Chicago Board of Trade

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06-2
(25)

August 1, 2006

Commodity Futures Trading Commission
Office of the Secretariat
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

Attention: Eileen A. Donovan,
Acting Secretary

Re: What Constitutes a Board of Trade Located Outside the United States, Request for Comment, 71 Federal Register 34070 (June 13, 2006) ("Request for Comment")

Dear Ms. Donovan:

The CBOT appreciates the opportunity to respond to the above-referenced Request for Comment[1]. As Chairman Jeffery stated at the Commission's June 27 hearing on this matter, the agency is considering this question "in an era of technology and globalization" where the concept of physical location can be an "awkward" one. Chairman Jeffery also noted that "the Commission hopes to help foster a competitive level playing field...while avoiding interference with legitimate market forces and competition." We agree with the Chairman's assessment of the difficulty of defining location in today's marketplace and support the Commission's continued efforts to foster fair competition.

The No-Action process has worked well since its inception, and we are not convinced that it needs to be substantially revised, or that the Commission must necessarily draw a bright-line threshold for determining location. That said, we do believe that the analysis preceding the issuance of no-action letters must constantly be re-evaluated and updated to reflect changes and developments in today's dynamic marketplace. That analysis should include an examination of potential regulatory disparities as well as the efficacy of relevant cross-jurisdictional regulatory information sharing agreements.

Our principal and immediate concern is that the Commission remain faithful to its "[c]ommit[ment] to simultaneously initiate processes to address the comparative regulatory levels between U.S. and foreign electronic trading systems so as not to provide one with a competitive advantage,"[2] and that its efforts in this area should "neither inhibit[] cross-border trading nor impose[] unnecessary regulatory burdens."[3] We are also concerned that overly broad action by the Commission in this area could lead to reciprocal action by other regulators and complicate the efforts of registered DCMs to expand and compete internationally.

[1] The comment period was extended to August 1, 2006, 71 Fed. Reg. 40081 (July 14, 2006).
[2] 64 Fed. Reg. 32839, 32830 (June 18, 1999) (the "1999 Order").
[3] Request for Comment, 71 Fed. Reg. at 34073.

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The current no-action letters that allow sixteen unregistered boards of trade[4] to be accessed electronically from the United States (the "No-Action Letters") are said to be based on the conclusion that each was a bona fide foreign board of trade, which is to say that it was "located outside the United States" for purposes of Section 4(a) of the Act at the time the letter was issued. Each of the thirteen registered Designated Contract Markets is presumed not to be located "outside the United States," although the orders granting those registrations may not be explicit on that point.

According to the Request for Comment, the No-Action Letters do not "identify the specific circumstances when no-action relief is no longer appropriate. In order to promote regulatory clarity in this area, the Commission is considering whether to set forth objective criteria for determining when an FBOT is no longer "located outside the U.S." for purposes of Section 4(a) of the Act."[5] As stated above, this would be a difficult task to undertake, made even more complicated by the statutory limitations placed on the Commission by Section 4(b) of the Act.

Earlier this year, the Commission justified the revision of its Statement of Policy[6] "in light of its experience since the issuance of the Statement of Policy and in recognition of the fact that the listing of new products may raise previously unidentified regulatory issues. For example, certain foreign board of trade contracts directly accessible in the U.S. may be directly linked to a U.S. designated contract market's [DCM] prices and thus may create a need for enhanced market surveillance or additional information sharing with the foreign board of trade and/or its regulator to address market integrity issues with respect to the Commission's oversight of the DCM's contracts."[7] The revised Statement of Policy extended the notice period for new products to allow Commission staff to ensure that adequate information sharing arrangements were in place.

