



U.S. COMMODITY FUTURES TRADING COMMISSION
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June 21, 1996

The Honorable Charles E. Schumer
U. S. House of Representatives
2211 Rayburn House Office Building
Washington, D.C. 20515-3209

Dear Representative Schumer:

Thank you for your letter of May 31, 1996, concerning the Commodity Futures Trading Commission's ("Commission") authority over foreign boards of trade and the offer and sale of foreign futures and options in the United States. Your inquiry is particularly timely in light of recent revelations concerning the activities of the Sumitomo Corporation, a non-regulated foreign firm trading copper in the London market. I have included answers to your questions, as well as some other thoughts I have about the important issues raised in your letter.

1. Registration Requirements for Professionals

The offer or sale of foreign futures or option products to U.S. customers are subject to regulatory safeguards comparable to those applicable to domestic transactions ^{1/} under Part 30 of the Commission's rules, 17 C.F.R. Part 30.

In general, the Part 30 rules require that both U.S. and non-U.S. persons engaged in foreign futures and options transactions on behalf of U.S. customers register with the Commission in the appropriate capacity--that is, as futures commission merchants (FCM), introducing brokers, commodity pool operators, commodity trading advisors or associated persons. However, under rule 30.10, the Commission may exempt a firm located outside the United States

^{1/} See S. Rep. No. 384, 97th Cong., 2d Sess. 45-46 (1982) and 51 FR 12104 (April 8, 1986).

and selling only foreign products to U.S. customers from certain Commission rules, relying instead upon the firm's compliance with the comparable regulatory requirements of the foreign jurisdiction.

The Commission has issued such rule 30.10 exemptive orders only to (1) foreign regulatory or self-regulatory organizations which have filed the information and representations required and have demonstrated that the foreign regulatory scheme is comparable to the U.S. regulatory scheme for futures trading, and (2) the firms which they designate. Individual firms must receive written confirmation from the Commission to operate under such an exemptive order. Such firms also must meet specified procedural requirements, such as filing a valid agency agreement with the National Futures Association. They also must have been checked in the Commission's data-base for any derogatory information that would suggest such persons were unfit to do business in the United States because they would be disqualified if they had applied directly.

As with registration of domestic entities, there is no provision for public comment or input regarding the specific, individual determinations made under these rules. However, the procedures themselves were promulgated only after public notice and an opportunity for comment, consistent with the requirements for rulemaking of the Administrative Procedures Act.

2. Decisions to Grant Part 30 Exemptions

As a guide to its determinations in granting exemptive relief under rule 30.10, the Commission, in conjunction with its promulgation of Part 30, issued an Interpretative Statement providing the framework for review of a rule 30.10 petition and stating the elements the Commission will examine in determining whether a foreign regulatory program should be deemed to be comparable.^{2/} In assessing comparability of regulation, the Commission examines: (1) registration or fitness review of professionals; (2) minimum financial requirements for persons accepting customer funds; (3) protection of customer funds; (4) minimum sales practice standards, including risk disclosure; and (5) procedures for auditing regulatory compliance.

In reviewing a rule 30.10 petition, the Commission has broad discretion to determine whether those elements of comparability have been met. The petitioner under Commission rule 30.10 must present, with particularity, the factual basis for such a finding, particularly in light of any differences of degree or kind in the

^{2/} Appendix A -- Part 30 -- Interpretative Statement With Respect to the Commission's Exemptive Authority Under Section 30.10 of Its Rules ("Interpretative Statement"), 17 CFR 30.10, Appendix A.

petitioner's regulatory program. Finally, the Commission must be assured that it has adequate access to information through information sharing arrangements between the Commission and the appropriate regulatory authorities in the foreign jurisdiction.

3. Subsequent Review of Exemptions

Rule 30.10 Orders typically require the foreign regulator to monitor for compliance the firms to which relief is granted, notify the Commission or National Futures Association ("NFA") of any change in a firm's eligibility, cooperate with the Commission with respect to any inquiries, use its best efforts to notify the Commission if it becomes aware of any information which affects the financial or operational viability of a firm under its regulation, and to notify the Commission of any material changes in relevant laws.

Rule 30.10 orders are expressly subject to the condition that they may be conditioned, modified, suspended, terminated or withheld, either generally or with respect to an individual firm, on the Commission's own motion, if the Commission determines that the continued effectiveness of the order would be contrary to public policy or the public interest.

