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Ms. Jean A. Webb
 Secretary
 Commodity Futures Trading Commission
 Three Lafayette Centre
 1155 21st Street, N.W.
 Washington, D.C. 20581

COMMENT

COMMODITY FUTURES
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Re: Concept Release on the Placement of a Foreign Board of Trade's Computer Terminals in the United States 63 FR 39779 (July 24, 1998)

Dear Ms. Webb:

The New York Mercantile Exchange ("NYMEX" or the "Exchange") appreciates the opportunity to comment, on its own behalf and on behalf of its wholly-owned subsidiary, Commodity Exchange, Inc. ("COMEX"), on the Commodity Futures Trading Commission's ("CFTC" or the "Commission") Concept Release on the placement of a foreign board of trade's computer terminals in the United States ("Concept Release").

NYMEX is a not-for-profit corporation organized under the laws of the State of New York. It has been designated by the Commission as a contract market for the trading of numerous commodity futures and commodity futures option contracts. NYMEX is the largest exchange in the world for the trading of futures and option contracts based on physical commodities. Public investors in our markets include institutional and commercial producers, processors, marketers and users of energy and metals products.

The Exchange believes that the issues posed by this Concept Release are of significant importance to the futures industry at a critical juncture in its history and that the Commission, in carrying out its statutorily mandated duties, carefully consider the issues presented prior to taking any permanent action. This is particularly true in an era when technology is advancing at a rate faster than the ability of the regulatory system to respond.

In sum, the Exchange agrees with the general approach suggested by the Commission in the Concept Release as a possible regulatory process for the review of the placement and use of foreign board of trade terminals in the U.S. However, there are certain essential points that must be emphasized. First, in crafting the rules applicable to foreign boards of trade seeking to establish an electronic presence in the U.S., the Commission should specifically identify its objectives consistent with its statutory obligations under the Commodity Exchange Act ("Act") in determining the appropriate level of regulatory scrutiny to which such foreign board of trade should be subject. The Exchange believes that heightened regulatory scrutiny should be required when the foreign board of trade's activities impact U.S. market integrity. Second, the Commission should endeavor to compile adequate and complete information before evaluating petitions from a foreign board of trade. Third, a major factor which must be taken into account in assessing a foreign board of trade's petition is the ability of a U.S. exchange to have electronic access to the foreign board of trade's "home" jurisdiction subject to requirements no more burdensome than those imposed on the foreign board of trade by the home regulator. Finally, in order to establish the appropriate regulatory framework, the CFTC should focus upon the concept of "electronic access" rather than focusing on the type or location of the hardware involved.

I. In reviewing whether the electronic trading activities of a foreign board of trade constitute a presence in the U.S. for the purpose of exercising CFTC jurisdiction, the appropriate level of regulation should depend upon the nature of the regulatory interests implicated by the foreign board of trade's electronic trading activity.

The Commission noted in the Concept Release that "[a]t some level of U.S. activity, a board of trade can no longer claim to be a board of trade located outside the U.S. and would be required to be designated as a contract market."¹ NYMEX supports this approach and believes that the focus of the Commission's inquiry should be on the type of activity conducted by the foreign board of trade in the U.S. and the potential impact on U.S. markets and market participants and the resulting regulatory interest implicated by such activity rather than focusing primarily on the level of activity conducted. The Commission's statutory duty under the Act is clearly to protect U.S. markets so that the pricing integrity of such markets are maintained and to protect U.S. customers from any potential fraud and manipulation of these markets.

In assessing the level of regulation which should apply to a foreign board of trade's activity in the U.S., the Commission should distinguish between those products

¹63 FR 39779, 39787 (July 24, 1998)

offered by a foreign board of trade which are delivered in the U.S. or are settled by reference to prices derived from U.S. markets and those which are not. The Exchange believes that an application by a foreign board of trade to provide electronic access to products which have little or no impact on U.S. markets and which are offered to U.S. customers should be reviewed by the Commission to determine whether U.S. customers are adequately protected. When the regulatory interest being invoked is primarily one of customer protection, the CFTC may choose to place greater reliance on the "home" regulator. However, with respect to products which are U.S.-delivered or are otherwise U.S.-based, the CFTC, in addition to reviewing any customer protection concerns, should require strict standards to be placed upon the foreign boards of trade which provide regulatory protections designed to maintain market integrity consistent with the requirements imposed on domestic boards of trade.