The revision to the Statement of Policy highlights a concern that the particular specifications of products offered for trading by a foreign board of trade could have effects on interstate commerce that the Commission would be expected to address. We understand this concern, but also understand that such effects could presumably exist whether or not the board of trade can be accessed electronically from the United States. This concern cannot be addressed by issuing an agency interpretation of the phrase "located outside the United States" in Section 4(a) of the Act. Perhaps a review the judgments made by Congress when it designed the Commission's authority in Section 4(b)[8] of the Act in 1983 and by the Commission when it adopted its Part 30 regulations in 1987 would assist in the effort to try to identify ways to address that concern. Even in that context, we do not believe that any substantive change in the Commission's approach to the regulation of foreign futures and options is warranted. We strongly believe, however, that in this rapidly changing industry, the Commission is right to look for regulatory disparities and to eliminate them when possible. The current debate about this issue has highlighted at least one specific area that should be addressed – that of speculative position limits. We believe that the retention of Commission-imposed speculative position limits in CFTC Regulation 150.2, which effectively direct volume to boards of trade that are protected by Sections 4a(a) and 4(b) of the

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[4] Id. at 34071, nn. 11 and 13.
[5] Id. at 34070.
[6] 65 Fed. Reg. 41641 (July 6, 2000).
[7] 71 Fed. Reg. 19877 (April 18, 2006).
[8] See Concurring Opinion of Commissioner James E. Newsome—Proposed Rules Concerning Automated Trading System Use in the United States (March 15, 1999), 64 Fed. Reg. 14159 at 14178 (March 24, 1999) (proposed rules withdrawn in 1999 were in "possible conflict with the Act's §4(b) jurisdictional limitations.")

Act, is an example of a disparity that can and should be eliminated. In addition, we suggest that the Commission review its regulation governing exchange-set speculative position limits (Regulation 150.5) to allow greater flexibility to boards of trade in establishing and adjusting those limits.

A. Legislative and Regulatory History

Section 4(a) of the Act, including the parenthetical excluding futures contracts traded on or subject to the rules of a board of trade "located outside the United States" from the DCM trading requirement, was added to the Commodity Exchange Act by section 204 of the Futures Trading Act of 1982. The language it replaced barred the use of the mails or means of interstate commerce to trade futures contracts "on or subject to the rules of any board of trade in the United States," unless such board of trade had been designated by the Commission as a 'contract market.'"[9] Section 204 also added Section 4(b) to the Act, which authorized the Commission to adopt rules governing the solicitation of U.S. residents to trade foreign futures and options, but explicitly denied the Commission the authority to adopt a "rule or regulation...under this subsection" that "(1) requires Commission approval of any contract, rule, regulation or action of any foreign board of trade, exchange, or market or clearinghouse for such board of trade, exchange, or market, or (2) governs in any way any rule or contract term or action of any foreign board of trade, exchange, or market, or clearinghouse for such board of trade, exchange or market."[10]

The legislative history appears to contain no discussion of the meaning of the term "located," but a statement was submitted into the legislative record by Junius W. Peake, President of the International Futures Exchange (Bermuda) Ltd. ("INTEX"), which at the time was a nascent electronic exchange in the process of accepting members in the United States.[11] In his statement, Professor Peake observed that "[m]any of INTEX's U.S. members are already CFTC-registered futures commission merchants."[12] Despite the direct electronic access that INTEX's U.S. members were expected to have, the legislative record does not seem to contain any challenge to the view that INTEX was "located outside the United States." After Section 4(a) was amended in 1983, INTEX sought and obtained no-action relief from the Commission's Office of General Counsel to offer cash-settled futures on the Financial News Composite Index, an index of U.S. stocks, in the United States.[13] This no-action process would not have been available to a board of trade that was not "located outside the United States."

Congress did not modify the phrase "located outside the United States" in Section 4(a) when it adopted the CFMA in 2000.

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[9] By comparison, the registration requirement for securities exchanges in Section 5 of the Securities Exchange Act of 1934 requires an exchange to register if "the mails or any means or instrumentality of interstate commerce" are used "for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States." 15 U.S.C. §78e. (Emphasis added).

[10] Sen. Rep. 97-384, Report of the Committee on Agriculture, Nutrition and Forestry, United States Senate, Sen. Rep. 97-384 to accompany S.2109 (97th Cong. 2d Sess.), pp. 45-47 and 128 Cong. Rec. S 13080 (Oct. 1, 1982).