The Commission, however, does not itself audit the internal operations of the foreign regulatory organizations which have received rule 30.10 relief and which have undertaken certain supervisory responsibilities with respect to firms operating under a rule 30.10 Order. As noted previously, Part 30 exemptive relief is premised on substituted compliance by the foreign broker with comparable regulatory requirements imposed by the foreign jurisdiction. Essentially, the Part 30 exemptive program recognizes that if foreign brokerage activities are to be permitted, the foreign regulator is best situated to ensure direct oversight activity taking place in that foreign jurisdiction.

To date, the Commission has received no complaints which would warrant modifying or revoking any order granting rule 30.10 relief. In general, the Part 30 program has been a success, materially advancing the level of protection to U.S. customers for the offer and sale of foreign futures products, which previously were not subject to any regulation or oversight other than the operation of an anti-fraud rule.

4. Approval Process of Listing by a Foreign Exchange of a Contract With Delivery in the United States.

As noted in your letter, Section 4(b) of the Commodity Exchange Act ("Act") limits the Commission's authority to approve the contracts, rules or actions of a foreign board of trade. The Commission does not generally have an "approval" process to address a decision by

a foreign board of trade to list a contract calling for future delivery of a commodity within the United States.^{3/} Nevertheless, the Commission's staff did informally review the potential implications of such a delivery provision for the United States futures and cash copper markets, when a foreign exchange, the London Metals Exchange ("LME"), recently decided to list United States delivery points in copper.

This review was carried out by the Commission's Market Surveillance staff in furtherance of its responsibilities under the anti-manipulation authority of Sections 6(c) and 6(d) of the Act, as well as its general oversight responsibilities. In particular, the review included an exchange of correspondence with the LME, as well as contact with its regulator, the United Kingdom Securities and Investments Board ("SIB"), and several meetings. Specifically, the Commission's correspondence stressed the Commission's view that a United States' regulatory interest was invoked as a consequence of the listing United States delivery points in a commodity for which there was an existing, actively traded U.S. futures contract. The Commission sought written information about, and analysis regarding, the potential effects of such a delivery point. Subsequently, the staff obtained clarification through a number of follow-up questions to the foreign exchange. Finally, the Commission's market surveillance staff reviewed relevant materials independent of those provided by the foreign exchange and conducted a number of interviews with those in the United States trade to gain a more complete understanding of the manner of operation of the United States delivery points under the foreign exchange's

^{3/} With respect to a foreign futures contract based on an index of foreign securities, the Commission's Office of General Counsel has issued numerous no-action letters allowing the offer and sale of certain of such contracts in the United States. See section 2(a)(1)(B)(v) of the Act and H.R. Rep. No. 565, Part 1, 97th Cong., 2nd Sess. 85 (1982). In general, staff examines such foreign stock index contracts under the criteria set forth in section 2(a)(1)(B)(ii) of the Act, which apply generally to the designation of domestic exchange-traded stock index futures contracts.

Separately, the offer and sale of foreign commodity options to U.S. customers previously had required a specific Commission order under rule 30.3(a) authorizing such sales. However, on March 12, 1996, following notice and review of public comment, the Commission eliminated the requirement that the Commission issue an order authorizing the offer and sale of a particular foreign exchange-traded commodity option before it can be offered or sold in the United States. This action was based, among other things, on the Commission's generally positive experiences with the foreign options program.

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rules, the trading system of the foreign exchange, and any possible effect these might have on United States markets.

This was the first instance where a foreign exchange listed delivery points in the United States for a commodity for which there already exists an actively traded United States contract. Thus, there was no specific, preexisting administrative practice regarding the procedures, scope or method of review of such an action by a foreign exchange. Despite the fact that the Commission cannot approve or disapprove the rules of a foreign exchange, the procedures used by the staff in this case mirror those used when reviewing rule changes submitted by domestic exchanges for Commission approval under section 5a(a)(12) of the Act, or other domestic exchange proposals or actions requiring Commission approval. Thus, these procedures would certainly act as the template to be followed in reviewing any subsequent, similar actions by foreign exchanges.

5. Information Which the Commission Can Obtain

The Commission has a number of avenues through which to obtain information regarding trading in copper on the LME. First, the Commission operates an extensive market surveillance program under which the staff can make informal requests for information from other regulators, from the various self-regulatory organizations, including exchanges, both foreign and domestic, or from various traders, directly. Cooperation with such informal requests is quite high.

Moreover, the Commission is authorized under Section 12(a) of the Act to request foreign futures authorities' assistance in obtaining information. The Commission has entered into a number of Memoranda of Understanding and information sharing agreements with foreign regulators, including those of the United Kingdom, to facilitate such cooperation.

