

COMMODITY FUTURES
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October 6, 1998

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Secretary of the Commission
Commodity Futures Trading Commission
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COMMENT

Re: Concept Release on the Placement of a Foreign Board of Trade's
Computer Terminals in the United States

Dear Ms. Webb:

Deutsche Bank AG ("DB") and its wholly-owned subsidiary, Deutsche Bank Securities Inc. ("DBS") (collectively referred to herein as "Deutsche Bank"), respectfully submit this comment letter in response to the Commodity Futures Trading Commission's ("CFTC" or "Commission") request for comment on its Concept Release on the Placement of a Foreign Board of Trade's Computer Terminals in the United States ("Concept Release"). 63 Fed. Reg. 39779 (July 24, 1998).

DBS is registered as a futures commission merchant ("FCM") with the Commission and DB and DBS are members, either directly or through affiliates, of both national and international futures exchanges.

Overview and General Comments

Deutsche Bank commends the Commission for its willingness to address the important issues related to providing electronic access to a foreign futures exchange from locations within the United States. Technological advances are fundamentally altering the way futures markets operate and automated mechanisms are facilitating the means by which foreign markets are accessed. New technologies will greatly increase access to foreign markets and products, make trading more efficient and cost effective and promote competition at all levels of the marketplace.

Deutsche Bank welcomes the tremendous opportunities and benefits that technology provides. At the same time, we support the Commission's decision to carefully consider the regulatory implications of new technology and to re-examine fundamental regulatory constructs in light of these developments. Technology is facilitating remote access to futures exchanges by dispersed firms and customers, and the Commission has a legitimate interest in ensuring that the use of new technology does not affect core customer protections mandated under the US



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Commodity Exchange Act ("CEA")¹ or a firm's financial or operational viability. In this environment, the Commission is right to seek comment on whether the existing regulatory structure is appropriate for the global business and technological environment in which markets and firms operate today.

However, we urge the Commission to adopt a flexible, forward-looking regulatory framework that will accommodate evolving technology and new practices, situations and technology. Specifically, the Commission should avoid imposing detailed, prescriptive rules concerning the method and means by which firms and markets comply with Commission requirements. It should instead articulate standards for customer protection and market integrity and allow markets and firms to have the latitude necessary to make commercial and operational judgments about how they will meet regulatory requirements. Failure to adopt this approach will perpetuate regulatory uncertainty for markets, firms and customers as to the consequences of the use of specific technologies. Ultimately, it will affect the ability of US customers to hedge the risk associated with their international portfolios and the ability of US firms to deliver the services and provide the software that their competitors around the world are now able to provide.

It is in this context that Deutsche Bank offers the following comments to the questions posed by the Commission.

Responses to Certain Questions Raised in the Concept Release:

The Concept Release requests comment on a broad range of issues related to a foreign exchange's placement of computer terminals in the US and the appropriate treatment of order routing systems. This letter does not respond to each inquiry on which the Commission seeks comment. Rather, we have highlighted those issues that Deutsche Bank believes are particularly relevant to maintaining high levels of customer protection, the safety and soundness of FCMs and the financial integrity of global futures exchanges.

¹ 7 USC §1 et seq.



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I. Computer Terminals vs. Order Routing Systems

The Commission solicits comment on whether mechanisms that enable customers to submit orders electronically to an FCM and, subsequently, to a foreign futures exchange without any human intervention at the FCM, should be considered a "computer terminal" under Commission rules.² The Commission asks what characteristics would distinguish an automated order routing system from a computer terminal, and asks in this regard whether the Commission should require an employee of the FCM to take some "affirmative, non-automated action" to transmit the order for execution and whether any restrictions, such as the type and amount of information available on the system should apply.³ The Commission also inquires whether fully automated order routing systems should be permitted to provide access to all foreign futures exchanges, even if the foreign exchanges have not received permission to place terminals in the US.⁴

Technology has made it possible for a customer who is not a member of a foreign futures exchange to trade directly on that exchange using the electronic interfaces of a member of the exchange, who could be either the customer's broker or the broker's foreign affiliate. The member provides a direct, automated link between the customer and the foreign exchange by connecting the customer's computer to its own, which is connected with the foreign exchange's electronic trade execution system (i.e., computer terminal). The member's system, which can be proprietary or developed by a third party vendor or a futures exchange, disseminates market and trade information to the customer and routes the customer's orders directly to the market.

