

December 20, 2012

CFTC Approves Final Rule Requiring Recording of Oral Communications

Summary

On December 17, 2012, the Commodity Futures Trading Commission (CFTC) adopted final rules amending CFTC Regulations 1.31 and 1.35. The final rules require certain market participants to record oral communications that lead to the execution of a commodity interest transaction.¹ All such recordings must be kept for a period of one year in a form and manner that is identifiable and searchable by transaction. The final rules also expand upon the requirement that futures commission merchants (FCMs), introducing brokers (IBs), members of a designated contract market (DCM) and retail forex dealers (RFEDs) retain complete, full and systematic records including all data and memoranda related to their commodity interest business for a period of five years, and apply these requirements to members of a swap execution facility (SEF).

Records of Oral Communications

Under the final rules, FCMs, IBs with aggregate revenues exceeding \$5 million over the preceding three years, certain members of a DCM or SEF, and RFEDs must record all oral communications that lead to the execution of a commodity interest transaction, including oral communications conveying quotes, solicitations, bids, offers, instructions, trading and prices communicated by telephone, voicemail, mobile device or other digital or electronic media. Members of a DCM or SEF that are not registered or required to be registered with the CFTC in any capacity, floor traders, commodity pool operators, swap dealers and major swap participants are not subject to the recording requirements for oral communications set forth in CFTC Regulation 1.35.² Oral communications that lead solely to the execution of a related cash or forward transaction and oral communications provided or received by a floor broker that do not lead to the purchase or sale of any commodity for future delivery, security futures product, swap or commodity option for any person other than the floor broker are also exempted from the recording requirements.

Any conversation that leads to the execution of a covered transaction must be recorded regardless of whether the conversation occurs on a firm-provided or personal phone. The CFTC expressly denied industry requests to provide a safe harbor for market participants that adopted a policy prohibiting the use of personal telephones to solicit or accept orders, but acknowledged that good faith policies and procedures reasonably designed to achieve compliance serve as a mitigating factor in enforcement actions.

Although compliance with the rule is ultimately the responsibility of each market participant, the CFTC indicated that firms may rely upon a DCM, SEF or other CFTC registrant to maintain certain records on their behalf. For example, if an FCM records its

¹ The term "commodity interest" means: (1) any contract for the purchase or sale of a commodity for future delivery; (2) any contract, agreement or transaction subject to CFTC regulation under section 4c or 19 of the Commodity Exchange Act (the "Act"); (3) any contract, agreement or transaction subject to CFTC jurisdiction under section 2(c)(2) of the Act; and (4) any swap as defined in the Act, by the CFTC, or jointly by the CFTC and the Securities and Exchange Commission.

² Although not subject to the requirements of CFTC Regulation 1.35, swap dealers, major swap participants and certain floor traders are required to record oral communications concerning swap transactions and related transactions in the cash and forward market pursuant to CFTC Regulation 23.202.

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telephone calls with an IB, the IB need not separately record the same calls if the IB and FCM agree that the FCM will maintain and provide the IB with access to the records. If, however, the IB receives a customer order by telephone and then calls it in to the FCM, the IB must record its telephone call with the customer.

Market participants who are required to retain records of oral communications must be able to identify and retrieve records related to a particular transaction. The adopting release clarified that market participants may comply with this requirement by maintaining searchable databases and need not compile the records into individual electronic files. The CFTC also indicated that it expects market participants to search and select records related to a particular transaction using an electronic means of scanning records for keywords or identifying keywords and concepts by listening to recordings. The CFTC's cost analysis appears to rely heavily upon information from a vendor that offers a cloud-based system with speech analytic search capabilities, which presumably meet the CFTC's retrieval requirements, for a cost of \$40 to \$80 per line per month.

Privacy Concerns

A number of commenters identified concerns related to wiretapping and privacy laws. According to the CFTC, market participants will be able to comply with the recording requirements without violating any state or federal laws by informing parties that a call is being recorded. The adopting release observed that a conversation may be recorded under federal law and many state laws if one party to the conversation has given prior consent. However, other states require both parties to consent before a conversation may be recorded. As a practical matter, all market participants will need to ensure that customers and counterparties have consented to the recording of all oral communications that may be subject to the final rules.

Written Communications

Under the revised rules, each FCM, IB, member of a DCM or SEF, and RFED must keep full, complete and systematic records of all data and memoranda related to its business of dealing in commodity interests and related cash or forward transactions. These records include all orders (filled, unfilled or canceled), trading cards, signature cards, street books, journals, ledgers, canceled checks, copies of confirmations, copies of statements of purchase and sale, and all other records prepared in the course of a market participant's commodity interest business. In addition, FCMs, IBs, members of a DCM or SEF, and RFEDs must retain written communications concerning quotes, solicitations, bids, offers, instructions, trading and prices that lead to the execution of a transaction in a commodity interest or a related cash or forward transaction that is communicated by facsimile, instant messaging, chat room, electronic mail, mobile device, or other digital or electronic media. All written communications must be retained in their original form or native file format for a period of five years and must be readily accessible for a period of two years.

Compliance Date

The final rules will become effective 60 days after publication in the Federal Register, but market participants will have 365 days after publication of the final rule in the Federal Register to comply with the requirement to record all oral communications under CFTC Regulation 1.35(a)(1). In addition, CFTC Regulation 1.35(a)(4) provides a mechanism for market participants to request an alternative compliance schedule if it is technologically or economically impractical for the market participant to comply with the oral communication recordkeeping requirements by the compliance date.

³ The phrase "related cash or forward transaction" is defined as a purchase or sale for immediate or deferred physical shipment or delivery of an asset related to a commodity interest transaction where the commodity interest transaction and the related cash or forward transaction are used to hedge, mitigate the risk of, or offset one another.

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