A. Customer Protection Standards

The Exchange believes that the provision of electronic access to any or all products of a foreign board of trade to U.S. customers raises customer protection concerns which must be addressed by the Commission. These types of concerns relate to, among other things, solicitation, disclosure and the protection and integrity of customer funds. Thus, the Commission's rules should be structured in a manner that assures that adequate protections are provided to address these concerns. The Exchange believes that many of these concerns can be addressed by the Commission's verification that foreign boards of trade are subject to "comparable" regulation in a process similar to that performed in evaluating Part 30 exemptions. The Exchange also believes, however, that the Commission should take this opportunity to examine whether any gaps exist between U.S. regulations and the regulations of the foreign board of trade's home country.

The Exchange also believes that the CFTC should retain a certain level of control by requiring that an entity in the U.S. which provides access to the products of a foreign board of trade to U.S. customers should be registered as a Futures Commission Merchant ("FCM"). In the Concept Release, the Commission specifically requested comment upon potential lists of conditions which may be included in any order allowing electronic access in the U.S. to a foreign board of trade. Among those mentioned by the Commission was the requirement that any member or affiliate of the foreign board of trade be registered as an FCM unless it trades solely for its proprietary account. The Exchange understands that this information is comparable to that already applicable to the Deutsche Terminbörse ("DTB"). NYMEX believes that, in the event an entity were to solicit or transmit U.S. customer orders and/or were to hold or otherwise handle U.S. customer funds, registration with the Commission would be appropriate and necessary to maintain and to protect the public interest. For an entity to be involved in these activities requires a level of accountability to and control by the Commission which would be provided by registration.

B. Market Integrity Standards

In determining what level of regulation should apply to the activities of foreign boards of trade seeking to establish electronic access in the U.S., the CFTC must assess the extent to which such activities impact the CFTC's statutory duties and whether further regulation is necessary to protect those interests. The Commission set forth in the Concept Release a number of possible informational requirements that would allow the Commission to determine whether the U.S. presence of a particular foreign board of trade warranted requiring that board of trade to obtain designation as a contract market for one or more of its contracts. In this regard, the Exchange believes that the level of regulation required of any futures market should be rationally related to the regulatory interests that are implicated by the proposed activities and potential market impact of the product(s) to be offered by the foreign board of trade.

In particular, the Exchange believes that the trading by a foreign board of trade of a product for physical delivery in or which is settled by reference to prices derived from United States markets necessitates regulation by the CFTC because of the potential impact on the pricing integrity of the U.S. markets, including the potential for fraud and manipulation which would affect these markets. This level of regulation should incorporate those market integrity protections which are currently imposed on U.S. contract markets, as well as those customer protections noted in Subsection A. above. It is clear that the offering of a contract for trading in the U.S. which is designed to reflect the economic conditions related to a U.S. product in interstate commerce and which could substantially affect the pricing structure of such a commodity in the broader U.S. physical marketplace impacts to a far greater degree the regulatory concerns of the Commission than the mere placement of trader workstations by a foreign exchange trading its home products. Moreover, the Commission should recognize that any failure to provide sufficient regulatory protections which could lead to actual or perceived price distortion will have an adverse impact on U.S. consumers as well as the reputational interest of the entire futures industry generally and the U.S. futures industry in particular.

Although the interests relating to the price integrity of U.S. market-based contracts may not require full contract market designation, concerns about the impact that such trading will have on the U.S. commodity markets should be no less than if a product were offered by a U.S. exchange. The types of protections which NYMEX believes would be appropriate would include those protections designed to prevent any adverse market disruptions and thereby maintain market integrity. A full panoply of regulatory protections which have been traditionally used by the Commission to effect this purpose should apply, such as the ability of the CFTC to examine the books and records of the foreign board of trade, including the agreement of the foreign board of trade to submit to a "special call" procedure, the imposition of reporting levels and position reporting, and the reservation of authority by the CFTC to set position limits

where appropriate. Most importantly, the Commission should expressly reserve the ability to revoke or impose any other conditions in any order permitting electronic access if the foreign board of trade's market were shown to be subject to market integrity abuses.

