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OFFICE OF THE SECRETARIAT

Ms Jean A. Webb,  
Secretary of the Commission,  
U.S. Commodity Futures Trading Commission,  
Three Lafayette Centre,  
1155 21<sup>st</sup> Street, N.W.,  
Washington D.C.  
USA

**COMMENT**

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COMMODITY FUTURES  
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21<sup>st</sup> September, 1998

Dear Ms Webb,

**Re Foreign Board of Trade Terminals**

I am pleased to enclose a Memorandum prepared by OMLX, the London Securities and Derivatives Exchange Limited and OM Stockholm AB in which our comments on the matters raised in the Commission's Concept Release on the above matter published on 24 July 1998 are set out.

Yours sincerely,

**Derek Oliver**  
**Director of Legal Affairs**

A Recognised Investment Exchange in the United Kingdom

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**RESPONSE BY OMLX, THE LONDON SECURITIES AND DERIVATIVES EXCHANGE LIMITED (THE "OMLX EXCHANGE") AND OM STOCKHOLM AB ("OM STOCKHOLM") TO THE COMMODITY FUTURES TRADING COMMISSION (THE "COMMISSION") CONCEPT RELEASE ON THE PLACEMENT OF A FOREIGN BOARD OF TRADE'S COMPUTER TERMINALS IN THE UNITED STATES PUBLISHED IN THE FEDERAL REGISTER VOL. 63 NO. 142 ON FRIDAY 24 JULY 1998**

1. The OMLX exchange and OM Stockholm are very grateful for the opportunity of commenting on the Commission's Concept Release. This letter is presented jointly by the OMLX exchange and OM Stockholm in response to the Concept Release.
2. The Concept Release invites responses to and comments on a number of issues and the OMLX exchange and OM Stockholm set out their opinions below. Before dealing with these specific matters, the OMLX exchange and OM Stockholm would like to make some general comments on what they regard as the main principles which should be applied in the policy areas covered by the Concept Release.

**General Principles applicable to the Commission's Regulation of Foreign Exchanges' trading terminals in the United States**

3. The OMLX exchange and OM Stockholm believe that formal transparent Rules are a preferable basis for the Commission's policy and procedures governing this issue than the former no action process. The more formal and less flexible nature of a Rules-based process makes it important that the scope and nature of the Rules are correctly cast and that such Rules are based on sound foundations. In this respect the OMLX exchange and OM Stockholm have certain concerns about the form that the Rules foreshadowed by the Concept Release might take and the burden that they might impose on applicant exchanges. Many of these concerns are the result of an apparent attempt to codify the principles on which the Commission's no action policy was based. The OMLX exchange and OM Stockholm believe that at this stage the Commission should take the opportunity of making a more radical re-assessment of the proper basis of its policy in this area. The OMLX exchange and OM Stockholm believe that this basis should be:
  - (i) a recognition that there is nothing special about an electronic trading terminal per se which requires a different regulatory approach by the Commission from that adopted in respect of other means of transmitting orders to exchanges;
  - (ii) the Commission's policy and Rules should not involve any unnecessary review of or inquiry into an applicant exchange, the technical features of its electronic trading system or the regulatory background of the exchange's country of domicile UNLESS special circumstances exist which warrant attention being given to such factors by the Commission;
  - (iii) the Commission should take account of factors such as an established record of use and reliability of an electronic trading system and a favourable regulatory background in reviewing applications so as to create a "fast track" regime for exchanges with the requisite reputable credentials;
  - (iv) the Commission's policy and Rules should focus on what is necessary to achieve its proper policy objectives and to protect US investors from any dangers that might result from the presence in the United States of electronic trading terminals provided by foreign exchanges. The OMLX exchange and OM Stockholm believe that these objectives can and should be met by limitations on the category of organisation to whom an electronic trading terminal can be provided as contemplated in the Concept Release.