[11] Hearings before the Subcommittee on Conservation, Credit and Rural Development of the Committee on Agriculture, House of Representatives on H.R. 5447 (97th Cong., 2d Sess) 520-535. (February 25, 1982).

[12] Id. at 525.

[13] CFTC Interpretative Letter No. 85-5, [1984-1986 Tr. Binder] Comm. Fut. L. Rep. ¶22,751 (September 5, 1985).

Part 30

The Commission's concern with foreign futures and options predates the issuance of the No-Action Letters. The Commission's Part 30 rules, adopted in their current form in 1987, directly address the customer protection issues raised by the offering of foreign futures and options contracts in the United States.

To date, the Commission has granted exemptions from certain aspects of Part 30 to intermediaries that are regulated by exchanges and/or national regulators in Australia, Brazil, Canada, France, Germany, Japan, New Zealand, Singapore, Spain and the United Kingdom.[14]

A Part 30 exemption does not exempt a related board of trade from the DCM registration requirement under section 4(a) of the Act. However, of the sixteen No-Action Letters issued to date, only four (EEX, Eurex Zürich, Euronext Amsterdam and Hong Kong Futures Exchange) have been issued to a board of trade whose products were not covered by a Part 30 exemption.

In evaluating a request for a Part 30 exemption, the Commission has identified six minimum elements of a comparable regulatory program:

> (1) Registration, authorization or other form of licensing, fitness review or qualification of persons through which customer orders are solicited and accepted; (2) minimum financial requirements for those persons that accept customer funds; (3) protection of customer funds from misapplication; (4) recordkeeping and reporting requirements; (5) minimum sales practice standards, including disclosure of the risks of futures and options transactions and, in particular, the risk of transactions undertaken outside the jurisdiction of domestic law; and (6) compliance."[15]

Part 30 reflects a Congressional judgment that the regulation of intermediaries, rather than the boards of trade offering foreign futures and options, was sufficient. This judgment is particularly reflected in the last sentence of Section 4(b):

> "No rule or regulation may be adopted by the Commission under this subsection that (1) requires Commission approval of any contract, rule, regulation, or action of any foreign board of trade, exchange, or market, or clearinghouse for such board of trade, exchange, or market, or (2) governs in any way any rule or contract term or action of any foreign board of trade, exchange, or market, or clearinghouse for such board of trade, exchange, or market."

The sentiment expressed in Section 4(b) finds few explicit counterparts abroad, but there is general agreement on both sides of the Atlantic on the concept of deferring to the home regulator on contract design and approval matters.

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[14] http://www.cftc.gov/opa/backgrounder/opap30bkoia.htm

[15] Appendix A to Part 30—Interpretative Statement With Respect to the Commission's Exemptive Authority Under §30.10 of Its Rules, Comm. Fut. L. Rep. (CCH) ¶2707

B. The Commission's Speculative Position Limits Are an Impediment to Fair Competition

In Regulation 30.2, the Commission extended the application of a number of provisions of the Act and its regulations to foreign futures and options:

> (a) Except as specified in this part or unless the context otherwise requires, the provisions of sections 1a, 2, 4, 4c, 4f, 4g, 4k, 4l, 4m, 4n 4o, 4p, 6, 6c, 8, 8a, 9, 12, 13 and 14 of the Act and parts 1, 3, 4, 10, 11, 12, 13, 14, 21, 155, 166 and 190 of this chapter shall apply to the persons and transactions that are subject to the requirements of this part as though they were set forth herein and included specific references to foreign board of trade, foreign futures, foreign options, foreign futures and foreign options customers, and foreign futures and foreign options secured amount, as appropriate.
> (b) The provisions of §§1.20 through 1.30, 1.32, 1.35(a)(2)-(4) and (c)-(i), 1.36(b), 1.38, 1.39, 1.40 through 1.51, 1.53, 1.54, 1.55, 1.58, 1.59, 33.2 through 22.6 and Parts 15 through 20 of this chapter shall not be applicable to the persons and transactions that are subject to the requirements of this part.