In this regard, the recent past demonstrates the adverse effect on U.S. markets and the related need for additional regulation that can result from activity on a foreign board of trade involving a contract for physical delivery that can be delivered in the U.S. Specifically, the CFTC announced on May 14, 1998 that it was issuing an order, in connection with settling the matter by consent, finding that Sumitomo Corporation of Japan ("Sumitomo") manipulated the copper market in 1995 and 1996. In the order, which accepted an offer of settlement in which Sumitomo neither admitted nor denied the findings, the Commission found that Sumitomo engaged in a scheme to manipulate the price of copper through actions taken on the London Metals Exchange ("LME"), which caused artificial prices in cash and futures markets in copper, including those in the United States, in violation of Sections 6(c), 6(d) and 9(a)(2) of the Commodity Exchange Act ("Act"). The CFTC ordered the company to cease and desist from further violations of those provisions of the Act and to pay a total of \$150 million.²

In announcing the settlement, the CFTC's Chairperson observed that "[t]oday's settlement imposes a substantial civil monetary penalty in response to misconduct which caused very serious harm to the United States markets and users of copper." In the Commission's order, the CFTC detailed how this manipulation involved LME warehouses located in the U.S.³

²Of that amount, \$125 million was paid as a civil monetary penalty immediately. The remaining \$25 million was placed into escrow for a period of up to four years.

³For example, the order stated that beginning in early 1994, Sumitomo's copper trader and personnel at the U.S. copper merchant were in daily communication concerning the coordination of their market activities with a view toward increasing LME copper prices. Sumitomo's copper trader and the U.S. copper merchant agreed that they should strive, through their purchases of physical metal in LME warehouses and elsewhere as well as their purchases of futures and options contracts, to inflate artificially the market price of copper.

The order further stated that:

"[p]ursuant to the plan, beginning in late October 1995, Sumitomo, through its copper trader, rapidly increased its ownership and control of LME deliverable warehouse stocks. By November 24, 1995, Sumitomo owned 93% of all LME warehouse stocks through one brokerage house alone. Combined with holdings

The CFTC has a statutory duty to maintain the integrity of U.S. markets and to provide protections to U.S. customers. By permitting a foreign board of trade to establish electronic access in the U.S. for the trading of U.S.-delivered or U.S.-based products, which will undoubtedly have an effect on interstate commerce in the U.S., the Exchange believes that the level of CFTC regulation that should apply in order to maintain U.S. market integrity should be the same as that which is currently imposed on U.S. contract markets. Any failure to do so would be a disservice to the U.S. marketplace, U.S. customers and others who rely upon the pricing integrity of this marketplace.

C. Other Standards

In the Concept Release, the Commission asked, in the event that it permitted a particular foreign board of trade to place terminals without being designated as a U.S. contract market, under what changed circumstances would it become appropriate to require that foreign board of trade to be designated by the CFTC as a contract market.

As noted in Section I above, the Exchange believes that, as a primary concern, in assessing the level of regulation which should apply to a foreign board of trade's activity in the U.S., the Commission should distinguish between those products offered by a foreign board of trade which are delivered in the U.S. or are settled by reference to prices derived from U.S. markets and those which are not. The Exchange has set forth a paradigm of customer protections and market protections which it believes should apply. These standards should apply regardless of whether the activities of the foreign board of trade in the U.S. give rise to regulation as a contract market; however, the existence of these protections should not preclude the Commission from determining that the foreign board of trade's activities in the U.S. require designation as a contract market.