- (v) the Commission's policy and Rules should provide a simple, straightforward and speedy means for foreign exchanges to secure clearance for the provision of electronic trading terminals in the United States. To this end, absent the special circumstances referred to in (ii) above, the OMLX exchange and OM Stockholm believe that the process should be mainly administrative in nature requiring (a) an initial application by foreign exchanges to the Commission, (b) a review by the Commission in which it would establish the presence or absence of any special circumstances and determine whether the "fast track" procedure should be applied and (c) subsequent notification to the Commission of each FCM with whom a terminal is placed and reporting of other data of specific relevance to the Commission in the monitoring of the use of the foreign exchange's terminal in the United States on an annual or other periodic basis to the Commission;
- (vi) the Commission should clearly recognise in its Rules that the provision of an electronic trading terminal to an organisation in the United States does not per se render the exchange susceptible to the Commission's regulation as an exchange or require the Commission to satisfy itself as to the integrity of the exchange or its technical system. The Commission's Rules and procedures should recognise that such matters are the responsibility of the home state regulator and should place reliance on the work done by that regulator to avoid duplication unless special circumstances are present. The Commission's policy should also recognise that the electronic trading terminal is nothing more than a more modern and efficient means of transmitting instructions to an exchange. If the Commission would not make special inquiries into the exchange's background and other issues where instructions were transmitted by way of telephone, facsimile or any other means of communication, it should not seek to do so in respect of instructions transmitted by means of an electronic trading terminal.

#### **Proper Objective of the Commission's Rules**

- 4. The OMLX exchange and OM Stockholm believe that the Rules to be adopted by the Commission should provide a realistic and workable basis for exchanges seeking approval for the placement of electronic trading terminals in the United States. Rules of the sort that the Commission appears to be minded to adopt on the basis of the content of the Concept Release would provide a clear route for exchanges seeking such approval. The OMLX exchange and OM Stockholm believe that while the proposed Rules contemplated by the Concept Release would certainly be a step in the right direction, they would still involve overseas applicants in some considerable duplication of effort which could well be avoided. Much of the focus of the proposed Rules contemplated by the Concept Release would be directed in such a manner as to require the overseas applicant exchange to satisfy the Commission on issues in respect of which it should in all probability already have satisfied its own domestic regulator in considerable depth.

#### **Relationship between the Commission's Rules and the work of other Regulators**

- 5. The OMLX exchange and OM Stockholm believe that both as a question of practice and of principle the Commission should not inquire into matters which have already been reviewed and established to the satisfaction of the home state regulators of the exchange which wishes to provide the electronic trading terminal unless such factors have a clear and direct impact on the Commission's proper regulatory concerns. If the home state regulator has satisfied itself that the trading system meets or surpasses the IOSCO principles for screen-based trading system no purpose is served by the Commission requiring the exchange to demonstrate the self-same compliance to it. If there is an established record of successful practical use of a trading system there is no benefit in the

Commission exploring theoretical issues pertaining to the technical merits and standards of the trading system.

6. Putting this another way, the extent of the Commission's inquiries with regard to an application by a foreign exchange concerning the placement of its electronic trading terminals should vary according to the extent to which that exchange is able to demonstrate that identified matters have already been reviewed to the satisfaction of an acceptable regulator. This degree of variation could involve a number of stages from green light for those applicants who can demonstrate that issues of concern to the Commission have been reviewed to the satisfaction of an acceptable regulator to a red light for those exchanges based in a jurisdiction where the Commission lacks confidence in regulatory standards. The objective should be for the Commission to rely on reliable regulatory work undertaken in other jurisdictions so as to avoid any unnecessary duplicative burden and to reserve its own inquiries into issues which should have been dealt with by the home state regulator of the exchange to cases where the Commission has reason to doubt either that such matters have been reviewed by such regulator or the quality of any such review that may have been carried out.
7. These and other similar questions are of direct relevance both to applicant exchanges and to the Commission. If the Rules require unnecessary matters to be presented to and reviewed by the Commission considerable and avoidable costs will be incurred and time will be spent on matters which do not merit the devotion of such resources to them. The Rules should be drafted to ensure that that does not happen.
8. By way of practical illustration of these general concepts, one of the statutory requirements which the OMLX exchange must satisfy in order to retain the status as a recognised investment exchange obliges it to ensure that business carried out by means of its facilities is conducted in an orderly manner so as to afford proper protection to investors. It follows necessarily from this that the electronic trading system we provide to our members must be considered as sound by our regulator, the Financial Services Authority. The issues identified in the Concept Release as being important constituent elements of an electronic trading system from a regulatory perspective are of equal importance to the system provider in establishing confidence in its system and to users of the system. It is not easy to envisage a situation in which an electronic trading system could have been operated over a number of years in a number of different markets without there being an acceptable order execution algorithm, for example. The OMLX exchange and OM Stockholm believe that the widespread use of their electronic trading system among the combined membership of OM Stockholm and the OMLX exchange and by a large number of exchanges around the world, confers on their electronic trading system an established record of regulatory acceptability which should be deemed sufficient by the Commission in any evaluation of the trading system.