In adopting Regulation 30.2, the Commission was mindful of the limitations of Sections 4a(a) and 4(b), as it excluded provisions like Section 4a and 5 of the Act and the regulations relating to approval of contracts and speculative position limits. In the course of the Part 30 rulemaking, U.S. exchanges expressed concern that the absence of speculative position limits on foreign futures and options would give foreign boards of trade a competitive advantage.

Ironically, the 1999 Statement of Policy was intended to provide regulatory parity to foreign boards of trade: "In light of newly-adopted Commodity Futures Trading Commission Rule 5.3 [footnote omitted] and the lack of difficulties that have arisen regarding the placement of the automated trading systems of foreign boards of trade in the U.S. pursuant to no-action relief issued by Commission staff,"[16] a foreign board of trade that has secured no-action relief need not seek supplemental relief to list new futures or options contracts. The Commission's sensitivity to the possible regulatory advantage conferred on U.S. markets by Commission Regulation 5.3 seems to stem from another part of the 1999 Order, in which the Commission ordered itself to "[c]ommit to simultaneously initiate processes to address the comparative regulatory levels between U.S. and foreign electronic trading systems so as not to provide one with a competitive advantage."[17]

Commission staff has relied on the finding of Part 30 comparability in the No-Action Letters. None of the sixteen No-Action Letters refers to speculative position limits imposed by a governmental body, and in no case does their presence or absence affect the view of the Commission or its staff of the comparability of the foreign regulatory regime. If speculative position limits are not included in the comparability analysis under Part 30, the IOSCO Principles or the Core Principles[18] under the Act, then one may reasonably ask why they should remain part of the regulatory regime for registered designated contract markets.

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[16] 65 Fed. Reg. at 41642.

[17] 64 Fed. Reg. 32829 at 32830 (June 18, 1999).

[18] Exchange-set speculative position limits continue to have a place in a DCM's market surveillance repertoire, as noted in Core Principle 5. But Federally-imposed limits are cumbersome and redundant.

The CFTC differs from many of its counterparts in regard to both its imposition of government-set speculative position limits for some contracts and the specificity of its guidance for exchange set position limits. In the United Kingdom, for instance, the FSA does not impose position limits on recognised investment exchanges or on recognised overseas investment exchanges. As a result, market participants can carry larger positions in contracts traded on FSA-regulated exchanges than they can on CFTC-regulated exchanges.
As we have argued previously[19], Commission Regulation 150.2 is outdated and should be repealed. The regulation, which sets government-imposed speculative limits on certain exchanges' agricultural products, does not apply to other products, including agricultural products on other exchanges. Products introduced after the Commission promulgated Regulation 150.5, which requires boards of trade to set their own speculative position limits for certain contracts, have never been subject to Regulation 150.2. As such, Regulation 150.2 seriously threatens the competitiveness of the contracts subject to its requirements. For example, the regulation sets speculative position limits for the CBOT corn contracts. Those limits would not apply to another exchange listing corn contracts tomorrow, be it domestic or foreign. In order to revise the limits on contracts covered by Regulation 150.2, the exchange must not only change its own limits, but ask the Commission to engage in a rulemaking to change its Regulation as well.

At this point, the Regulation is unwieldy and counter to the overall regulatory approach of of the Commodity Exchange Act and the CFTC. When Congress passed the Commodity Futures Modernization Act of 2000 (CFMA), it replaced a rules-based approach with a more flexible model based upon exchange compliance with Core Principles. Core Principle 5 of Section 5(d) of the Commodity Exchange Act as amended, applicable to designated contract markets, deals with Position Limitations or Accountability, and states that:

> To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the board of trade shall adopt position limitations or position accountability for speculators, where necessary and appropriate.