It is possible, therefore, for a non-member customer to have electronic trading capabilities that are equivalent to the trading privileges of a member of the foreign exchange. Moreover, from the foreign exchange's perspective, orders transmitted by customers in this manner may be indistinguishable from orders received from their members

² 63 Fed. Reg. at 39787.

³ Id., at 39788.

⁴ Id.



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For these reasons, Deutsche Bank urges the Commission to focus on the regulatory concerns, if any, posed by the activities undertaken using the facilities of new technology and not on whether the system is an exchange operated computer terminal or whether the system is an automated order routing system. If the Commission determines to establish a framework for regulating foreign markets that permits direct automated access from locations in the US, it also should seek to ensure that the concerns addressed by that framework are not circumvented because the system providing the direct access is an automated order routing system that interfaces with an exchange's computer terminal, and not a computer terminal.

We do not advocate that order routing systems should themselves be regulated as exchanges. Rather, as technology has made actual location less relevant in the analysis of regulatory risk, the proper inquiry for the Commission should be: is the foreign exchange physically in the US or should it be deemed to be in the US by virtue of the manner in which persons in the US access the products of the exchange?

The Commission asks in this regard what "features would the system have to include or lack so that it would not be deemed a computer terminal under Commission rules?"⁵ In distinguishing between order routing systems that have the functionality of computer terminals and those that do not, the Commission should undertake a qualitative analysis and focus on the type of "human intervention" rather than on the amount of "human intervention." Specifically, the determination should turn on whether the automated order routing system in the normal course of business is exercising the "discretion" that the broker normally exercises in the context of transmitting an order for execution.

For example, if an order routing system requires an employee of the firm to review, accept and take some affirmative, non-automated action to transmit each and every order for execution on the foreign exchange, that system would not be deemed to have the functionality of a "computer terminal" with the consequences of that definition. On the other hand, if the "human intervention" consists only of a review of only those customer orders that fail to satisfy certain prudential filters programmed into the system by the FCM and tailored to that customer, or otherwise consists solely of the press of a keyboard by a clerical employee of the firm to transmit every order for execution, a real question arises as to whether access to the foreign

⁵ Id.



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futures exchange via the automated order system is not equivalent to the access provided by a foreign futures exchange's computer terminal.

We further urge the Commission not to adopt an approach that would require the pre-approval of each new order routing system prior to its use. The Commission should instead promulgate clear standards for such systems consistent with customer protection concerns and make those providing innovative systems responsible for ensuring that the system satisfies the standards.

II. Access to Computer Terminals and Order Routing Systems

The Concept Release incorporates an approach developed by the CFTC's Division of Trading and Markets ("Division") to permit members of a foreign futures exchange and their affiliates to place "computer terminals" in their US offices or in their firm booths on the floor of a US futures exchange.⁶ The Commission also inquires to what extent customer use of automated order routing systems and computer terminals should be permitted and what safeguards, restrictions and conditions should apply to their use.⁷ The Commission notes that the Division's approach does not currently contemplate that the proposed rules would permit a customer to have a direct link to a foreign futures exchange's floor or computer terminal without first flowing through a registered FCM that is also a member or affiliated with a member of the foreign futures exchange.⁸

To date, the Commission has not expressed a view on the status of entities that provide US persons the ability to trade directly on foreign futures markets from US locations. Our comments on the Division's proposed approval process for foreign futures exchanges that provide direct access to their products from US locations is set forth in Section III below. The principal focus of this Section is the broker/client relationship and the appropriate status of those who provide US customers with systems that provide direct access to the foreign futures exchange's products.

⁶ Id., at 39784-39786.

⁷ Id., at 39787-39788.

⁸ Id., at 39787.