#### **Relevant Factors to be considered by the Commission**

9. The OMLX exchange and OM Stockholm recognise that the Commission has a proper interest in ensuring that markets and trading platforms used by members based in the United States are of an acceptable quality. The OMLX exchange and OM Stockholm believe that the interest can properly be satisfied in appropriate cases by reference to the factors outlined below with a more rigorous approach being reserved for use in circumstances in which those factors do not apply. In formulating its approach to the proper basis of its policy for the review of applications from overseas exchanges for approval for the placement of electronic trading terminals in the United States the Commission should differentiate between steps that are required to be taken for a given category of applicant from a well-regulated background and those more rigorous steps required in other circumstances.

10. It is neither in the interests of the Commission nor those of the applicant exchanges for this process to be unnecessarily protracted. Steps which the Commission could take to reduce the possibility of such eventualities would be:
- (i) for the Commission to recognise clearly that its Rules governing the provision of terminals in the United States by foreign exchanges should not be based on the same principles and practices as the Commission would adopt if it had the sole or primary responsibility for the regulation of the exchange but should rather give proper credit to prior determinations by other regulators concerning the applicant exchange and its system;
  - (ii) for it to take account of the established status of an electronic trading system by reference to a combination of the regulatory acceptance of the system by recognised regulators, its proven record as an efficient trading system both on the applicant exchange and on other exchanges and its use by member firms of high repute;
  - (iii) for the Rules to recognise the fact that certain electronic trading systems are used by a number of exchanges and to incorporate a procedure in the Rules that reduces or eliminates any unnecessary duplication in the review work on the quality and standards of an electronic trading system in respect of a petition from a foreign exchange where the trading system used by that exchange is generically the same as a system used by a previous petitioner. Thus, if following acceptance of a petition submitted by the OMLX exchange and OM Stockholm, the work of the Commission in reviewing subsequent petitions from OTOB, the Hong Kong Futures Exchange or other exchanges using the OM CLICK system should be significantly reduced; and
  - (iv) for the Commission to focus its review of applications on issues which are of proper concern to it and which have not been sufficiently covered by other channels.

**Focus on the protection of U.S. Investors as the Commission's principal regulatory concern regarding the provision of foreign terminals**

11. On the other hand, the Commission will also have a proper interest in protecting the interests of U.S. customers. Part of that protection will be derived from the systems integrity issues discussed above and its concerns in that area can be satisfied in the manner indicated above. Other aspects of customer protection can only be dealt with on a case by case basis and will necessarily involve the Commission in considering questions particular to the situation in the United States. Which organisations will be provided with terminals? Which of these organisations will be able to execute transactions on behalf of U.S. investors? Is the system operator able to limit access for US investors to products which have been cleared for trading by such person? As indicated in detail below, the OMLX exchange and OM Stockholm broadly support the Commission's proposals in these respects.
12. The OMLX exchange and OM Stockholm believe that in framing its Rules governing the provision of electronic trading terminals the Commission should recognise clearly the nature of its regulatory requirements with regard to this question and should also take full account of issues which have already been addressed by other regulators. Duplication and complication of what should really amount in many cases to a merely administrative registration process as a result of a failure by the Commission to take note of appropriate regulatory work undertaken in other jurisdictions would impose an unnecessary burden on foreign exchanges and deny or delay US organisations the optimum means of access to foreign markets. That is in nobody's interest. Such an attitude could also call into question the Commission's commitment to international co-operation, an issue best

judged by reference to practical experience rather than well-intentioned pronouncements, and encourage the construction of other equally complex and costly procedures restricting, delaying or discouraging US participation in foreign markets or the presence of US exchanges in foreign markets.

