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European Committee of Options and Futures Exchanges
Chairman: D.H. Hodson (LIFPE)

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COMMODITY FUTURE SECRETARIAT

18 September 1998

Ms Jean A Webb
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington DC 20581

COMMENT

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Dear Secretary,

CFTC CONCEPT RELEASE ON THE PLACEMENT OF A FOREIGN BOARD OF TRADE'S COMPUTER TERMINALS IN THE UNITED STATES

I am writing as Chairman of ECOFEX – the European Committee of Options and Futures Exchanges – to let you have our comments on the CFTC Concept Release which proposes a regime that would allow foreign exchanges to place terminals in the United States for the trading of products which are subject to CFTC regulation.

ECOFEX

By way of introduction, ECOFEX is an association representing twenty-four derivatives exchanges and clearing houses in Europe. It exists to enable its members to discuss issues of common concern, particularly those which enable us to raise the standards of the derivatives industry in Europe and, where possible, worldwide.

Most of the exchanges in ECOFEX, including those which use open outcry trading platforms as their main means of executing business, have screen-based trading platforms for trading some or all of their instruments. Some ECOFEX member exchanges trade products which are marketed in the United States. Many of the exchanges would wish to place trading screens in the US and, indeed, one has done so through the granting of a no-action letter by CFTC staff.

ECOFEX warmly welcomes the CFTC initiative in issuing the Concept Release. Individual members of ECOFEX may well respond to you direct with their own comments. In this letter, I set out a response which has been endorsed in principle by all members of ECOFEX. As you will appreciate, the letter comments on the broad issues raised by the Concept Release. It has been left to individual Members of ECOFEX to comment on the detailed operation of the regime envisaged by the CFTC.

The CFTC Concept Release

The Concept Release acknowledges, quite rightly, the globalisation of financial markets and the increased use by futures and options exchanges, their members and other users, of advanced technology which is designed to increase the efficiency, affordability and distribution of those markets. We believe that these important innovations have the potential to increase significantly the investment and risk management opportunities which are available to investors, including those in the United States. If these benefits are to be maximised, it is equally important, of course, that the use of new technology is not restricted by outdated, burdensome or inequitable regulation.

ECOFEX supports the CFTC's decision to devise a procedure of general applicability under which foreign exchanges will be able to apply to place trading facilities in the United States. We believe it is quite proper that the Commission intends to subject the new procedure to public scrutiny and debate, and we are grateful for the opportunity to participate in that process. We therefore welcome the publication of the Concept Release, which we regard as generally thoughtful and constructive.

We would, however, urge the Commission to implement the new regime expeditiously because any delay could distort competition between foreign exchanges. A number of foreign exchanges wish to make applications now to place trading facilities in the United States. They are currently unable to obtain regulatory approval to do so, at a time when other foreign exchanges continue to enjoy such access to the US. It is therefore critical to us that the new CFTC procedure, under which applications for such access will need to be made, is implemented by January 1999 as planned.

In considering the timetable, we are conscious of the fact that the granting of permission to individual foreign exchanges could face further delay as a result of a potential bottleneck in applications once the new procedure has been implemented. There are, to our knowledge, six foreign exchanges which will wish to apply from the outset, and there may be others.

Timing apart, the Concept Release raises three additional issues which are of particular importance to European exchanges. The first is the definition of a 'bona fide foreign exchange'. As a matter of principle, ECOFEX does not believe that a bona fide foreign exchange should be defined by reference to the amount of US business which is transacted on it. We believe that doing so could create practical problems for the CFTC and exchanges, particularly as - in view of the global nature of the futures industry, and the size of the US economy - most large foreign exchanges will have significant US membership and trading volume.

Instead, we believe that a foreign exchange should be permitted to place trading screens in the US purely on the basis of the CFTC satisfying itself that the regulatory system, under which the foreign exchange operates, affords a degree of investor protection and market integrity which is comparable to that provided by the US system. This would recognise the primary role of the foreign exchange's home

regulator in supervising the activities of the foreign exchange. Moreover, such an approach would impose minimum additional costs on foreign exchanges and thus on the users of those exchanges – including US investors – while at the same time offering security to US investors, since the CFTC would retain discretion over the granting of permission to individual foreign exchanges.