In addition, the Commission can compel traders with reportable positions on U.S. designated contract markets to provide complete information regarding those positions, as well as any related positions, whether in the cash markets or on other futures markets, wherever located. The Commission requires that such information be provided through the mechanism of a "special call." See 17 C.F.R. §§18.05, 21.02 and 21.03. In addition, the Commission can require that United States registered futures commission merchants provide information regarding the potential financial impact of an affiliate's activities--including the potential impact of positions which the affiliate may be carrying in a foreign cash or futures market--on the futures commission merchant. See 17 C.F.R. §1.15. Finally, under Section 6(c) of the Act, the Commission has broad authority to issue administrative subpoenas, which are enforceable in the Federal courts, to compel the testimony of witnesses and the

production of documents, as appropriate.

The Commission is satisfied that, so far, using a variety of the tools noted above, as appropriate, it has been able to obtain all of the information that it has needed to discharge fully its statutory mandate.

6. The Commission's Authority to Respond to Conduct on a Foreign Exchange

To the extent the Commission can show conduct, or the effects of conduct, in the U.S., the Commission could apply its enforcement authority to address adverse effects on the pricing of U.S. cash or futures markets of conduct originating outside the U.S.

One of the Act's fundamental protections, that of the price integrity of commodities in interstate commerce, remains applicable where abnormal trading activities on a foreign exchange adversely affect United States cash and/or futures market prices, through transmission into the U.S. market by means of a U.S. delivery facility. There may be, of course, limits to the extraterritorial exercise of judicial and administrative authority that may, at times, prevent obtaining jurisdiction over some individuals or prevent the presentation of important information.

Thus, provisions of the Act, such as those prohibiting causing a false price to be reported or on manipulating or attempting to manipulate, would apply to activities affecting interstate commerce without regard to the location from where they originated. Nevertheless, the Act's applicability may not be co-extensive in situations where all of the trading as well as the participants are located outside the United States. Where the exchange is located offshore, for example, it may not be possible to use one of the remedies provided under the Act, such as ordering contract markets to deny trading privileges to the guilty individuals, requiring instead that other available remedies be used. Although in this instance the applicability of a particular provision in the Act may not be co-extensive to a situation completely within the United States, that alone does not imply that coverage under the Act as a whole is not sufficiently complete or effective in addressing situations described in your letter involving non-U.S. exchanges. Moreover, any increased restrictions on cross-border access to markets should be weighed against their possible implication for international trade.

7. Sufficiency of the Current Legislative/Regulatory Framework

The Commission generally has responded to the challenges posed by greater globalization of the futures industry by taking a leading role in encouraging information sharing and enforcement agreements among various national regulators and self-regulatory organizations

and by reexamining its existing rules and enhancing them as appropriate.^{4/} In light of the relatively infrequent need to test their efficacy in the context of specific market problems or situations, the Commission believes that greater experience is required before a studied determination can be made of what, if any, additional statutory or regulatory authorities are necessary or advisable.

I have a few other thoughts I would like to share about the issues raised in your letter.

The questions you raise are both significant and complex. The Commission is quite sensitive to the growing challenge it faces as a result of the increasing globalization of trading in the financial services industry and is constantly reviewing the adequacy of its regulatory scheme to address this issue. However, even though the globalization of the financial services industry has been thought to be a recent phenomenon, there is a long history of foreign participation in United States futures contracts, generally, and of futures contracts which cross national borders with respect to their delivery terms, in particular. For example:

- the London Metals Exchange has long traded contracts in aluminum, lead and zinc which are deliverable in the United States;
- MATIF, a commodity exchange located in France, and the London Commodity Exchange trade sugar contracts which are deliverable in the United States;
- the New York Mercantile Exchange previously listed a heating oil contract deliverable in Rotterdam harbor and recently applied to the Commission, and is awaiting approval, for designation as a contract market for natural gas deliverable in Alberta, Canada;
- the New York Coffee, Sugar and Cocoa Exchange trades a sugar contract deliverable in twenty-nine different countries; and
- COMEX, Inc. was designated to trade a now dormant cash-settled contract on Dubai Crude Oil.

A complete listing of U.S. futures markets with foreign delivery points or foreign-based cash settlements and of foreign futures

^{4/} For example, the CFTC and the SIB encouraged the development of the large exposure information sharing arrangements which were signed this past March by international futures exchanges and clearing organizations and their regulators.

markets with U.S. delivery points is attached.