13. The OMLX exchange and OM Stockholm believe that the maximum benefit would result if the focus of the Rules was centred on issues which are of clear and direct concern to the Commission and its regulatory concerns. The OMLX exchange and OM Stockholm believe that these concerns are the protection of the interests of US investors from the risks that might arise from the provision by an overseas exchange of an electronic trading terminal in the United States. Those risks are greatly reduced if the Rules require the electronic trading terminal in the United States used for executing orders on behalf of a US investor to be operated by a FCM. Questions of the suitability of the product and the market on which it is traded would most likely have been covered already in other regulatory processes applied by the CFTC and SEC. In such cases where the products have already been cleared by the Commission, there should be no greater risk for the US investor than would arise if the transaction were to be executed on a domestic market.
14. The OMLX exchange and OM Stockholm believe that the identification of specific areas of concern by the Commission and the limitation of the scope of the Rules to issues which are directly relevant to such concerns should be the objective. The OMLX exchange and OM Stockholm also believe that in appropriate cases, the Rules should provide for proper account to be taken of factors which demonstrate the acceptability of an established trading system. Re-invention of the wheel or submission of technical explanations to demonstrate that in theory the wheel is well-designed and should function efficiently and perform its allotted tasks is both unnecessary and avoidable once the wheel has been used successfully and extensively.
15. To summarise these general comments, the OMLX exchange and OM Stockholm believe that the proposed Rules should prove beneficial and provide a better means of dealing with these issues than has been available in the past. At the same time, there remains scope for further improvement by reducing unnecessary duplication of regulatory effort which the OMLX exchange and OM Stockholm believe is eminently achievable by the development of improved arrangements for regulatory reciprocity among international regulators.

#### **Scope and Focus of the Commission's Rules**

16. Another principle that the OMLX exchange and OM Stockholm believe is of vital importance in this area is that the Rules are sufficiently flexible in their drafting and structure to enable their continued use in what will, given the rapid pace of technical innovation in the area, assuredly be materially different circumstances five or ten years from now. The OMLX exchange and OM Stockholm note and endorse the Commission's intent to attempt to apply the Rules on a purposive basis rather than to focus solely on the provision of trading terminals by exchanges. In drafting the Rules the Commission should seek to avoid the dangers of a "technology warp" which could result if the Rules were directed too specifically at dealing with the particular technical status quo at the adoption of the Rules.
17. Bringing order-routing systems and other means of electronic communication within the orbit of the Rules raises the question of what the proper focal point of the Rules should be in order to achieve the intended regulatory purpose of protecting U.S investors. There are already means by which a U.S organisation can transmit orders to a member of an overseas exchange without that exchange providing the organisation with one of its terminals or doing any other act which could properly be regarded as bringing the exchange within the scope of U.S regulation.

18. It is a fundamental issue of principle whether the Commission should base its approach in this area on the concept that the provision of a terminal by an overseas exchange to an organisation based in the United States brings the exchange within the ambit of U.S regulation rather than seeking to regulate the activities of U.S organisations and the manner in which they use an overseas market. The OMLX exchange and OM Stockholm believe that the latter option is preferable for a number of reasons described in paragraphs 20 to 23 below.
19. Firstly, one must not lose sight of the fact that the electronic trading terminal is nothing more than a means of executing an order in a market. It is analogous to the use of a telephone or a telefax to transmit instructions to a broker to execute a trade on the floor of an exchange.
20. Neither case justifies the position that the overseas exchange needs to be subjected to U.S regulation in order to provide protection to U.S investors. That protection is best afforded by a combination of the existing and separate framework of U.S regulation governing product approvals and the regulation of U.S brokers in their dealings with U.S investors.
21. Secondly, the OMLX exchange and OM Stockholm believe that this approach is better suited to the challenges posed by future technological innovations. A framework that implicitly relies on an overseas exchange approaching the Commission for approval does not lend itself well to the possible future situations in which the policy may need to be applied.
22. The OMLX exchange and OM Stockholm would suggest that it would be sounder for the Commission to focus its regulatory attention on the regulated entities resident in the United States. Such an approach provides several benefits for all concerned. The Commission is able to apply the necessary degree of control at a point which is already regulated by it and is relatively easy to monitor. US investors would know that, consistent with arrangements with which they will already be familiar with in relation to trading in other non-US products, they would need to deal through the medium of a FCM. The FCM would similarly know that it was operating in familiar territory regarding product approval with a simple additional inquiry required to confirm that the exchange's terminals had been cleared for use in the United States by the Commission. The exchanges would have a clear and simple test to apply in determining whether a terminal could be provided to a particular organisation and whether any restrictions were required. Most importantly, all parties concerned, the investor, the FCM and the exchanges would have the benefit of a system which allowed their common interest in the development of business in diverse financial markets to be fulfilled.
23. The OMLX exchange and OM Stockholm believe that the adoption by the Commission of Rules requiring US registered brokers to inform the Commission of:
  - (a) each overseas exchange with which it operates a direct electronic trading connection
  - (b) each overseas market in respect of which it provides an order routing service to US residents and the identities of the persons it provides such services to;
  - (c) each product traded on such overseas market which it trades on behalf of United States residents