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The Commission's customer protection rules currently mandate that those who do business with US customers involving foreign futures and options transactions (and accept funds related thereto) must register as an FCM or be exempted pursuant to relief provided under Part 30 of the CFTC rules.⁹ Except in the case of FCMs who have customer omnibus accounts with foreign exchange member firms or foreign affiliates, or of US persons who trade solely for proprietary purposes through an affiliate, all US persons must have an account with an FCM or firm exempted under Part 30.¹⁰ Although technology has changed the manner in which brokers and customers relate to, or communicate with, each other and with the markets, it is not clear that technology has changed the core regulatory relationships between the parties, or their rights and obligations. The customer remains obligated to the broker to meet margin obligations and the broker is responsible for all mandated customer protection requirements and similarly remains responsible to the clearing firm or the exchange/clearinghouse for all trades executed for or on behalf of its customers. In general, Deutsche Bank believes that this regulatory framework addressing registration requirements for those who do business with US customers should continue in effect. However, for the reasons set forth below, we do not believe that the same analysis should necessarily apply in respect of the manner in which intermediaries provide access to the products of a foreign futures exchange.

A. Futures Commission Merchants

The CEA sets forth a comprehensive regulatory structure applicable to registered FCMs. The program for customer protection and market integrity ensures the following: (i) that only those who are fit and proper may deal for customers or otherwise control the operations of the firm; (ii) that the firm adheres to sales and trading practice requirements to ensure that customers are treated fairly, are not misled and are provided with material disclosures; (iii) that FCMs

⁹ See 17 CFR Part 30.

¹⁰ See CFTC Staff Interpretative Letters Nos. 88-15, Comm. Fut. L. Rep. (CCH) ¶24,296 (August 10, 1988) (which provides that the registration requirement does not apply to any person trading solely for proprietary purposes), and 87-7, Comm. Fut. L. Rep. (CCH) ¶23,972 (Nov. 17, 1987) (which provides that the registration requirement does not apply to a foreign firm that is either a member of a foreign exchange or is affiliated with an FCM whose sole nexus with a US customer is that it carries that FCM's customer omnibus account).



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provide customers with proper documentation related to the status of their accounts; (iv) that the firm protect the funds of US customers; and (v) that it complies with prescribed capital requirements to ensure that FCMs do not assume a level of risk that would affect their financial and operational viability. More importantly, these requirements are backed by a rigorous surveillance program pursuant to which US regulatory and self-regulatory authorities, on both a routine and as needed basis, monitor FCMs for compliance with these requirements. The framework also provides recourse for customers who believe their FCMs have abused them and sanctions by both regulatory and self-regulatory authorities in circumstances where FCMs are found to have breached requirements.

In the case of an FCM subject to the regulatory framework described above, Deutsche Bank believes that the FCM is best suited to determine whether and how its customers, or persons who control the trading for such customers, e.g., registered commodity trading advisors, obtain access to exchange computer terminals or automated order routing systems. Absent the existence of any restrictions in this regard imposed by the foreign futures exchange, the FCM should be able to determine which of its customers (and customers' account managers) should be permitted access to computer terminals, or to any other new technology that makes trading more efficient and cost effective. We believe that it would serve little or no regulatory purpose for the Commission to distinguish between different categories of customers in determining who may be provided with direct access systems. Indeed, certain features of new technology, particularly those that integrate risk management filters so that FCMs can program credit and position limits tailored to individual customers, greatly enhance an FCM's ability to manage its exposure to such customers. In such circumstances, limiting access only to certain institutional customers would not seem to serve a valid regulatory purpose.

The Commission should, however, seek to ensure that FCMs implement proper internal control procedures to protect against unauthorized access and trading to ensure that access to such systems does not create financial and operational risks for the firms. For example, the Commission could legitimately require that in providing its customers access to computer terminals or automated order routing systems, the FCM provide only those systems that, at a minimum, integrate credit and position limits.¹¹ Alternatively, if determinations cannot be made pre-trade, the FCM should have the capability of unilaterally and contemporaneously blocking, or

¹¹ 63 Fed. Reg. at 39788.

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directing the foreign exchange or clearing/exchange member firm to block, any customer's access to the order execution facility if the FCM determines that its security may be affected by such customer's trading. The procedure that will need to be implemented will vary based on among other things, the characteristics of the particular system provided to customers, the manner in which the FCM conducts its global transactions and through whom. For these reasons, in a fast evolving marketplace, we urge the Commission to permit firms to have the latitude necessary to make commercial and operational judgments about the manner in which they meet regulatory requirements.