The Exchange agrees with the Commission's view that there is a level of activity by a foreign board of trade in the U.S. whereby the Commission should consider whether it is still appropriate to exempt a foreign board of trade from the requirement to obtain designation as a U.S. contract market. However, NYMEX does not believe that

at other brokerage houses, Sumitomo, together with the U.S. copper merchant, owned and controlled up to 100% of LME stocks (including in the LME warehouse in Long Beach, California) at various times in the fourth quarter of 1995. Sumitomo also maintained large and controlling LME futures positions during the fourth quarter, which Sumitomo and personnel at the U.S. copper merchant managed in a manner that bore little legitimate relationship to the marketing of physical copper to Sumitomo's customers, but rather were specifically designed to cause artificial prices and price relationships."

volume should be the primary basis upon which the Commission should base its determination. In view of the inherent fluctuations in price of many futures contracts, trading volume similarly may fluctuate considerably from one quarter to the next.

In the Concept Release, the Commission staff noted that the prior relief provided to the DTB intended to leave open the possibility that at some point DTB's activities in the U.S. might rise to a level that would necessitate greater Commission regulation. The Commission noted that the DTB was required to provide quarterly updates of U.S.-originated trading volume. The Commission suggested that a foreign board of trade could be required to submit, on a quarterly basis on a contract-by-contract basis, total trading volume data as well as trading volume data pertaining to trading activity generated through terminals placed in the U.S.

Any order granted by the CFTC granting electronic access in the U.S. to a foreign board of trade should be conditioned upon the ability of the CFTC to subsequently review the foreign board of trade's activity to determine whether its presence in the U.S. reaches a certain level of activity so as to require contract market designation. This determination should be based upon several factors which, when considered as a whole, would enable the Commission to determine whether the activity has reached a threshold level of activity above which it would be appropriate for the CFTC to assert its regulatory interest. As discussed previously, the fact that a contract of a foreign board of trade provides for physical delivery in the U.S. or otherwise impacts U.S. markets is a primary factor to be considered. Trading volume is another factor to be considered by the Commission. However, if the Commission were to use trading volume in its analysis, open interest generated by U.S. customers is an additional quantitative factor which might be considered. Other factors to be considered might include, but should not be limited to, the extent to which the contracts of the foreign board of trade are denominated in U.S. currency or the extent of marketing or educational activity conducted in the U.S. by the foreign board of trade and/or its members that is directed at U.S. customers.

II. The Commission should endeavor to compile adequate and complete information before evaluating petitions by foreign boards of trade.

The Commission suggested in the Concept Release that one possible approach that it might employ in establishing procedural guidelines to review a foreign board of trade's request for electronic access to U.S. markets would be to require a foreign board of trade to petition for an order that would allow the foreign board of trade to

place its computer terminals in the U.S.⁴ The Commission suggested in the Concept Release that it could require such petitions to include six general categories of information.⁵

(1) general information concerning the petitioner foreign board of trade and its products;

(2) information concerning the petitioner's rules and regulations, the laws and regulations in effect in the petitioner's home country, and the methods for monitoring compliance therewith;⁶

⁴In the Concept Release, the Commission expressed its belief that it would be most appropriate for the foreign board of trade itself to submit such a petition, rather than a member of the foreign board of trade or an affiliate thereof (acting on behalf of the foreign board of trade) or the foreign board of trade's foreign regulatory authority. NYMEX agrees with the Commission on this point.

⁵The Commission also suggested that it could publish the petitions in the Federal Register for public comment. NYMEX feels strongly that this approach would be the most effective way to allow interested persons to assist the Commission in its review by providing informed public comment and thus recommends that the CFTC include this step in its rules implementing the petition procedure process.

⁶The Commission suggested that the petition should address: (a) the petitioner's status under the laws of the country; (b) applicable requirements established by law or by regulatory and self-regulatory authorities in the petitioner's home country regarding the protection of customer funds (including in the event of insolvency), recordkeeping, reporting, timing of transactions, allocation of orders, ability to obtain the identity of customers, including rules concerning entry of account numbers, and trade practice standards, including any rules concerning prearranged trading, noncompetitive trading, "frontrunning," trading ahead of customers, wash sales and bucketing of transactions; (c) procedures employed by the regulatory and self-regulatory authorities in the petitioner's home country to ensure compliance with their rules, including a history of market failures and defaults in the petitioner's home country; (d) information sharing arrangements in effect among the relevant regulatory authorities and the Commission, including information concerning any blocking statutes or data protection laws in effect in the petitioner's home country which might impair the Commission's ability to obtain information under such an arrangement; and (e) a discussion of any disciplinary action taken against the petitioner by its home country regulatory authorities. NYMEX agrees with the Commission that this information should be included in the petition; however, with respect to information sharing arrangements, the Commission should also examine whether there have been any previous problems with receiving materials from the