should be a sufficient basis for protecting US residents and would be considered more efficient and effective than regulation based on a detailed evaluation of an electronic trading system and would provide all parties concerned with an effective and efficient means of securing their individual objectives while meeting all proper regulatory

concerns arising from the provision of electronic trading terminals in the United States by foreign exchanges.

### **Proposed Rules and Petitioning Process**

24. As indicated elsewhere in this Memorandum, the OMLX exchange and OM Stockholm have serious general concerns as to the nature of the Rules foreshadowed by the Concept Release and of the requirements to which they would be subject if Rules on those lines were adopted by the Commission. In this section the OMLX exchange and OM Stockholm elaborate on these concerns specifically.

25. The Concept Release indicates that the Commission might require an exchange applying for permission to place electronic trading terminals in the United States to provide the Commission with the information set out below. The OMLX exchange and OM Stockholm comment against each item on the relevance of the information to the question in hand.

**(i) General information concerning the petitioner board of trade and its products**

This is necessary but should not duplicate any existing filing: if use of the terminal is to be restricted to approved products, there should be no need for information concerning those products which would already have been filed with the Commission or the SEC as part of the product approval process to be reproduced. Equally there should be no requirement to provide information relating to products which will not be tradable by way of the terminal by the registered US user.

**(ii) Information concerning the petitioner's Rules, the laws and Rules in effect in the petitioner's home country and the methods for monitoring compliance therewith**

These matters are of no relevance to the question of the provision of an electronic trading terminal. To the extent that they are of regulatory concern to the Commission they would need to be reviewed at the time when the products themselves are being considered for approval. No additional specific concerns arise from the provision of a trading terminal as an alternative means of executing transactions in the products which require a re-examination of these issues.

**(iii) Information related to the petitioner's technological system and standards**

Information requested under this heading should be limited to that which is strictly required for the Commission's purpose. The Commission should evaluate carefully what information it really requires for such purposes and ensure that the Rules are framed accordingly: does it need to know that the system uses IBM XYZ or does it need a detailed description of all of the features of IBM XYZ ?

As indicated elsewhere, the OMLX exchange and OM Stockholm believe strongly that the Rules adopted by the Commission should differentiate clearly in the amount of information that is required to be provided by an applicant exchange which has a well-established and proven trading system and/or is based in a jurisdiction which the Commission recognises as having an acceptable regulatory framework and an exchange which does not fall within one or both categories.

**(iv) Financial and accounting information pertaining to the petitioner**

This does not appear to be of any relevance to the consideration by the Commission of the provision of electronic trading terminals by an overseas exchange.

**(v) Information concerning the ability of US Boards of Trade to place and operate computer terminals in the petitioner's home country**

The proposed adoption by the Commission of a regulatory reciprocity requirement is discussed elsewhere in this Memorandum. To the extent that such a test is adopted, the information that would be required under this heading would be relevant to the Commission's consideration of the petition. The Commission could provide in its Rules or procedures that such information need not be provided by exchanges in designated jurisdictions, i.e. those which the Commission had already satisfied itself regarding regulatory reciprocity or by exchanges based in jurisdictions in which other exchanges had previously satisfied the Commission with regard to this issue.

**(vi) Information concerning the petitioner's intended US activities and presence**

The OMLX exchange and OM Stockholm recognise that this information may be of relevance to the Commission's consideration of the petition.

**General Comment**

27. The OMLX exchange's general conclusion concerning the nature of the information that petitioning exchanges should be required to provide to the Commission is that such information should be restricted closely to information that is relevant to the issue in hand, namely the provision of an electronic trading terminal by a foreign exchange. The OMLX exchange and OM Stockholm believe that the Rules and procedures adopted by the Commission should recognise the fact that the Commission's approach should not be to require the petitioner to provide the Commission with the sort of information which a body seeking designation from the Commission as a contract market might be required to provide. The Commission should in all appropriate cases take account of the fact that the petitioner is already regulated by a regulatory body in an appropriate jurisdiction and that the regulation covers the exchange's electronic trading system. Specific additional inquiries should only be required in cases where the petitioning exchange does not have an established presence in an acceptable jurisdiction or that its trading system is new or lacks an established record of satisfactory usage.