B. Part 30 Firms

Under the CFTC's Part 30 rules, the Commission has established a framework for exempting certain foreign firms who act in the capacity of an FCM from the requirement to register based on an assessment that such firms are subject to rules and regulations in their home jurisdiction that are comparable to those in effect in the US. Notwithstanding the comparability analysis, the Commission does not monitor firms exempted under Part 30 for compliance with applicable foreign requirements that address the protections described above. Moreover, under the information sharing arrangements currently in effect, the Commission does not have the ability to obtain information from foreign firms or foreign futures exchanges on the same basis it can from FCMs or US futures exchanges.

The proposed "bona fide foreign futures exchange" analysis of the CFTC would permit direct access to the products of that exchange from US locations. That status, we believe, places these foreign exchanges in a materially different position than a foreign futures exchange that has not taken steps to permit direct access from US locations. The Commission's determination to review the rules and regulations governing the operation of the foreign exchange and the issuance of an approval order creates, in essence, a "hybrid" exchange that is neither a designated contract market nor a foreign exchange in whose financial and market integrity the Commission has no regulatory interest. In respect of such exchanges, it will be less tenable for the Commission to take the view that it regulates simply the intermediaries through whom US customers access the foreign market and not the market itself.

For these reasons, we believe a distinction is warranted between FCMs that provide direct access capability to such markets and Part 30 firms that seek to provide similar access. Although firms exempted under Part 30 can today deal with any US customer involving foreign futures and options transactions, in the case of these "hybrid" markets, we would argue the



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Commission has a more direct interest in assuring the integrity of firms that provide direct access to such markets, both to ensure customer protection and the integrity of the foreign futures exchange and the Commission's ability to access necessary information. Another matter we note is that US customers fully comprehend that when they trade with a foreign firm on a foreign market, they rely on the protections of the relevant foreign jurisdictions. When those same US customers have "direct" access to the foreign exchange from a US location, it may not be as clear that the protections that apply when they trade on a US futures exchange are not available even though the market is "located" in the US. This customer protection concern, coupled with the Commission's inability either to monitor for compliance with the types of internal risk management procedures that protect both firms and markets, or to obtain prompt access to information as it would in the case of FCMs could justify a more cautious approach at this preliminary stage regarding the types of systems that foreign firms, whether Part 30 exempted or not, can provide in the US and to whom.

Specifically, with respect to all firms located outside the US who are not registered FCMs, the Commission could adopt the limited approach of the no-action letter issued to the Deutsche Terminbourse regarding placement of its computer terminals in the US.¹² Such conditions could include: (i) that the foreign firm that provides direct access to computer terminals or order routing systems connected to a foreign futures exchange in locations in the US must be a member of that exchange or affiliated with a member of the exchange; (ii) that it may place terminals in its branch offices or that of its affiliates in the US for proprietary trading purposes; and (iii) that it may provide computer terminals and automated order routing systems to any registered FCM, whether for customer or proprietary trading purposes.

In summary, a Part 30 firm should be able to provide US customers direct automated access to a particular foreign exchange only if such firm is a member or affiliated with a member of that foreign exchange. As the Commission is well aware, "comparability of regulation" should not be confused with "equivalence of regulation," either in respect of regulatory standards or the method and means of compliance monitoring. Unless the Part 30 firm is subject to the additional regulatory scrutiny associated with exchange membership (e.g., higher capital requirements), the Part 30 firm should not be permitted to provide US customers direct automated access to a foreign exchange.

¹² CFTC Staff Interpretative Letter No. 96-28, Comm. Fut. L. Rep. (CCH) ¶26,669 (Feb. 29, 1996).



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If the Commission determines not to adopt this more limited approach, at a minimum, additional disclosures to US customers, as well as amendments to the relevant rule 30.10 orders to address with more particularity the risk management procedures such firms should implement and the procedures to monitor for compliance with such procedures, may be warranted.

