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The Foreign Exchange Committee

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COMMENT

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

Re: Proposed Rules 1.71 and 30.11 Concerning Automated Trading Systems Providing Access to Electronic Boards of Trade Operating Primarily Outside the U.S.

Dear Ms. Webb:

The Foreign Exchange Committee respectfully submits this letter in response to the issuance by the Commodity Futures Trading Commission (the "Commission" or the "CFTC") of proposed rules concerning automated trading systems providing access to electronic boards of trade operating primarily outside the U.S. (the "Proposed Rules") which was published in the Federal Register on March 24, 1999 (the "Release"). This letter highlights some of the Foreign Exchange Committee's general concerns with the regulatory framework that would be created by the adoption of the Rules and the legal basis under which the Commission proposes to assert jurisdiction over foreign boards of trade that would allow for electronic access from United States ("U.S.") locations.

The Foreign Exchange Committee greatly appreciates this opportunity to comment on the Release and the Proposed Rules. The Foreign Exchange Committee was formed in 1978 under the sponsorship of the Federal Reserve Bank of New York, and includes representatives from major domestic and foreign commercial and investment banks and foreign exchange brokers. The Foreign Exchange Committee represents many of the most significant participants in foreign currency trading in the U.S.

Overview

The Foreign Exchange Committee believes that the approach taken in the Release and the Proposed Rules is fundamentally at odds with the express language of the Commodity Exchange Act ("CEA") and raises several important public policy concerns. Specifically, we have three objections to the Release and the Proposed Rules.

- First, we disagree with the Commission's statement in the Release that a foreign board of trade is no longer "located outside the U.S." solely by virtue of having terminals in the U.S. In our view, this approach is problematic as a matter of sound statutory construction and wholly unnecessary in order to address the Commission's legitimate concerns over electronic access to foreign boards of trade from within our borders.

- Second, the similar treatment of Automated Order Routing Systems ("AORSs") and Direct Execution Systems ("DESs") is inappropriate. We do not believe that the CFTC should equate terminals that are directly connected to a board of trade's electronic execution system with automated order routing systems that are under the control of participants in the system. Such an approach does not take into account some important differences between AORSs and DESs and would unnecessarily impose regulatory burdens on FCMs and foreign boards of trade.

- Third, the notion that the foreign board of trade must be subject to a regulatory regime that is "generally comparable to that in the U.S." is counterproductive and inconsistent with important policies underlying the CEA. We do not believe it would be appropriate for the CFTC to engage in a "merit review" of the comparability of a foreign regulatory scheme as a condition to approval of terminal access from the U.S. Instead, we respectfully suggest that the CFTC should extend greater deference to the *bona fide* home country regulator of any foreign board of trade.

A. Foreign Boards of Trade Located within the U.S.

The Commission's notion that a foreign board of trade that is accessible from within the U.S. via an AORS or a DES is no longer "located outside the U.S." for purposes of Section 4(a) of the CEA is legally insupportable and factually inaccurate. The ability to access a foreign board of trade's electronic execution system from within the U.S. is simply not the same as locating the board of trade itself within the U.S. As a matter of law, this interpretive position is inconsistent with the express language contained in of Section 4(b) of the CEA. Section 4(b) clearly prohibits the Commission from adopting rules or regulations that require Commission approval of, or govern in any way, any contract, rule, regulation or action of any foreign board of trade, exchange, market or clearinghouse therefor. By regarding foreign boards of trade having U.S. DESs

and AORSs as being "located" within the U.S., however, the Commission is trying to invent a jurisdictional predicate in order to inappropriately regulate most aspects of the operation of these boards of trade.

The Commission's interpretive position is also inconsistent with the plain meaning and underlying purpose of Section 4(b) which was intended to require deference to home country regulators of foreign boards of trade so as to promote greater cooperation and coordination among regulators and facilitate increased cross-border trading. Because of its proximity to and familiarity with the board of trade's management and operations, the home country regulator of a board of trade is invariably in the best position to provide comprehensive regulation with the least amount of burden on the board of trade. Moreover, where a foreign board of trade has terminals located in multiple jurisdictions, deference to the home country regulator is the only practical regime.

The practical effect of the Proposed Rules is that foreign electronic trading systems (be they Boards of Trade or private systems) will not allow U.S. firms – including U.S. dealers – to have access to these systems through terminals located domestically. This will deny the benefits of easy access to those systems to numerous large, sophisticated U.S. parties who do not need the protection of the CFTC in this connection.

B. Commission Approval of Home Country Regulation

While the Commission clearly has an interest in preventing attempts to evade the CEA by organizing boards of trade in jurisdictions lacking *bona fide* regulatory regimes, the Proposed Rules' requirement that the Commission undertake a broad review of a foreign board of trade's home country regulatory scheme is an inappropriate and unnecessary solution to this problem. Proposed Rule 30.11 (b)(ii) would require that the petitioner's home country have "established a regulatory scheme that is generally comparable to that in the U.S." and Proposed Rule 30.11(b)(v) requires that the home country regulator's review of the petitioner's automated trading system comply with the relevant IOSCO standards. Any such review is inconsistent with the important policies underlying Sections 4(a) and 4(b) of the CEA. In adopting Section 4(b) of the CEA in 1982, Congress clearly intended to prohibit the Commission from regulating foreign boards of trade and other exchanges and markets. A substantive review of a foreign regulatory regime in order to determine whether it is sufficiently comparable to the U.S. model is fundamentally inconsistent with the important principles of international cooperation and deference among regulators.

C. Automated Order Routing

Finally, the Proposed Rules discount important distinctions between DESs, which provide non-intermediated access to a foreign board of trade's systems, and AORSs, which provide electronic entry of orders through an intermediary. Because

AORSs are installed by a foreign board of trade's members–and not the exchange itself–they should not affect the board of trade's status as foreign especially since the Commission already has adequate authority to regulate intermediaries.

Conclusion

For the reasons described above, we believe that the approach to electronic trading systems reflected in the Proposed Rules is misguided. The Proposed Rules would unnecessarily complicate access from the U.S. to foreign boards of trade, and they rely upon an approach that is inconsistent with the express language of the CEA and the legislative intent of Congress in enacting 4(b) of the CEA. Finally, the Proposed Rules would impede technological innovation and global market access. We recognize the need to implement an appropriate regulatory framework for permitting terminal access from the U.S. to foreign boards of trade. However, we believe that such a framework should focus on intermediaries dealing with U.S. customers and, with respect to issues related to the foreign boards of trade, defer to home country regulators in jurisdictions having *bona fide* regulatory schemes.

If you have any questions or would like further information regarding this letter, please feel free to contact the undersigned at 212-761-2860 or Michael S. Nelson at 212-720-8194.

Sincerely,

Paul G. Kimball
Chairman

cc: The Honorable Brooksley E. Born
The Honorable Barbara P. Holum
The Honorable David D. Spears
The Honorable James E. Newsome
I. Michael Greenberger