**Proposed Conditions on an Order**

28. The OMLX exchange and OM Stockholm would like to comment as follows on the proposed conditions to an order outlined in the Concept Release.

- (i) The OMLX exchange and OM Stockholm believe that a condition that electronic trading terminals must be located only in the offices of members of the exchange is appropriate and is indeed consistent with the established policy of the OMLX exchange and OM Stockholm with regard to the provision of such terminals generally.

The extension of the definition of "member" to include "affiliates" and "office" to include "booth on the floor of a US board of trade" is appropriate and welcome.

- (ii) The condition that a person executing a trade other than for its proprietary account must be registered as a FCM and the related proposal that the operator of any terminal provided to a FCM would be one of its associated persons are appropriate, acceptable and consistent with the general policies currently applied by the OMLX exchange and OM Stockholm.
- (iii) The condition requiring the notification to the Commission of any material changes in the information provided by the petitioning exchange is appropriate and acceptable. This comment needs, however, to be considered in the light of our general comments regarding the proper nature and the extent of the information to be provided by a petitioner.
- (iv) The condition requiring notification of known violations of the order, the Act, the Commission's Rules or any other futures regulatory scheme by the exchange or a member or affiliate operating under a Commission order could benefit from being drawn more specifically. Notification of "known violation" would in many cases be too late in time and would in many cases constitute a repetition of an already reported matter to the Commission. The OMLX exchange and OM Stockholm would favour notification obligations which related to matters concerning the activities of a FCM or affiliate in using the electronic trading terminal.
- (v) Conducting on-site reviews are accepted as an appropriate means of ensuring compliance by members with applicable exchange requirements. The ability to delegate such process to the NFA or to a US self-regulatory organisation should be incorporated into the Rules.
- (vi) The condition regarding information sharing arrangements is acceptable although consideration should be given to the exact nature and scope of such arrangements which would be required for such purposes. The OMLX exchange and OM Stockholm, however, believe that there is no need to go further than a requirement that the exchange itself agrees to provide information to the Commission.
- (vii) The condition regarding the filing of quarterly reports with the Commission is acceptable although it is not really clear that the Commission requires any information beyond the number of transactions executed by US users, the total transactions executed by US users for each product, and the percentage that number represents of the overall level of transactions in each product. These comments should, however, be considered in the context of our general observations on the use of such traded volumes as a means of establishing an exchange's presence in the United States.
- (viii) The ability for the Commission to modify, revoke etc. any order or take any required enforcement action is appropriate.

### **Regulatory Reciprocity**

- 29. The OMLX exchange and OM Stockholm note that the Commission is proposing to apply a test of regulatory reciprocity as one of the factors to be considered in determining an application from an overseas exchange for permission to place its terminals in the United States.
- 30. The OMLX exchange and OM Stockholm recognise that there are strong arguments to support such a policy and that greater international co-operation and harmonisation of regulatory principles and approaches bring all-round benefits. The OMLX exchange and OM Stockholm also recognise that the inclusion of such a test reduces the ability of

protectionist interests who would seek to exclude terminals of overseas exchanges from their domestic markets on the basis that they are denied parallel rights of access in the country in question.