Therefore, although the Commission retains authority to set speculative position limits pursuant to Section 4a(a) of the CEA, the CFMA's Core Principles squarely place responsibility for establishing any appropriate position limits upon the exchanges themselves.

In keeping with this philosophy, in addition to eliminating Regulation 150.2, the CBOT urges the Commission to review Regulation 150.5 governing exchange-set position limits. Regulation 150.5 is highly specific in terms of its guidance to exchanges in determining position limits. Amending the regulation to allow increased flexibility to exchanges in determining and setting appropriate limits would be in keeping with Core Principle 5 and the underlying philosophy of the CFMA. It would also assist U.S. DCMs to be more competitive with foreign-regulated exchanges that are often not required to have any position limits at all.

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[19] See Petitions of the Chicago Board of Trade, the Kansas City Board of Trade, and the Minneapolis Grain Exchange Pursuant to Commission Regulation 13.2 for Repeal or Amendment of Speculative Position Limits in Commission Regulation 150.2, 69 Fed. Reg. 33874 (June 17, 2004); Revision of Federal Speculative Position Limits, Notice of Proposed Rulemaking, 70 Fed. Reg. 12621 (March 15, 2005); Revision of Federal Speculative Position Limits, Final Rule, 70 Fed. Reg. 24705 (May 11, 2005).

C. The Commission Has Authority To Act When U.S. Cash Markets Are Disrupted by Activities in Foreign Futures Markets.

Section 4(b)'s limit on the Commission's rulemaking authority does not limit the Commission's enforcement authority. Regulation 30.2(a) confirms the applicability of Section 9 to foreign futures and options. As such, the Commission has subject matter jurisdiction under Section 9(a)(2) over manipulation of the price of a commodity in a U.S. cash market, where such manipulation was effected by trading in a foreign futures contract with a U.S. delivery point or a settlement price based on a DCM contract with a U.S. delivery point.

D. An Overbroad or Novel Interpretation of "Located Outside the United States" Will Create Regulatory Confusion.

If the Commission takes action that over-inclusively requires boards of trade with foreign addresses and foreign regulators to be identified as not "located outside the United States," it will be presented with a number of difficult collateral issues.

FCM and DCO Registration. If a board of trade with a foreign address is required to register as a DCM, would the firms presently operating under a related Part 30 exemption have to register as FCMs? Would the Part 30 exemption be revoked? Would that board of trade's clearing organization have to register as a DCO?

Enforceability of futures contracts. If a board of trade that is not registered as a DCM or DTEF, "located outside the United States," or exempt can be accessed directly from the United States, are its futures contracts valid and enforceable when traded from a direct connection in the United States?

Reciprocal action by foreign regulators. A growing number of regulators have begun to emulate the substantive approach of the Commission to direct electronic access (regardless of whether they characterize it as a registration, exemption, recognition, etc.), and it is reasonable to expect that any changes to the Commission's procedures could find its way into rulebooks around the world. Some regulators in the Pacific region already have substantially greater authority, which they have exercised gingerly to date.

Legal Confusion. If the Commission were to try to regulate a board of trade that was already regulated by a foreign jurisdiction, how would the Act intersect with FBOT rules, and the local law that governs them? The disclosure statements presently required by Commission Regulations 1.55(b) and 30.12(b)(3) point out that foreign law may apply to transactions with foreign brokers and trading on foreign exchanges, and that no U.S. regulator "has the power to compel enforcement of the rules of the foreign exchange or the laws of the foreign country." If the Commission attempts to regulate an exchange that is already properly licensed and regulated in its home jurisdiction, no reliable prediction can be made about the legal consequences of dual regulation. U.S. market participants may be confused or misled about the degree to which U.S. law can be applied or enforced.

Furthermore, the Commission will not be able to require the application of U.S. bankruptcy law: if a DCM's clearing organization or one of its clearing members goes bankrupt, the governing law will be the law of the country where the funds are located.

