize requesters in a way that leaves them worse off than they would have been had they not initiated the request.

The Act does not, except in express circumstances such as registration or contract market designation, place the Commission in the role either of a gatekeeper or even as the ultimate arbiter of what is permitted under the Act. The Act permits market participants to act, at their peril and subject to future sanction, based on their own interpretation of the statute. This is true even if the market participant had requested and been denied staff relief. An adverse response to a request for no-action relief does not mean that the proposed conduct is conclusively prohibited by the Act or the rules, despite the strong disincentive to the proposed conduct that is created by an adverse response.

Of course, a requester who withdraws a request does so at its peril: the Commission knows the requester. The Commission could initiate enforcement proceedings, seek an injunction or institute other administrative or judicial action. Alternatively, the Commission, or its staff, could proceed despite the withdrawal to address the underlying issues by an advisory, interpretation or rulemaking. Each of these courses is consistent with the range of sanctions and remedies which the Act contemplates and authorizes the Commission to pursue. These sanctions and remedies are more than adequate, and avoid the inequity and chilling effect of the proposed limitation on withdrawal of requests.



## **b. Undesirable incentives to potential requesters**

By creating a significant disincentive to potential no-action requests, proposed paragraph (f) would have several undesirable consequences. First, it would reduce Commission and staff access to valuable information on novel types of market behavior. Second, it would reduce opportunities for the Commission to communicate informal regulatory guidance where such guidance would be most useful. Third, it would either chill desirable innovative activity or increase the likelihood of conduct inconsistent with the Commission's regulatory objectives (potentially requiring more active and costly intervention by the Commission and staff) - - either of which would be undesirable.

The Committee believes that these undesirable outcomes would not be offset by any benefit arising from the proposed requirement. The Committee appreciates that the withdrawal of a request for staff relief might be frustrating to the staff involved. Nonetheless, the Committee believes that the range of sanctions and remedies currently available to the Commission are more than adequate and that, as a matter of federal law and regulatory policy, the Commission should not seek to impose, through procedural rules, substantive constraints on conduct that are neither required nor authorized under the Act.

## **c. Requests for relief in the alternative are not a substitute**

In the Release, the Commission states that the provision in proposed paragraph (c)(7) allowing for requests for relief in the alternative should eliminate the desirability of withdrawing a request when an adverse response seems likely. The Committee strongly disagrees.

The Committee does not believe that allowing requests for relief in the alternative would materially alter the analysis of prospective requesters. In addition, proposed paragraph (c)(7) would increase the burden on both requester and staff, by encouraging the requester to anticipate the need for and to provide for alternative relief for numerous potential outcomes and by requiring the staff to consider and respond to these contingencies. More important, certain issues and circumstances simply do not lend themselves to requests in the alternative, because the issue calls only for a binary response: either the proposed activity may be undertaken or it may not be undertaken.

## **2. Prohibition against Draft Submissions**

As the Commission acknowledges in the Release, and as the Securities and Exchange Commission and other commentators have observed, the ability of regulators to communicate informally to market participants is very valuable to both sides. Such informal communication is extremely resource-efficient, both for regulators and market participants, in relation to more formal or adversarial proceedings. Informal communication results in lower costs for both sides: regulators are able to influence behavior without incurring costly enforcement actions or more costly rulemakings, and market participants are able to conform their behavior to regulations *ex ante*, rather than incurring the cost of defending enforcement actions *ex post*. The Committee is concerned that by precluding staff from reviewing draft requests, the Commission will sacrifice many of the benefits of informal communication.

Most often, even formal requests for staff relief are preceded by informal discussions with staff. These discussions are highly desirable because they constitute a highly resource-efficient mode

of communication between the staff and regulatees.

In these conversations, staff may indicate definitively that a requested form of relief is so unlikely that it would be unproductive to submit a request. Such an outcome obviously saves resources for all concerned. Staff might alternatively identify a prior precedent either unpublished or overlooked by the prospective applicant that positively or negatively resolves the issue.<sup>3</sup>

Alternatively, the staff might be in a position to identify specific areas of concern that should be emphasized or suggest modifications or voluntary undertakings, conditions or restrictions that might address Commission concerns and that would maximize the likelihood that an initial request would not require supplementation or make it clear to the prospective petitioner that, from its perspective, a request for relief is not likely to be productive.<sup>4</sup> From a resource utilization perspective, each of these outcomes is beneficial.