31. The OMLX exchange and OM Stockholm believe that there is a natural and justified interest in promoting a regulatory playing field that is level and that, subject to the points set out below, it is appropriate for the benefits of, in this case, the ability for an exchange to provide its electronic trading terminals in the United States being conditional upon its regulator adopting or continuing a similarly open approach to applications from United States exchanges seeking similar privileges.
32. In instituting a regulatory reciprocity requirement the OMLX exchange and OM Stockholm believe that it is essential that the Commission concentrates on the end of achieving equal rights of access rather than the means whereby reciprocity is delivered by any individual regulator. The OMLX exchange and OM Stockholm believe that it would be wrong in principle and problematical in practice for the Commission to prescribe a particular framework of policy or procedure as the means of judging whether sufficient regulatory reciprocity exists or not. It may well be that in the course of time international co-operation will promote a standard pattern by which regulators agree on the procedures and tests to be applied in considering applications from foreign exchanges concerning the provision of terminals in their jurisdiction. That is a very different proposition from the adoption of a policy which says approval is dependent upon reciprocity and reciprocity itself is dependent upon the mirror image of one set of Rules being applied in the other jurisdiction.
33. The OMLX exchange and OM Stockholm would favour the application of a test of regulatory reciprocity which operated on the basis that the Commission in considering an application from an overseas exchange, should satisfy itself that the regulator in the jurisdiction in which the applicant exchange is based does not apply policies and procedures in considering such applications which are materially more restrictive than those applied by the Commission. In considering in any given case whether the required level of reciprocity is present, the Commission should have regard to the record of prior applications and approvals concerning the placement of terminals by United States exchanges in a given jurisdiction. The OMLX exchange and OM Stockholm believe that it should go without saying that a jurisdiction in which United States exchanges have already been allowed to place terminals would by that fact be deemed to have satisfied the regulatory reciprocity requirement.
34. By way of illustration, the OMLX exchange believes that the United Kingdom operates a regime for the recognition of overseas investment exchanges which provides a simple and straightforward mechanism for overseas exchanges to place electronic trading terminals in the United Kingdom and which recognises that the responsibility for the supervision of the overseas exchange should be left in the hands of the home state regulator. This regime is described in section C of the Concept Release headed "Foreign Regulators' Treatment of U.S Terminals in Their Jurisdictions". The Chicago Board of Trade, the Chicago Mercantile Exchange, the New York Mercantile Exchange and NASDAQ have been recognised by HM Treasury under these arrangements.
35. The policy applied by Sweden in this area is that a non-Swedish exchange may place electronic trading terminals in Sweden provided that such terminals are placed with firms which are authorised to conduct investment business in Sweden. No application is required by the exchange to the Swedish Financial Supervisory Authority (the "FSA") prior to the placement of the terminal. The focus of the FSA's supervision in this area is the use that the Swedish investment firms makes of the terminal provided by the non-Swedish exchange. The OMLX exchange and OM Stockholm believe that this approach is an appropriate method for regulators generally to adopt concerning the placement by

foreign exchanges of electronic trading terminals within the regulator's jurisdiction and we comment it to the Commission.

36. The OMLX exchange and OM Stockholm also believe that it is vitally important that the adoption of a policy of regulatory reciprocity is accepted by all concerned as an integral element of a process of opening financial markets around the world to appropriate participants rather than, as evidence from other markets suggests is often the case, as a means of seeking benefits from access to overseas markets while seeking to exclude access to one's domestic market on the grounds of lack of reciprocity.
37. The OMLX exchange and OM Stockholm would also add one final word of caution regarding the adoption of a regulatory reciprocity requirement. Reciprocity is by definition bilateral in nature. There is a possibility that the response of other jurisdictions to the imposition of a regulatory reciprocity requirement by the Commission might be to follow suit by adopting a similar requirement. That in itself need not be a problem unless and until a jurisdiction which had a more liberal and easier process than the Commission's decided to interpret its reciprocity test as being satisfied by processes which were as liberal and welcoming as its own. There is a danger that the application of such a requirement could lead to unintended and unwelcome consequences through a resultant tit for tat policy instigated by vested interests in each jurisdiction seeking to protect their domestic market. This militates in favour of a general application of the reciprocity test and in favour of a broad, general recognition of jurisdictions which meet such reciprocity requirements at an early stage.