E. Difficulty in Identifying Appropriate Threshold Criteria.

The Request for Comment identifies "the level of U.S. presence" as a possible criterion for determining that a board of trade is not, or is no longer, "located outside the United States." Three ways to measure the level of presence were identified in the 1999 proposed rulemaking and renewed in the Request for Comment: "activities and personnel in the U.S.," "trading volume...originating in the U.S." and the location of the board of trade's "main business activities" in the U.S. A vigorous debate on these issues in 1999 produced no consensus, and the proposed rulemaking was set aside in favor of the current no-action process. Developments in the industry since that time have only served to make these types of issues less clear.

Management. Some jurisdictions use this type of criteria; they consider a board of trade to be domestic if it is organized as a business entity in that country or if its head office or principal place of business is located in that country.

For example, in the U.K., an "overseas investment exchange" is defined as "an investment exchange which has neither its head office nor its registered office in the United Kingdom."[20]

In Australia, section 795B(2) of the Corporations Act (2001)[21] provides:

> If an applicant is authorised to operate a financial market in the foreign country in which its principal place of business is located, the Minister may grant the applicant an Australian market licence authorising the applicant to operate the same market in this jurisdiction.

Singapore law presents an extreme example of the approach being considered by the Commission. The Monetary Authority of Singapore (MAS) has taken a reasonable and practical approach to the regulation of foreign boards of trade, but its statutory and regulatory powers are virtually unlimited and should not serve as an example to be followed by the Commission. In Singapore, the MAS has to date regulated its domestic exchange as an "approved exchange" and the major foreign futures exchanges as "recognized market operators." While Section 9(4) of Singapore's Securities and Futures Act (ch. 289) appears to focus on the location of the

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[20] http://fsahandbook.info/FSA/glossary-html/handbook/Glossary/O?definition=G820
See Request for Comment, 71 Fed. Reg. at 34072, n. 20. If an overseas investment exchange or overseas clearing house wishes to undertake regulated activities in the United Kingdom, it will need to:

(1) obtain a Part IV permission from the FSA;
(2) (in the case of an EEA firm or a Treaty firm) qualify for authorization under Schedule 3 (EEA Passport Rights) or Schedule 4 (Treaty rights) to the Act, respectively; or
(3) obtain exempt person status by being a regulated market under the Investment Services Directive; or
(4) obtain exempt person status by being declared by the FSA to be (in the case of an overseas investment exchange) an ROIE or (in the case of an overseas clearing house) an ROCH.

FSA Handbook, REC 6.1.1 http://fsahandbook.info/FSA/html/handbook/REC/6/1

[21] For more detail, see ASIC Policy Statement 172, Australian Markets Licenses: Australian Operators (June 3, 2002), particularly §§172.38-.40 and .177
http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps172.pdf/$file/ps172.pdf
and ASIC Policy Statement 177, Australian Markets Licenses: Overseas Operators (October 30, 2003)
http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps177.pdf/$file/ps177.pdf

exchange's "head office,[22]" Sections 6-11 actually give MAS discretion to determine whether an exchange should be regulated as an "approved exchange" or a "recognised market operator."

Regulation 7 of the Securities and Futures (Markets) Regulations 2005 explicitly permits MAS to change its treatment of a foreign exchange if the local economy is disrupted:

> (1) For the purposes of section 9 of the Act and without prejudice to section 8(7) of the Act, the Authority may approve a corporation as an approved exchange under section 8(1) of the Act if—
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> (a) the Authority is satisfied that a disruption in the operations of a market to be operated by the corporation could trigger, cause or transmit further systemic disruptions to the capital markets or financial system of Singapore;
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> (b) the Authority is satisfied that a disruption in the operations of a market to be operated by the corporation could affect public confidence in the capital markets, financial institutions or financial system of Singapore; or
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> (c) in any other case, the Authority is satisfied that the corporation, having applied to be an approved exchange under section 7(1)(a) of the Act, is able to comply with the obligations or requirements imposed on approved exchanges under the Act.

Despite these examples, with cross-border joint ventures and mergers between boards of trade both existing and proposed, it is likely to become more and more difficult to determine the primary location of an exchange.