(3) information related to the petitioner's technological system and standards;⁷

(4) financial and accounting information pertaining to the petitioner;

(5) information concerning the ability of U.S. boards of trade to place and operate computer terminals in the petitioner's home country; and

(6) information concerning the petitioner's intended U.S. activities and presence. More specifically, the first category of information discussed above (general information concerning the petitioner and its products) could include information such as the petitioner's main business address, its address in the U.S. for service of process, a copy of the petitioner's organizational documents and a list of the contracts that the petitioner desires to trade in the U.S. through its terminals.

The Commission further requested comment as to whether specific tests should be used to evaluate each required item of information rather than reviewing all of the information based upon a "totality of the circumstances." NYMEX believes that all of the information contained in the above-listed elements are critical and that no specific level of information can be set forth for each element. It is essential that all of the information be gathered and evaluated in such a way as to accurately assess the impact of the foreign board of trade's activity on the U.S. marketplace and on U.S. customers.

The Exchange also wishes to emphasize that the Commission should require that a foreign board of trade submit detailed information regarding its clearing processes. This information is essential to ensure that an accurate evaluation of systemic risk issues can be performed. In the event a clearing organization is a separate corporate entity from the foreign board of trade, the Commission must also ensure that it has the continued ability to receive all appropriate information from the

relevant regulators or self-regulatory organization.

⁷In the Concept Release, the Commission indicated that information concerning technological systems and standards of the petitioner might include a discussion of the order processing system, its system integrity and architecture and its clearing and settlement process. In addition, NYMEX recommends that the Commission require the petitioner to provide information concerning the technological standards of its home country regulator. Thus, for example, the petitioner should specify whether the home country regulator has adopted as part of its regulatory policy the principles for Screen-Based Trading Systems for Derivatives Products set forth by the International Organization of Securities Commissions, and, if so, how the home country regulator ensures compliance with these principles.

clearing entity as it would from the petitioner foreign board of trade.

More specifically, in the Concept Release, the CFTC indicated that each petitioner might be required to provide a statement from its home country regulator as to any requirements or restrictions placed by authorities in its home country on U.S. boards of trade with respect to the placement and operation of computer terminals or the sale of products in such country. In addition, the Commission noted that if any such requirements or restrictions existed, the statement could include a description of the restrictions or regulations, be accompanied by copies of any relevant statutes or other relevant legal materials, and include a description of the application process, if any, required for a U.S. board of trade and their members or affiliates of members to place its computer terminals and/or to sell products in the petitioner's home country. NYMEX strongly supports the CFTC's requiring such information to be included in the petition.

With regard to the petitioner's U.S. activities, the Commission suggested that the petition might include, for example, information concerning the location of any office, delivery points or employees of the foreign board of trade within the U.S. and any marketing, educational or other activities in the U.S. in which the foreign board of trade engages. The Exchange strongly believes, particularly in light of the concerns expressed in Section I. of this letter, that a foreign board of trade should be required to submit this information in its petition in order for the Commission to fulfill its purpose of determining what level of regulation is appropriate in furtherance of its statutory obligation of maintaining the integrity of U.S. markets.