#### **U.S. Presence Test**

38. The Concept Release invites comment on whether a volume test should be applied to determine whether an exchange is "foreign" for the purposes of US regulation.
39. The OMLX exchange and OM Stockholm do not believe that such a test is an appropriate method of determining whether an exchange is foreign or conversely whether it should be subject to U.S regulation.
40. The OMLX exchange and OM Stockholm recognise that certain bodies might choose to establish an exchange under a flag of convenience with a clear intent of running a market in predominantly US products, with a predominantly US membership and a predominantly US customer base at a lower cost and at a lesser standard of regulation than it would be subject to if based in Chicago or New York. That is a specific potential problem which should be dealt with by specific means. An exchange which is genuinely established in the United Kingdom or Sweden and which is subject to United Kingdom or Swedish regulation as the case may be should not be put in a position in which it might, as a result of the degree of interest in one of its products among US investors, find itself being classified as an exchange subject to CFTC regulation. Such a test would be deeply flawed: the volumes on which it is based are transitory so that an exchange could not safely predict whether it would be able to become or to cease to be subject to US regulation. It would render exchanges liable to dual regulation in an unpredictable manner. It would not provide US investors with any greater protection.
41. The Commission in its Rules should recognise the fact that the relative economic strength of US interests will mean that the removal of measures which restrict US access to foreign markets will necessarily involve a significant percentage of the volume of trades on that market being represented by US investors. That fact alone should not render a Swedish, Swiss, Dutch or French market liable to be classified as a US market.
42. What this issue is really concerned with is improper attempts to evade the scope of US regulation. The regulatory response to such attempts should be specific and to the point and should not come in the form of a part of the Commission's policy regarding the

provision of electronic trading terminals in the United States by genuinely foreign exchanges.

### **Comparative Regulation**

43. The OMLX exchange and OM Stockholm have serious concerns with the Commission's suggestion that its Rules might require applicants to satisfy the Commission with regard to the relative standards of regulation in its country of domicile. These concerns are founded on a mixture of the length of time, the cost and the complexity which consideration of such factors would bring to the application process and the fact that such issues generally should not have any direct bearing on the question of the provision of trading terminals. Regulatory comparability can be of significance in certain areas of policy, for example, one which permits organisations based in certain jurisdictions exemptions from US registration requirements to which they would otherwise be subject.
44. In the current context, however, the OMLX exchange and OM Stockholm believe that circumstances which might justify the application of a regulatory comparability regime are conspicuously absent. Firstly, the provision of an electronic trading terminal on the basis contemplated by the Concept Release to United States FCMs does no more than provide an alternative and better means of access to the financial market in question. Such access would be restricted to products which have been approved specifically or generally as being suitable for trading by United States persons. In that context, a detailed examination of the level of background regulation applicable in the jurisdiction in which an exchange is based would be:
- (i) unnecessary in that it would involve issues which are not germane to the matter in question; and
  - (ii) duplicative in that such issues would have been considered in the review of the product by the appropriate regulatory agency.
45. To summarise the foregoing, the OMLX exchange and OM Stockholm do not believe that any additional specific requirement regarding regulatory comparability should be adopted in relation to applications for the placement of electronic trading terminals in the United States. A better basis for policy in this area is the recognition that the presence of an acceptable level of regulation in an exchange's home state reduces the required scope of the Commission's regulatory inquiries and enables it accordingly to establish a fast track procedure for well-regulated applicants. Such a test necessarily involves the Commission forming its own judgement on jurisdictions which have an acceptable level of regulation. That judgement should be made by the Commission generally and not in response to an individual application. The OMLX exchange and OM Stockholm recognise, however, that one of the factors that the Commission should have regard to in determining the beneficiaries of a fast track procedure is the fact that an exchange is based in a jurisdiction which has already secured Part 30.10 Comparability Relief on the basis that the Commission would already have reviewed the background regulatory structure in that jurisdiction and would by virtue of that process be aware that the relevant standards were satisfied.

### **Conclusion**

In conclusion the OMLX exchange and OM Stockholm would like to summarise their comments on the matters covered in the Concept Release as follows:

- (i) they support strongly the adoption of clear and appropriate Rules governing the provision of electronic trading terminals in the United States by foreign exchanges as representing a clear improvement on the previous no-action procedure;

- (ii) the Rules to be adopted by the Commission should be focused clearly and solely on issues that are of proper regulatory concern to the Commission;
- (iii) the adopted Rules should provide a flexible framework which will continue to be applicable as technology develops further;
- (iv) the adopted Rules should provide a clear and speedy framework for an exchange to meet its objective of providing electronic trading terminals to users in the United States;
- (v) the adopted Rules should impose the minimum regulatory burden on petitioning exchanges that is consistent with the proper discharge of the Commission's regulatory responsibilities;
- (vi) in accordance with the above, the Commission should ensure that it gives due credit to adherence to applicable regulatory standards for the petitioning exchange and its electronic trading system which the petitioning exchange is also to demonstrate by reference to its regulatory establishment, the established used of the trading system and other relevant factors.

We trust that our comments are of assistance to the Commission in its consideration of these issues and would be happy to participate in any further discussion as the Commission may wish.