Operations and Infrastructure. IT and data processing operations are frequently outsourced and can be located almost anywhere. Their location should be driven by the needs of the business, not by regulatory considerations. The Winnipeg Commodity Exchange has a No-Action Letter and runs on a matching engine located in Chicago. At times, the CBOT, a registered DCM, has had its matching engine located in Frankfurt and London.

Australia provides an example of a contrary approach, one that we would encourage the Commission to avoid. ASIC says that a financial market is located in Australia if "all or a significant part of the market infrastructure is located in Australia."[23] In ASIC's view, the mere location of a network hub in Australia is sufficient to cause a financial market to be located in Australia. This position ought to encourage international markets to locate their network hubs elsewhere, to the detriment of Australian market participants.

Volume. We do not support the use of volume-based measures to determine location. As the Request for Comment observes, the CBOT can identify the location from which orders are entered into our system, but it is not as easy to identify the location of the account for which an

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[22] See also Guidelines on the Regulations of Markets http://www.mas.gov.sg/masmcm/upload/mm/MM_65AA3C7D_CD8D_43A8_ADE53E9B270FC7CE__65AA3C9C_0250_4E35_26BF0BA28ED3C113/Guidelines_Regulation_of_Markets.pdf and Guidelines on the Applicability of Section 339 (Extra-Territoriality) of the Securities and Futures Act, http://www.mas.gov.sg/masmcm/upload/mm/MM_E702841B_D606_FSE9_6C4FE43AA0FB4C24__E702842B_D606_F5E9_64D1BE3005D914E/SF_Guidelines_S339_1Jul05.pdf

[23] PS 172.39(b). http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps172.pdf/$file/ps172.pdf Compare Section 5 of the 1934 Act, supra n. 9.

order is entered. How do you assign a geographic location to any of the multi-national market participants that play significant roles in our markets?

Also, volume ebbs and flows, and an exchange or a product might meet the threshold in one reporting period and not the next. Would the "location" of the exchange shift with its volume patterns? This lack of stability will only create uncertainty.

Would this volume test be applied for an exchange's total volume, or would it apply on a product-by-product basis? If the former, the Commission could end up regulating futures contracts that have no nexus with the United States at all. If the latter, boards of trade will find themselves with multiple, and possibly conflicting regulators, which would probably lead them to create multiple exchange entities in different jurisdictions.

Would a volume requirement apply in reverse? That is, If the CBOT's U.S. volume in a particular product fell below the threshold, would it mean that the CBOT would be "located outside the United States" for purposes of that product? Would DCMs also have to report U.S. volume to the Commission?

U.S. Delivery Points. The terms of a futures contract are typically governed by the law of the place where the exchange is located, and the delivery terms of a contract that calls for physical delivery must necessarily be in keeping with the law of the place where delivery occurs. A futures contract with a U.S. delivery point would necessarily have to have its delivery specifications governed by U.S. law.

Using contract specifications to determine the location of a board of trade looks like an evasion of Section 4(b), and is likely to provoke a similar response abroad, hampering our efforts to develop our international markets.

There are already some DCM contracts that have delivery points outside the United States (e.g., the CBOT South American Soybean futures, certain NYBOT contracts). None of the jurisdictions where these delivery points are located have sought to require the exchanges to secure approval.

Foreign Futures Based on DCM Settlement Prices. Consider a futures contract that was based on the settlement price of a physical delivery futures contract traded on a DCM. There is a legitimate need in this situation for enhanced intermarket surveillance arrangements, and the Commission's revised Statement of Policy seems to be a reasonable step. There may also be a concern that persons who are ineligible to trade on one of the markets would evade that ban by trading on the other. Again, this would seem to be a matter than can be resolved by consultations between the relevant regulators. Again, the risk of reciprocal action from foreign regulators makes this an unattractive option as an exclusion from a definition of "located outside the United States."