Under the possible procedure indicated in the Concept Release, if the Commission issued a requested order to a foreign board of trade, a member of the board of trade or an affiliate of a member would then be permitted to request confirmation of relief under the order to allow the member or affiliate to place and to operate a foreign board of trade computer terminal in the U.S., subject to appropriate conditions contained in the order.⁸ The Exchange supports this approach. In this

⁸Thus, for example, pursuant to the DTB no-action letters, if a DTB member located in the U.S. wishes to install a DTB terminal in its office, the DTB itself must make a written filing to the National Futures Association ("NFA") on behalf of that member. The DTB makes this filing after a DTB member applies to the DTB to place a DTB terminal in the U.S. The filing identifies the member that intends to operate a DTB terminal in the U.S. and includes: (1) A Declaration signed by the member whereby the member declares that it acknowledges: (a) the terms and conditions of the Division of Trading and Markets' no-action letter, and that it will comply therewith and (b) its obligation to inform DTB in writing of any changes regarding its DTB membership or the placement of DTB terminals in the U.S.; and (2) an Acknowledgment of Jurisdiction

regard, NYMEX believes that it is appropriate for the CFTC or the NFA to conduct subsequent on-site reviews of the member of a foreign board of trade or an affiliate of such member in order to ensure compliance with the terms of the Commission's order.

III. Before granting access to U.S. markets to a particular foreign board of trade, the Commission should consider whether reciprocal access is available to domestic boards of trade.

Should the CFTC establish a petition process, a core condition of any such process should be an affirmative showing that U.S. boards of trade have fair and open access with respect to: (1) the placement and operation of computer terminals or the sale of products in the home country of the foreign board of trade; (2) the level of public customer to which such products may be offered and (3) such access is available to U.S. boards of trade through procedures that are no more restrictive, burdensome or time-consuming than the home regulator's requirements imposed upon the home country's domestic exchanges. This condition is required both as a matter of fundamental fairness and as a means of encouraging competition that will benefit U.S. customers and other market-users. Moreover, as a means of ensuring ongoing reciprocity in regulatory treatment, such equality in bilateral electronic access to markets should be required throughout the term of the Commission's order.

IV. In establishing standards, the Commission should focus upon the concept of "electronic access" rather than focusing on the type and location of the hardware involved.

The Exchange believes that it is necessary to address an apparent tension indicated in the Concept Release. On the one hand, the Commission acknowledges that "[h]istorically, the term "computer terminal" was thought to be a dedicated proprietary computer system that provided access to a board of trade. . . ." The CFTC further indicated that it sought to define such a term so as to "anticipate" changes in technology.

On the other hand, a good number of the questions in the Concept Release appear to rely upon the same analysis utilized by the Commission in assessing the electronic trading systems of U.S. futures exchanges that have been in operation for

signed by the member whereby the member acknowledges that (a) for purposes of the DTB no-action letter it is subject to the Act and the Commission's regulations thereunder, (b) it will provide upon request prompt access to original books and records and the premises where DTB terminals are installed in the U.S., and (c) the person signing the Acknowledgment on behalf of the member is duly authorized to do so.

several years. Thus, the CFTC sought comment in the Concept Release on the suitable definition of a "computer terminal." In addition, the Commission questioned whether foreign boards of trade should be limited to placing "dedicated" computer terminals in the U.S. In doing so, the CFTC thus suggested that it might exclude a system of a foreign board of trade that enabled customers to submit orders electronically to an FCM.

The Exchange believes that it is useful to emphasize the extent of the changes that have occurred in information technology in just the last few years. The Exchange's NYMEX ACCESSSM electronic trading system, along with the Chicago Mercantile Exchange's ("CME") Globex system and the Chicago Board of Trade's ("CBT") Project A system, which were designed at the beginning of this decade, may be considered as the "first generation" of futures exchange electronic trading systems. Commission staff have confirmed that, when these systems were designed and subsequently implemented several years ago,⁹ the Commission did not mandate use of closed-end trading systems involving use of dedicated computer terminals. Instead, the CFTC was responding to proposals submitted by those exchanges of the best technology that was available at the time of the submissions.

Since then, developments in information technology have been dynamic and are difficult to predict. In addition, a number of new electronic trading systems have been implemented by futures and securities exchanges globally. One consequence of these developments is that there is much more competition for the limited desk space that is available on the trading desks of the commercial participants who regularly trade in these markets. In addition, market users have become increasingly vocal in their preference for trading systems with "open architecture" that permit traders access to trading systems through a personal computer. Market-users also strongly prefer systems that will permit use of customized "front-end" trading software on such a work station. Thus, for example, the current version of the CME's Globex system includes an Application Program Interface ("API") function, which provides the features noted above that are sought by market-users. Both NYMEX and the CME are now in the process of designing the next generation of their respective NYMEX ACCESSSM and Globex trading systems, and both updated systems also will have an API capability.