Similarly, the types of transactions or circumstances that merit the time and expense of submitting a request for relief may be complex and difficult to communicate orally. Often, the reduction of these matters to a writing enables parties on both sides to focus their discussion in a way that is not possible when based solely on informal oral dialogue. Sometimes it is difficult to form judgments about whether no-action advice would be appropriate or to identify precisely all the regulatory issues or problems raised, or appropriate conditions, limitations or undertakings, without the level of understanding fostered by a written description of the facts.

The Committee appreciates the Commission's desire to minimize the scarce staff resources expended in seeking additional information from requesters. However, based on the extensive experience that members of the Committee have had both with the Commission and other federal agencies, it is clear that informal dialogues with staff and the ability to discuss draft submissions have the potential to avoid unnecessary expenditures of time and to promote a significantly more efficient use of staff and petitioner resources. In addition, without the benefit of these more informal processes, a prospective requester's threshold decision as to whether to submit a formal request would be significantly less informed and involve greater uncertainty. As a consequence, this would create a disincentive to participate in the staff relief process, with the same undesirable consequences discussed in section 1 above.

Of course, there may well be circumstances in which staff may determine that a draft submission would be unwarranted, unnecessary or otherwise inappropriate. Staff should have and exercise the discretion to reach such a conclusion in appropriate circumstances. However, it would be undesirable for the Commission to eliminate the staff's discretion to determine when review of a draft submission would be in the best interests of the Commission and the prospective petitioner.

### **3. Indefinite Obligation to Supplement Factual Background**

Proposed paragraph (c)(3)(ii) would impose an affirmative obligation on the requester to supplement its request in the event that, at any time, a material representation ceases to be complete and accurate.

The Committee appreciates the need to avoid the expenditure of staff resources devoted to seeking additional information from requesters. However, by requiring constant updates from the requester, the proposed rule would significantly increase the burden on both sides. The

Committee does not believe the proposed requirement is necessary or appropriate.

There are several possible scenarios in which this issue may arise. First, the petitioner may have discontinued the relevant conduct. This situation speaks for itself.

Alternatively, for one or more reasons, including intervening events, the petitioner may have ceased relying on the staff relief. In that circumstance, the petitioner may be relying, at its peril, on its own legal analysis. Similarly, the petitioner may be continuing to rely on the original relief and may have formed a judgment that the relevant change is not material. In either case, since the original relief is invariably limited to the facts recited, the petitioner is at risk that the Commission or staff would regard the change in facts as material. This is the appropriate posture for the petitioner under these circumstances and it is not necessary to impose an additional burden to update the initial request, where the petitioner is willing to assume the risk of not doing so, based on its analysis of the law. Because a no-action letter would not be binding against the staff if the circumstances of the transaction were to change materially, the requester already has a strong incentive to keep the staff well-informed of material developments. Given this incentive, the Committee believes that the requester is in the best position to determine whether changed circumstances warrant a supplement to the request.

Conversely, due to the rapidly changing environment in which transactions are developed and negotiated, the obligation to update a request at any time circumstances change would potentially require the requester to submit frequent updates, which the staff, in turn, would be required to analyze. The complexity of policing and implementing such an obligation must not be underestimated. Very frequently, requests relate to conduct that could go on for many years, or that might be intermittent, such as securities issuances over many years, or that involve facts, such as market statistics, that change constantly. Assuring that all changes in fact are filed with the Commission will create an enormous burden with a significant risk of inadvertent transgression.

It is also not clear what the appropriate materiality standard should be: Material to the grant of relief? Or material to the status of the relevant conduct under the Act? What if the change is material to but not dispositive of the relevant legal issue? This uncertainty would likely lead diligent petitioners to err on the side of filing supplements, further burdening Commission and petitioner resources. Against the background of these burdens, the undesirability of imposing this requirement can be seen plainly in considering the context of a petitioner who has failed to supplement a request.

If the petitioner has failed to supplement a request in respect of a fact that is material to the status of the transaction under the Act, the petitioner will have been in violation of a substantive provision of law. What is gained by adding a second, procedural violation? Similarly, why should such a petitioner be in a worse position than a market petitioner who never even filed a no-action request and would only be in violation of the relevant substantive provision of law?

