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April 20, 1999

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FUTURES

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. 20581

COMMENT

Dear Ms. Webb:

Re: Access to Automated Boards of Trade

The Hong Kong Futures Exchange, Ltd. (the "HKFE") welcomes this opportunity to provide its comments on the *Federal Register* release and accompanying draft Regulations to govern placement within the United States, its territories or possessions of devices referred to either as "direct execution systems" (or "DES") or as "automated order routing systems" (or "AORS").<sup>1</sup>

After a careful reading of the Commission's release on the above subject, it is not clear to the HKFE that a regulatory program is necessary to deal with the order-entry phase of transactions which will continue to be matched and executed at the site of a foreign board of trade. The definitions of both a DES and of an AORS state very plainly that the core exchange service of matching and executing (that is, completing) a transaction will remain outside the United States.<sup>2</sup>

Despite uncertainties in the narrative accompanying the specific rules proposal,<sup>3</sup> the rules themselves are clear. A DES simply performs the final phase in transmitting an order for offshore execution, while an AORS conducts a precedent transmittal (usually from a customer) to a DES for offshore execution.

<sup>1</sup> 64 Fed. Reg. 14159 (March 24, 1999).

<sup>2</sup> Proposed Regulation § 1.3(rt) defines an AORS as a device "that allows entry of orders through another party for transmission to a board of trade's computer or other automated device where, without substantial human intervention, trade matching or execution takes place" (emphasis added). Proposed Regulation § 30.11 uses substantially the same language emphasized above.

<sup>3</sup> For example, the term "automated" migrates among a variety of functions: "automated trading," "automated access," and "automated order routing."

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Transmittal of orders via an electronic communications device like a computer keyboard or the Internet that has been disabled from executing the transaction would appear to pose no regulatory issues not shared equally by use of older electronic technology such as the telephone or fax machine which the Commission has never proposed to regulate as a "contract market" under the Commodity Exchange Act.

We understand the Commission's position to be, however, that if one were to (1) unplug a telephone and snap into that same outlet a modem line, and (2) convey by keyboard the exact data that would have been phoned in, one has established an exchange "located" in the United States that the Commission, absent an exemption sought by that operator, is entitled to regulate as a "contract market" under §4(a) of the Commodity Exchange Act. This analysis, in our view, is highly questionable; a better case can be made that the exchange remains outside the U.S. and that the Commission must honor the constraints imposed on it by §4(b) of the Act.<sup>4</sup>

In addition, adoption of the Commission's proposal would isolate the United States from the regulatory approach taken in other jurisdictions, to the best of our understanding, and could lead to the diminution rather than the expansion of global trade in services. For example, in Hong Kong, even though the Securities and Futures Commission (the "SFC") has not issued a formal policy statement on this matter, in fact the SFC has permitted both order entry and trading terminal devices of overseas exchanges, duly licensed in their home jurisdictions, to be placed in Hong Kong without any special regulatory requirements.

We would specifically recommend to the Commission the following:

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<sup>4</sup> E.g., "No rule or regulation may be adopted by the Commission under this subsection that (1) requires Commission approval of any contract, rule, regulation, or action of any foreign board of trade, exchange, or market, or clearinghouse of such board of trade, exchange, or market, or (2) governs in any way any rule or contract term or action of any foreign board of trade, exchange, or market, or clearinghouse for such board of trade, exchange, or market."

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- (1) The Commission should undertake a fresh look at this subject because, in the end, it would be reasonable for the Commission to conclude that the presence in the United States of devices that lack matching and execution capability but that facilitate order transmittal to foreign markets where such matching and execution continue to occur do not warrant any new regulatory standards or procedures; and
- (2) While that review is being conducted, and in light of the substantial customer protection safeguards already in place,<sup>5</sup> foreign markets wishing to place such devices in the U.S. or to allow order routing systems to be used should be permitted to do so subject to reasonable conditions and in coordination with the home regulator.<sup>6</sup>

Sincerely,



cc. The Honorable Brooksley Born  
The Honorable Barbara Pedersen Holum  
The Honorable David D. Spears  
The Honorable James E. Newsome

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<sup>5</sup> Existing Part 30 of the Commission's Regulations already provides an array of protections for U.S. customers trading on foreign markets.

<sup>6</sup> While most electronic trading systems have been examined in depth by the markets' home regulators, any doubts about such a system's efficacy can be addressed through cooperative review between the agencies.