C. Non-Clearing Member Firms

The Division's approach in the Concept Release would permit members of a foreign futures exchange and their affiliates to place "computer terminals" in their US offices or in their firm booths on the floor of a US futures exchange.¹³ We have noted our views regarding FCMs and firms located outside the US in this regard. We now seek clarification with respect to non-clearing members of a foreign futures exchange who are located in the US. The Commission's registration requirements described above generally require that persons who engage in foreign futures and options transactions for US persons be registered or exempt from registration. Non-clearing members must have accounts with clearing member firms in order to execute and clear trades on the foreign exchange, a requirement that generally has been interpreted to require that the clearing member firm who is "intermediating" the trade must also be registered with the CFTC or be exempt from registration.

If the Commission determines to exempt foreign clearing member firms who carry the accounts of non-clearing members from the CFTC's registration requirement, it should do so based on an analysis of what it means to be a "member" of a foreign exchange. As the Commission may be aware, most international futures exchanges have strict requirements that apply to clearing members who, in most cases, collectively provide the clearing guarantee for that exchange. The rules that apply to non-clearing members, however, vary from exchange to exchange, both with respect to the cost of membership and to the prudential and monitoring requirements to which such members are subject.

¹³ 63 Fed. Reg. at 39784-39786.



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Deutsche Bank proposes in this regard that rather than requiring that all clearing member firms be registered or exempted, in the course of undertaking the "bona fide foreign futures exchange" analysis, that the Commission evaluate the prudential and supervisory requirements applicable to those members. If membership on the foreign futures exchange is based on an assessment of the fitness of the entity and exchange or regulatory rules require that the exchange and/or clearing member firms specifically have risk management procedures intended to assess the extent to which they wish to be exposed to each such member, clearing members should not be required to register. However, if the member is subject to no prudential or other requirements that would operate as a check on its trading activities, except in cases where the clearing member is affiliated with the non-clearing member firm or the non-clearing member firm is a registered FCM,¹⁴ Deutsche Bank believes the more prudent course of action would be to require the clearing members to register as an FCM to carry such US person's account.

III. Standards for Approval of Foreign Futures Exchange

A. Criteria for Approval

The Concept Release contains the proposed framework for analyzing who is a "bona fide foreign futures exchange."¹⁵ We have noted our position that such analysis should also apply in cases where the open architecture of the exchange's computer terminal permits a direct connection with automated order routing systems. We further believe that as a matter of good regulatory and public policy, the Commission should seek to avoid imposing unnecessary and/or duplicative regulation and defer as much as possible to home country regulation. The Commission should not seek to implement a process that essentially is a proxy for the contract market designation process.

¹⁴ See CFTC Staff Interpretative Letters Nos. 88-15 and 87-7, *Id.* Our request that foreign firms be permitted to carry the proprietary trading accounts of unaffiliated FCMs without having to register would extend the current interpretation of who may carry the accounts of US customers for foreign futures and options transactions. We urge the Commission to consider granting this request and would be pleased to work with the Commission and its staff in addressing this issue.

¹⁵ *Id.*, at 39784-39786.



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Consistent with the mandate of section 4(b) of the Commodity Exchange Act,¹⁶ we would urge the Commission to confine its review to addressing the core issue of whether the foreign market is a bona fide foreign futures exchange rather than seek to ensure that each element of the US regulation of contract markets is satisfied or to achieve some "comparable level" of supervision of the foreign futures exchange.¹⁷ This type of analysis, coupled with appropriate information sharing arrangements and the ability to obtain data on general levels of trading volume originating from the US, should be adequate to permit the Commission to evaluate on an ongoing basis whether the foreign futures exchange is bona fide or not. In addition, at best, it will be difficult to adopt specific tests to evaluate each required item or an objective set of criteria for a "bona fide" foreign futures exchange that will apply to all exchanges in all circumstances.¹⁸ In general, the Commission's approach should be qualitative, not quantitative, and should be able to accommodate an evolving global market and regulatory environment.

For these reasons, Deutsche Bank has concerns with the level of detail of the proposed approach and certain of the terms and conditions that appear to duplicate existing protections or seem to place a level of regulatory burden on firms and markets that do not appear to be warranted by the benefit to be gained. In the area of information proposed to be collected, we would include as examples, the following proposals:

- (i) that specific persons at the foreign futures exchange responsible for relevant compliance matters be identified in the application¹⁹ -- We believe that this level of specificity is unnecessary and will result in frequent notification to the Commission resulting from personnel changes.