Moreover, it is the Exchange's understanding that most of the foreign futures exchanges that have electronic trading systems either now have or will be modified shortly to incorporate the API capability. Thus, the Eurex system, which obtained a CFTC staff no-action letter prior to the merger of the DTB with the Swiss Options and

⁹CME and CBT contracts began trading on Globex on June 25, 1992. NYMEX ACCESSSM was launched on June 24, 1992, and Project A commenced trading on October 24, 1994.

Futures Exchange, now has this capability. The OM Click Exchange System, which is used or is being planned to be used by a number of foreign futures and securities exchanges, has this capability.¹⁰ The London International Financial Futures and Options Exchange's ("LIFFE") new trading system, LIFFE CONNECT™, will have this capability, as will the next generation of the SYCOM electronic trading system offered by the Sydney Futures Exchange.

The API capability also could permit a customer to transmit an order electronically to an FCM for routing to the host computer of the exchange's trading system. For example, an order could be routed to the FCM via the Internet or other telecommunications systems from a customer in Chicago or Kansas City to the FCM's network of computers.¹¹ This technology would not even require the FCM's network to have computer terminals physically located within the U.S. In effect, then, all exchanges with open API capabilities have created a global "virtual network," and the customer's personal computer thus could become a "virtual terminal" of an exchange's trading system.¹²

As noted previously, in the Concept Release, the Commission stated that it has a

¹⁰These exchanges include: the Swedish Futures Exchange; OMLX in London; the Austrian Stock Exchange; the Milan Stock Exchange; the Hong Kong Futures Exchange; the Australian Stock Exchange; the Korean Futures Exchange (planned); the Toronto Stock Exchange (planned); and Swedish Bond Futures (planned).

¹¹Indeed, the CFTC's Division of Trading and Markets, by letter dated August 14, 1997, notified the CME that a rule proposal submitted by the CME did not require prior Commission approval and could be made effective immediately. This authorization allows customers of FCMs to have electronic access to CME contracts traded on the Globex system initially by entering orders via the Internet, which then pass through the FCM's electronic interface with the Globex system for trade execution.

¹²With regard to such systems, the CFTC asked in the Concept Release whether any such system should be permitted to limit a customer's view of information to only a portion of that otherwise available to a member of a foreign board of trade that has a computer terminal. NYMEX believes that the level of information to be made available to a customer is a judgment best made by the particular futures exchange, be it domestic or foreign. Futures exchanges have an economic incentive to maximize the attractiveness to potential customers of trading on their electronic trading systems; customers clearly will make known the level of information that they prefer. Therefore, the Commission should defer to the business judgment of the exchanges on this issue and let the competitive pressures of the marketplace determine the equilibrium level of information to be made available to customers.

statutory duty to maintain the integrity of the U.S. markets and to provide protections to U.S. customers. The CFTC also expressed its belief that its regulatory approach should not inhibit cross-border trading by imposing unnecessary regulatory burdens. NYMEX suggests that the regulatory approach indicated in the Concept Release, which appears to focus to a great extent upon the technology being utilized by a foreign board of trade, may result in unnecessarily restrictive requirements applicable to foreign boards of trade and ignores the reality of a rapidly changing technological environment.

Therefore, the Exchange respectfully suggests that, rather than focusing upon a particular technology to be utilized by a foreign board of trade, the Commission should structure its regulatory approach around the concept of "electronic access." In other words, the regulatory focus generally should be on the activity that occurs through the terminals, rather than on the terminals themselves or their physical location. This approach would allow the Commission to carry out its regulatory obligation of protecting U.S. markets and U.S. customers by focusing upon the entity that provides a customer with access to the electronic trading system of a foreign board of trade.