We are aware that the CFTC has some concerns about the possibility of US exchanges seeking to locate offshore - in a less-well-regulated jurisdiction - purely as a means of avoiding direct regulation by the Commission. For the sake of clarity, I must state that such concerns could not apply legitimately to the home regulatory environment in which ECOFEX members operate.

If, despite our opposition, the CFTC were to decide to conduct an assessment of factors other than the home regulatory system, it would need to exercise extreme care. We believe that the Commission would need to consider a broad range of factors – in addition to the home regulatory environment - including the nature of contracts traded, composition of membership, and volume of US business. Moreover, given the significance of the US economy, we believe that the Commission would need to set high thresholds for US participation. It would also be important for the CFTC to conduct its analysis of these factors on a qualitative, rather than a purely quantitative, basis.

The second additional issue of particular importance for European exchanges concerns equivalence of treatment. Again, as a matter of principle, we believe that – taking account of the primary role of foreign regulators in supervising exchanges which are established within their jurisdiction - equivalent regulatory burdens should apply to the use of US and foreign exchange trading screens in the United States. This is particularly important in relation to the operation of order routing facilities to foreign exchanges. We recommend that there should be a level playing field in the operation of facilities in the US which allow customers electronically to submit orders, via a member – that is, an intermediary which is subject to the rules of the exchange - to the exchange trading host.

In this respect, we note that last year the CFTC approved electronic order routing from customers to CME clearing members who, having conducted automated or manual credit or position checking, submit the order to GLOBEX. We believe that a foreign exchange should be permitted to operate on a similar basis in the United States. The operation of order routing systems should be subject to the exchange satisfying itself that its members have adopted appropriate procedures which ensure that the use of such systems by their customers will not jeopardise the financial integrity of the exchange or its members. This discipline is, of course, a commercial as well as a regulatory imperative, both for the exchange and its members.

Order routing can provide market users with a highly efficient means of dealing on an exchange, while allowing the member to retain control over orders which are being submitted, via that member, to the exchange's trading host. We believe that investors, including those in the United States, should be able to benefit from such facilities in relation to their activity on US and foreign exchanges alike.

The final issue about which ECOFEX members have particular concerns is the extent to which the CFTC will seek to impose notification and reporting requirements on a foreign exchange and its members, both as part of the application process and as continuing obligations. The Commission will, of course, need to have information necessary for it to make an adequate assessment of the regulatory system operating in the home country of the foreign exchange. However, we believe that certain reporting and notification requirements suggested in the Concept Release would create onerous obligations for exchanges and members, for little or no regulatory benefit to investors.

We believe that such requirements will, instead, serve merely to undermine the principle of primary reliance on the home regulator of the foreign exchange in overseeing the exchange's activities. These requirements include the suggested obligation for firms to submit details of any relevant litigation, enforcement action and disciplinary proceedings within the five-year period prior to their application to use a foreign exchange trading screen in the US. The aim of this provision is presumably to protect clients from using an unscrupulous broker. However, the CFTC has stated that any firm in the US which wished to conduct client business using a foreign exchange trading screen would need to be a Futures Commission Merchant. FCMs are, of course, subject to reporting requirements similar to those suggested in the Concept Release, and should not be required to duplicate any previous notifications to the CFTC. Firms conducting US client business pursuant to Part 30.10 exemption would be doing so because the CFTC has satisfied itself that the relevant foreign regulatory authority provides protection which is equivalent to the CFTC's regulatory scheme. The CFTC should not seek to duplicate the foreign authority's regulation of such firms, but should, where necessary, continue to rely on existing information sharing agreements to access firm-specific information.

Conclusion

ECOFEX endorses the CFTC's decision to devise a procedure of general applicability under which foreign exchanges will be able to apply to place trading facilities in the United States. We recommend that the new procedure should recognise the primary role of the relevant foreign regulatory authority in supervising exchanges within its jurisdiction. We also submit that foreign exchanges should not be subject to burdens or restrictions, over and above those faced by US exchanges, in their operation of trading facilities in the United States.

As noted above, individual members of ECOFEX may wish to respond direct to the Commission. If you would find it helpful to discuss any aspect of this letter we should be very happy to comply.

I am copying this letter to Mr Georg Wittich and Mr Fabrice Demarigny, who are respectively the Chairman and Secretary General of the Forum of European Securities Commissions (FESCO).

Yours faithfully

John Foyle

John Foyle
Chairman