¹⁶ 7 USC §6(b).

¹⁷ 63 Fed. Reg. at 39784-39786. However, to the extent some or all of the issues relevant to whether a foreign market is a bona fide foreign futures exchange (i.e., the market has rules governing fair and orderly markets that are monitored for compliance by the relevant foreign market authority) have been addressed by the Commission in a Part 30 comparability or any similar analysis, the Commission should not seek to obtain duplicative information or undertake duplicative analysis.

¹⁸ 63 Fed. Reg. at 39784, 39787-39788.

¹⁹ Id., at 39784.



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It should be adequate for the foreign futures exchange to identify the responsible office only and/or designate a point of contact for the Commission for all inquiries.

- (ii) that the foreign futures exchange provide on a routine basis the percentage of trading volume that originates from each jurisdiction where trading activity occurs²⁰ -- The percentage of trading volume originating from the US compared with total exchange volume could assist the Commission in determining whether the foreign futures exchange remains a bona fide foreign futures exchange, but the Commission has not identified a regulatory purpose for the routine collecting of trading volume information with respect to each jurisdiction where trading takes place.

- (iii) that members of the foreign futures exchange provide a description of relevant litigation, enforcement actions, disciplinary proceedings or other civil, criminal or administrative proceedings within the past five years²¹ -- We would urge the Commission to undertake a more in-depth analysis of the criteria for membership on the foreign exchange. This analysis plus a certification by the foreign exchange and the member firm that the member is in good standing should be adequate in this regard.

In addition, the proposal that each foreign futures exchange conduct a biennial on-site review of the activities of each member or affiliate or upon notice of breach is very troubling in that it will impose high costs to markets and firms with no apparent regulatory benefit.²² If the member or affiliate is a registered FCM, that FCM will be audited by its US designated self-regulatory organization for compliance with requirements related to its foreign futures trading activities. If the member or affiliate is engaged solely in proprietary trading, all information regarding that person's trading activities on the computer terminal is accessible to the foreign futures exchange on a real-time basis. Moreover, the Commission's proposal would only have meaning if any US

²⁰ Id., at 39785, 39786.

²¹ Id., at 39786.

²² Id., at 39785.



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person with an automated order routing system were subject to the same audit requirement. Deutsche Bank, therefore, sees no regulatory benefit that would be achieved by this additional layer of audit for FCMs that is not already achieved by the existing audit program. Nor does it see any benefits to be achieved by conducting on-site inspections of proprietary traders on the systems. Finally, any possible benefit would be disproportionate to the costs to market users, to FCMs or to markets of complying with the audit requirement.

B. Reciprocity

Our final point relates to the Division's intention to seek information concerning the ability of a US exchange to place and operate computer terminals in the home jurisdiction of the foreign futures exchange seeking to place its terminals in the US. As a general matter, subject to customer protection and market integrity concerns, Deutsche Bank endorses open and competitive markets and believes that foreign futures exchanges should be permitted to place terminals in the US, just as we believe US futures exchanges should be able to place terminals in foreign jurisdictions. We would be concerned, for example, if the Commission were to adopt an express policy of reciprocity that would deny access to a foreign futures exchange solely on the basis that its home jurisdiction excluded US markets. The approach adopted by the Commission should discourage others from exercising similar powers. Further, in framing its approach to "outbound" transactions by US persons on foreign markets, whether on computer terminals or automated order routing systems, the Commission should consider the impact of similar restrictions and regulations that would likely be imposed on "inbound" orders on US futures exchanges from foreign jurisdictions.

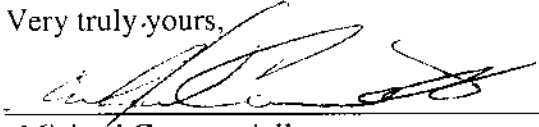
Conclusion

Deutsche Bank appreciates the opportunity to submit these comments in response to the Commission's publication of the Concept Release. If the Commission or its staff has any questions regarding this letter, please contact the undersigned at (212) 469-6607.



Karl Haeling
Director

Very truly yours,



Michael Communiello
Director