F. The Statement of Policy Should Exclude Futures on U.S. Government Securities.

If a board of trade with a No-Action Letter can offer trading in U.S. government debt futures and remain "located outside the United States," the Statement of Policy, or any document that replaces it, should exclude products subject to Section 2(a)(9)(B)(ii) in the same way that it excludes stock index products subject to Section 2(a)(1)(C).[24]

Section 2(a)(9)(B)(ii) of the Act provides:

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[24] See 71 Fed. Reg. 19877 (April 18, 2006) as corrected by 71 Fed. Reg. 21003 (April 24, 2006).

> When a board of trade applies for designation or registration as a contract market or derivatives transaction execution facility involving transactions for future delivery of any security issued or guaranteed by the United States or any agency thereof, the Commission shall promptly deliver a copy of such application to the Department of the Treasury and the Board of Governors of the Federal Reserve System. The Commission may not designate or register a board of trade as a contract market or designated transaction execution facility based on such application until forty-five days after the date the Commission delivers the application to such agencies or until the Commission receives comments from each of such agencies on the application, whichever period is shorter. Any comments received from the Commission from such agencies shall be included as part of the public record of the Commission's designation proceeding. In designating, registering, or refusing, suspending or revoking the designation or registration of, a board of trade as a contract market or derivatives transaction execution facility involving transactions for future delivery referred to in this clause or in considering any possible action under this Act (including without limitation emergency action under section 8a(9) with respect to such transactions, the Commission shall take into consideration all comments it receives from the Department of the Treasury and the Board of Governors of the Federal Reserve System and shall consider the effect that any such designation, registration, suspension, revocation, or action may have on the debt financing requirements of the United States Government and the continued efficiency and integrity of the underlying market for government securities."

On its face, this section requires the Commission to provide Treasury and the Federal Reserve an opportunity to comment on a DCM or DTEF's application to offer trading in futures on U.S. government securities. Section 2 is made applicable to foreign boards of trade by Commission Regulation 30.2, and the Commission should follow this comment procedure in the case of a foreign board of trade in the same way that it does for stock index futures contracts that foreign boards of trade seek to offer in the United States. The ten-day notice described in the revised Statement of Policy is inconsistent with the forty-five day comment period required by Section 2(a)(9)(B)(ii). In addition, the issuance of such no-action relief and the granting of a Part 30 exemption are each an "action under this Act," so the Commission is required to consider "the effect that such [no-action relief or Part 30 exemption] may have on the debt financing requirements of the United States Government and the continued efficiency and integrity of the underlying market for government securities.".

G. Summary

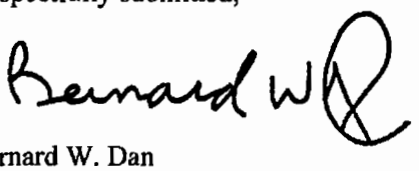
The CBOT commends the Commission for its commitment to reviewing its policies in light of recent market developments to analyze whether appropriate levels of regulation are in place and to identify and resolve potential areas of regulatory disparity. We understand the difficulty of creating a bright-line threshold to require U.S. registration of boards of trade that are already registered with a foreign regulator deemed comparable by the agency. We believe the existing no-action process has worked well, and while the agency may feel it is appropriate to make certain changes, we do not believe current developments warrant a full overhaul of the process.

The Commission's revision of its Statement of Policy was a positive one and should assist the agency in its efforts to appropriately analyze new contracts for any potential issues of concern. That said, the Statement of Policy, or any rule or policy that might replace it, should exclude products subject to Section 2(a)(9)(B)(ii) of the Act.

Finally, we urge the Commission to eliminate competitive advantages enjoyed by foreign boards of trade, such as the disparity that currently exists in terms of differences in regulatory regimes with regard to speculative position limits. The Commission should repeal Commission Regulation 150.2 and review Regulation 150.5 to provide U.S. DCMs increased flexibility in setting exchange speculative position limits.

Again, thank you for the opportunity to comment.

Respectfully submitted,



Bernard W. Dan