Thus, for example, the Commission currently requires that those who do business with U.S. customers involving foreign futures and option transactions must either register as an FCM or be exempted pursuant to relief provided under Part 30 of the Commission's rules. Under the terms and conditions of the CFTC staff no-action letter on the placement of DTB terminals in the U.S., any DTB member (or affiliate thereof) that executes a trade under an order must be registered as an FCM unless it trades solely for its proprietary account. As noted in Section I above, the Exchange believes that it is appropriate for any entity involved with public customer orders and/or customer funds to be registered appropriately. The Exchange submits that the CFTC can ensure that customers will be protected by requiring an FCM, which makes the determination on providing a potential customer with access to the foreign trading system, to have appropriate policies and safeguards governing access by that customer to the FCM's computer network. At a minimum, an FCM should maintain internal controls that will allow the FCM to monitor trading and credit limits imposed by the FCM on that particular customer in addition to any position limits imposed by CFTC rule or otherwise.

In this connection, the CFTC suggested in the Concept Release that it was considering requiring the human intervention of an employee of the FCM for each order received electronically from a customer. If an FCM has implemented adequate electronic financial and trade monitoring safeguards, the requirement for human intervention, such as requiring a clerk to hit a keystroke to transmit an order to the host computer of the electronic trading system, would appear to be unnecessary. While an individual FCM might determine on its own to include such a procedure, the Exchange suggests that requiring such intervention would introduce a measure of inefficiency into the order routing process and would seem to be inconsistent with the Commission's

announced goal of avoiding imposing unnecessary regulatory burdens. In addition, such a requirement could complicate attempts by U.S. futures exchanges to expand the reach of their own electronic trading systems.

While the existence of virtual terminals may make the specific placement of the physical terminals less significant, *i.e.*, whether in the office of a member of the foreign board of trade or an affiliate of such a member, the Exchange believes that one potential issue relating to placement of physical terminals should be addressed in any subsequent proposed rules or orders issued by the Commission in connection with the Concept Release. Specifically, a U.S. futures exchange may determine, as a service to its members and to its market-users, to allow the placement of terminals of a foreign board of trade on its trading floor. In the event that a foreign board of trade petitions the CFTC for such placement, and the Commission grants this petition, it is possible that the CFTC may include certain requirements as conditions for that approval. NYMEX believes that it is important for the Commission to clarify in any such order that the conditions included in that order are not exclusive and that the U.S. futures exchange (where the terminals are to be placed) is not prohibited from exercising its business judgment to specify additional requirements that are deemed to be necessary by that U.S. exchange.

V. Summary

In sum, the Exchange agrees with the general approach suggested by the Commission in the Concept Release as a possible regulatory process for the review of the placement and use of foreign board of trade terminals in the U.S. In this comment letter, the Exchange has endeavored to emphasize the following critical points:

1) In reviewing whether the electronic trading activities of a foreign board of trade constitute a presence in the U.S. for the purpose of exercising CFTC jurisdiction, the appropriate level of regulation should depend upon the nature of the regulatory interests implicated by the foreign board of trade's electronic trading activity.

2) The Commission should endeavor to compile adequate and complete information before evaluating petitions by foreign boards of trade.

3) Before granting access to U.S. markets to a particular foreign board of trade, the Commission should consider whether reciprocal access is available to domestic boards of trade.

4) In establishing standards, the Commission should focus upon the concept of "electronic access" rather than focusing on the type and location of the hardware involved.


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NYMEX wishes to emphasize to the Commission that the United States is the premiere market for the trading of futures and options in the world with the most experience in the regulation of these markets. The CFTC is reviewing complex issues which will have a far-reaching impact on how global business will be conducted in the future. It is the Commission's responsibility to establish standards and should not shy away from establishing standards that will give the Commission clear and unfettered authority to perform its regulatory obligations under the Act. There are clearly economic storms on the horizon and the Commission must make every effort to prevent these economic storms from hitting U.S. shores.

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NYMEX thanks the Commission for the opportunity to submit comments concerning the Concept Release and would be pleased to furnish additional information in this regard. If you have any questions, please do not hesitate to contact the undersigned.

Respectfully submitted,



R. Patrick Thompson
President

cc: Chairperson Brooksley Born
Commissioner Barbara P. Holum
Commissioner James E. Newsome
Commissioner David D. Spears
Commissioner John E. Tull, Jr.