Despite this history of cross-national delivery points on particular futures contracts, the increased pace of globalization has raised an even broader issue with regard to the sufficiency of regulatory authority to address potential problems of market or financial integrity which arise in connection with trading outside of the national regulator's borders. As demonstrated by the collapse of Barings Bank, events in a foreign market not directly related either to trading in the United States, or to delivery in the United States of contracts traded on a foreign exchange, nevertheless may have potentially far-reaching effects on United States markets and market participants. Indeed, transactions in cash products and trading on exchanges outside the U.S. can affect prices in the U.S., including on U.S. markets, irrespective of any domestic prohibitions on products and intermediaries imposed under the Act.

In general, national regulators have responded to these developments by seeking closer international ties and cooperation. Consistent with that trend, the Commission has entered into a number of bilateral Memoranda of Understanding ("MOUs") with foreign regulators to provide formal and informal avenues for legally sharing information and providing other forms of assistance. Most recently, the Commission has been instrumental in encouraging various self-regulatory organizations to enter into similar agreements. In addition, the Commission has encouraged the international harmonization of trading regulation and practices to the greatest degree possible.

As you quite rightly point out, because Section 4(b) of the Act limits the Commission's authority with respect to requiring Commission approval of any contract, rule, regulation or action of a foreign board of trade, such potential problems to some degree must be addressed through negotiation with, and the moral suasion of, foreign regulators. However, Section 4(b) does grant the Commission authority to promulgate rules "proscribing fraud and requiring minimum financial standards, the disclosure of risk, the filing of reports, the keeping of books and records, the safeguarding of customers' funds, and registration with the Commission by any person located in the United States . . . who engages in the offer or sale of any [futures] contract made . . . on or subject to the rules of a board of trade . . . located outside the United States. . . ." As described above in response to your specific questions, the Commission has exercised this authority, in part, by promulgating Part 30 of its rules. 17 C.F.R. Part 30. Moreover, Sections 6(c) and 6(d) of the Act prohibit any person from "manipulating or attempting to manipulate. . . the market price of any commodity, in interstate commerce. . . ." regardless of whether that person falls within a foreign regulator's jurisdiction.

As the most recent events involving the Sumitomo Corporation demonstrate, global markets and firms are linked and no single regulator will have access to all the information necessary to properly supervise its markets and protect its customers. In this global trading environment -- in which the Commission may not have authority over the activities of foreign firms trading on foreign markets -- the Commission must also rely upon the efforts of our international regulatory counterparts in order to accomplish the goals of protecting our markets and customers in an era of globalization and free trade.

Since last year, the CFTC has been conducting heightened surveillance of the copper market in response to unusual market conditions and increased volatility. For more than seven months, the CFTC and the SIB have been engaged in a joint investigation of a number of issues relating to the copper market. This investigation continues.

In response to last Thursday's announcement of Sumitomo's losses, U.S. and U.K. regulators have been working together with exchanges and market participants to gauge its effects. At the CFTC's request, Sumitomo gave specific reassurances that it would fully stand behind all its current financial obligations. (CFTC Press Release attached.)

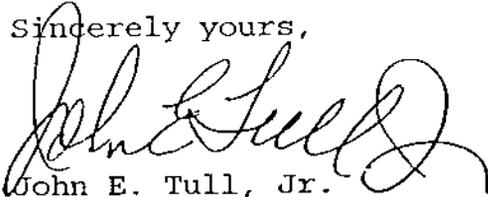
While Sumitomo's recent copper futures positions were held on the London Metals Exchange and not on any U.S. markets, we were concerned about any resulting volatility in our country or possible effects on U.S. firms. The CFTC and the SIB were particularly concerned about the effect of the announcement by Sumitomo on the June 19th "prompt" or delivery date for copper on the LME. As you may now be aware, the June 19th prompt date passed without undue effect on the market or financial system.

Furthermore, you may be interested to know that on June 19th, the SIB announced that in light of recent events it is opening a comprehensive inquiry into the regulation of the metals market and associated derivatives trading as a whole, both on the LME and over-the-counter. The review will examine, among other things, the scope of the LME's rules, its procedures and the extent of its authority over the metals traded on the LME. Furthermore, the review will examine both the rules and internal arrangements of the LME and the mechanisms in place for cooperation among regulators internationally. The SIB will work closely with the Commission and others in examining whether more needs to be done in relation to inter-professional markets such as the LME.

The Honorable Charles E. Schumer
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I trust that this letter satisfactorily responds to your request. Your interest in the Commodity Futures Trading Commission is appreciated. Please feel free to contact me if you have any additional questions or comments.

