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European Committee of Options and Futures Exchanges

~~Chairman: D.H. Hodson (LIFFE)~~

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30 April 1999

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

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### COMMENT

*Dear Ms Webb,*

#### **CFTC PROPOSED RULES ON "ACCESS TO AUTOMATED BOARDS OF TRADE" (64 Fed. Reg. 14159, March 24 1999 (the "Proposed Rules"))**

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

#### **ECOFEX**

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

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

Individual members of ECOFEX may well respond to you direct with their own comments. In this letter, I set out a response which has been endorsed in principle by all members of ECOFEX. As you will appreciate, the letter comments on the

broad issues raised by the Proposed Rules. It has been left to individual Members of ECOFEX to comment on the detailed operation of the regime envisaged by the CFTC.

### **The CFTC Concept Release**

On 18 September 1998, ECOFEX wrote to the CFTC in response to the Commission's Concept Release which foreshadowed the Proposed Rules. ECOFEX broadly welcomed the Concept Release while making a number of recommendations which we believed would improve the regime envisaged by the CFTC.

ECOFEX made a particular point of urging the Commission to implement the new regime expeditiously because any delay could distort competition between foreign exchanges. We pointed out that a number of foreign exchanges wished to make applications immediately to place trading facilities in the United States; and that they were unable to obtain regulatory approval at a time when other foreign exchanges continued to enjoy such access to the US. This crucial point was reiterated in a letter which I sent to the CFTC Chairperson and her fellow Commissioners on 15 March 1999. It has also been made by a number of individual ECOFEX members. It is therefore a matter of grave concern to us that the CFTC regime has yet to be implemented.

### **The Proposed Rules**

Our comments on the Proposed Rules are made without prejudice to alternative means which ECOFEX members might wish to pursue in order to obtain regulatory approval to place Direct Execution Systems (DESS) in the United States and for their member firms to operate Automated Order Routing Systems (AORSs) in the US. In particular, and in the light of the fact that the Proposed Rules have proved controversial and may take considerable time to finalise, we believe that interim relief should be available to foreign futures exchanges wishing to grant access to their markets through DESS and AORSs in the US.

We believe that implementation of the Proposed Rules in an acceptable form is an important step in the creation of truly global capital markets, from which investors stand to benefit considerably. Many market participants in Europe are currently able to enjoy direct access to US contract markets which have been authorised to place electronic trading facilities in Europe. For some of those participants, this has brought cheaper, more efficient and immediate access to US markets, enabling investors in Europe to participate on an equal footing with their counterparts in the United States. For others, direct access to US markets has been an important factor in making trading on those markets a viable proposition, thereby increasing investor choice. The US financial community, along with foreign futures exchanges, stands to reap similar benefits once the CFTC adopts a workable regime to allow foreign futures exchanges to place trading facilities in the United States.

We have a number of concerns about the Proposed Rules as they are currently drafted. Most fundamentally, we believe that their jurisdictional reach is excessive. Proposed Rule 30.11(d)(7) would require an approved foreign futures exchange to submit to the

jurisdiction of the CFTC and the state and federal courts in the United States with respect to the foreign exchange's activities which are conducted pursuant to the exchange's exemption from the Commodity Exchange Act. We are concerned that such activities will be interpreted very broadly and, at the extreme, could be regarded by the CFTC as including the running of the foreign futures market itself. We would object to this as a matter of principle. Furthermore, we believe that it would involve duplication of regulatory effort and increased costs for regulators, foreign futures exchanges and, ultimately, market participants.

We therefore believe that the Proposed Rule should be redrafted so that it recognises that, once approved, a foreign futures exchange continues to be subject solely to the jurisdiction of its home regulatory authority. The only exception to this approach would be any periodic review by the Commission of the original approval. In conducting any such review, the Commission should be under an explicit duty to exercise its powers reasonably and even-handedly. This is particularly important given that foreign futures exchanges and their US members will need to invest significant sums of money in order to provide direct access to foreign futures markets.

Notwithstanding our concerns about jurisdictional scope, the general approach taken elsewhere in the Proposed Rules does seem to acknowledge that responsibility for regulating foreign futures exchanges wishing to place trading facilities in the US should remain with the home regulator of the foreign exchange. We fully endorse this approach. We are, however, concerned that a number of detailed provisions in the Proposed Rules would serve to undermine it. The conditions in question relate both to the contents of petitions required under the Proposed Rules and to the continuing obligations which would be placed upon approved foreign exchanges.

For instance, Proposed Rule 30.11(d)(3)(i) would require foreign futures exchanges to submit to the CFTC, on at least a quarterly basis, the total trade volume originating from the United States for each contract available for trading through DESs and AORSs located in the United States. This would place a burdensome and, in our view, an unnecessary obligation on foreign exchanges and would yield no obvious benefit to investors.

Similarly, Proposed Rule 30.11(d)(8) would require an approved foreign futures exchange to provide the CFTC with any information that the Commission might decide, at its discretion, was necessary in order to evaluate the exchange's continued compliance with the Proposed Rules *or for any other reason* (my italics). This is an extremely broad requirement which goes far beyond the issue at hand and which would place a wholly inappropriate obligation on the foreign futures exchange. As an alternative, the CFTC should as a general rule seek any information – whether it is directly relevant or not to the foreign exchange's compliance with the Proposed Rules – through the established information sharing agreements which the Commission has with other national regulatory authorities.

We are also concerned that the conditions for granting approval to a foreign exchange are in many cases too prescriptive. They should, instead, recognise that different exchanges and their national regulators have different means of achieving regulatory objectives. By way of example, the CFTC has requested comment on whether it should require DESs to have the ability to provide pre-execution credit and trading or

position limit screening (section III.B.1.c of the commentary to the Proposed Rule refers to this proposal). However, while some exchanges may wish to ensure that risk is managed in this way, others follow different approaches. Many take the view that the appropriate place for pre-execution screening to be conducted is solely at the member level. One reason for this is because a member's client will often be trading, via the member, on a number of different exchanges; and trades on one market may be hedged by those on others. Risk management at the member level enables position and credit screening to be done in a way which takes account of the totality of a customer's positions. We would therefore submit that the CFTC should avoid imposing a uniform approach to dealing with risk management and other regulatory issues. This would argue for the CFTC adopting a principles-based approach in determining the conditions for approving foreign futures exchanges.

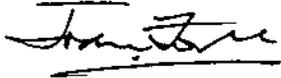
### **Conclusion**

ECOFEX endorses the CFTC's decision to devise a procedure of general applicability under which foreign exchanges will be able to apply to place trading facilities in the United States. However, we are concerned that the jurisdictional scope and burdensome obligations of the Proposed Rules would undermine the principle that the relevant foreign regulatory authority should retain sole responsibility for supervising exchanges within its jurisdiction. Unless the Proposed Rules are amended, this will result in duplication of effort for regulators and higher costs for foreign exchanges compared with US exchanges (because European regulators do not at present impose similar burdens on US exchanges). Higher costs will also fall upon exchange members and, ultimately, their customers.

Finally and crucially, the new regime should be implemented without further delay.

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

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

*Yours sincerely*  


John Foyle  
Chairman