If, on the other hand, the undisclosed fact is material to the grant of staff relief, but the underlying conduct nonetheless does not violate the Act, it would be unjust to penalize the petitioner who, it turns out, erred on the side of caution by seeking staff relief initially.

Balancing these considerations, the Committee believes that the Commission should not adopt the proposed supplementation requirement. It is sufficiently burdensome that its adoption could

create a disincentive to seek staff relief in some contexts. The fact that staff relief is based on the material facts presented by the petitioner creates an adequate incentive for petitioners to update changed facts as appropriate. Ultimately, the Commission retains its enforcement powers in those circumstances in which a petitioner inappropriately relies on staff relief previously issued.

#### **4. Additional Comments**

##### **a. Appropriate Process for Evolution of Regulatory Policy**

The Commission observes in the Release,<sup>5</sup> that formal rulemaking or exemptive relief, rather than the staff relief process, is the appropriate vehicle for addressing complex or novel issues. The Committee agrees that, ultimately, it is desirable to promulgate regulations of uniform general application, following public comment.

However, for many of the reasons cited above, the Commission does not always have the information or experience, or otherwise may not be in a position, to proceed most effectively by rulemaking. It is not always possible, in a formal rulemaking, to anticipate relevant issues and developments. Even though the rulemaking process entails the solicitation of public comment, particularly in the early stages of market developments, the exercise can be somewhat abstract.

The fact that a matter is complex or novel does not mean that it is ripe or appropriate for rulemaking. A matter that is novel may be inappropriate for rulemaking precisely because it is novel and the range of issues implicated is not clearly defined. Similarly, complexity can be a function of the petitioner's unique circumstances and may, for that reason, present an inappropriate case for rulemaking. In these contexts, the Commission should embrace the use of the staff relief process to assist it in addressing the concrete situations presented. This course would facilitate the evolution of the law and the development of Commission expertise and regulatory policy, with the ultimate objective of codification at the appropriate time.

##### **b. Certification**

Proposed paragraph (c)(3)(i) would require certification of the facts contained in any submission for staff relief. The Committee regards this requirement as unnecessary in light of the fact that the validity of any relief is contingent upon the accuracy of the facts recited and representations made. The Committee is not aware of abuses in this area that require additional measures such as the proposed certification requirement.

##### **c. Precedential effect of staff no-action relief**

In the Release,<sup>6</sup> the Commission clarifies that no-action relief is binding only on the issuing division and is effective only for the petitioner. The Committee agrees with this statement in relation to the strict estoppel impact of a no-action letter. However, it is widely understood that staff no-action letters also represent policy determinations that may be of general applicability. This is why each no-action letter is not followed by scores or hundreds of identical requests.

Clearly, no other party may assert an estoppel effect. Similarly, any other party relies at its peril on its conclusion that its circumstances are the same in all material respects as those of the petitioner granted the no-action relief. Having said that, unlike an exemption, which is clearly understood to be limited in all respects to the covered petitioners, market participants would be



surprised if they were informed that they should not rely for any purpose on no-action relief granted to a third party for guidance as to permissible conduct under the Act.

The Committee believes it would be helpful for the Commission to clarify this point.

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If you have any questions or would like further information regarding the matters discussed above, please feel free to contact Gerard J. Quinn, Staff Adviser to the Committee, at 212-618-0507, or Edward J. Rosen of Cleary, Gottlieb, Steen & Hamilton, counsel to the Committee, at 212-225-2820.

Very truly yours,

Zachary Snow, Chairman  
OTC Derivative Products Committee

**Footnotes:**

<sup>1</sup> SIA is the leading proponent of capital markets, bringing together the shared interests of nearly 800 securities firms throughout North America. SIA members -- including investment banks, brokers-dealers, specialists, and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the United States, SIA members collectively account for approximately 90%, or \$100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans.

<sup>2</sup> 63 Fed. Reg. 3285 (Jan. 22, 1998).

<sup>3</sup> In this regard, the Committee notes that, for a variety of reasons, research under the Act and Commission regulations can be challenging and yield incomplete results.

<sup>4</sup> Similarly, the ability of a petitioner to identify to staff potential conditions or undertakings that might be impractical or problematic and to suggest alternatives, without necessitating formal exchanges of correspondence, would also contribute to efficient use of staff resources.

<sup>5</sup> 63 Fed. Reg. at 3285.

<sup>6</sup> 63 Fed. Reg. at 3286.