Sincerely yours,



John E. Tull, Jr.
Acting Chairman

Attachments

**US FUTURES MARKETS WITH FOREIGN DELIVERY POINTS OR
FOREIGN BASED CASH SETTLEMENT**

<i>CONTRACT</i>	<i>FOREIGN DELIVERY POINT</i>
CSCE Sugar #11	29 enumerated countries in Asia, Africa & Central and South America
CSCE White Sugar *	France, Poland, Germany, Brazil, S Korea, Thailand, Netherlands, Belgium, UK as well as the US
CSCE Euro-Diff Coffee	Germany, the Netherlands & Belgium
CME Gold (European) *	UK accounts of members of London Gold Market
NYMEX Heating Oil *	Rotterdam, Netherlands
MCE Copper *	US & the UK, Netherlands, Germany & Belgium
CME/NYFE/NYCE/PHBT Currencies	Bank in home country of currency
CBT Foreign Government Bonds (UK, Japan, France, Germany, Canada & ECU bonds)	Through a non-US clearing system for the underlying foreign bonds (eg., CEDEL, EuroClear)

<i>CONTRACT</i>	<i>CASH SETTLEMENT PROVISION</i>
NYCE Cotlook World Cotton	Survey of European cash prices by UK price reporting firm
CBT FOSFA Edible Oils	Survey of European cash prices by UK industry organization
COMEX Dubai Crude Oil *	Survey of world oil companies' cash prices by a UK futures exchange (IPE)
ACC Gold Option *	London gold fix
CME Eurodollars One-Month LIBOR	Survey of price quotes of London banks
CME Euroyen	Tokyo International Financial Futures exchange price
CME Euromark	Survey of European banks by British Bankers Association
CME/CBT/COMEX Stock Indexes	Formula based on prices or quotes of securities market in home country of index

* Inactive or dormant contract

March 21, 1995

FOREIGN FUTURES MARKETS WITH US DELIVERY POINTS

<i>CONTRACT</i>	<i>DELIVERY POINTS</i>
LME Aluminum Aluminum Alloy Lead Nickel Tin Zinc	Cities throughout the world including Baltimore, Bridgeport CT, Chicago, Detroit, Long Beach, Louisville, New Haven, St Louis & Toledo in the US
LCE Raw Sugar #6	Cities in 33 enumerated countries throughout the world including cities in the US
MATIF White Sugar	Cities in 24 enumerated countries throughout the world including the following US cities: Baltimore, Boston, Gulfport, New York, New Orleans, Oakland, Philadelphia and Savannah
LCE White Sugar #5	Cities throughout the world including New Orleans & Savannah in the US

ENDNOTES

United States Futures Markets:

ACC	AMEX Commodities Corporation
CBT	Chicago Board of Trade
CME	Chicago Mercantile Exchange
CSCE	Coffee, Sugar & Cocoa Exchange
COMEX	Commodity Exchange, Inc.
MCE	MidAmerica Commodity Exchange
NYCE	New York Cotton Exchange
NYFE	New York Futures Exchange
NYMEX	New York Mercantile Exchange
PHBT	Philadelphia Board of Trade

Foreign Futures Markets:

LCE	London Commodity Exchange
LME	London Metals Exchange
MATIF	Marche a Terme International de France



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News Release

Release: #3918-96

For Release: June 14, 1996

CFTC STATEMENT CONCERNING THE COPPER MARKET

The Commodity Futures Trading Commission (CFTC) issued the following statement today concerning the ongoing activity in the copper market:

Since last year, the CFTC has been conducting heightened surveillance of the copper markets in response to market volatility. For more than seven months, the CFTC has been engaged in an investigation of a number of issues relating to the copper market and Sumitomo's trading activity.

In conducting this investigation, the CFTC has received extensive cooperation and assistance from the Securities and Investments Board (SIB), the Securities and Futures Authority (SFA), and the London Metal Exchange (LME) in the United Kingdom.

In the course of this undertaking, the CFTC has had extensive contact with the Sumitomo Corporation and, as a result, was informed yesterday, June 13, 1996, of the Sumitomo Corporation's discovery of significant unreported losses in its Non-Ferrous Metals Division. At the CFTC's request, Sumitomo specifically reassured the agency that it will stand fully behind its financial obligations.

CFTC Acting Chairman John E. Tull noted the steps being taken by Sumitomo in this regard and welcomed the assurances given by Sumitomo. Chairman Tull stated, "the CFTC has been in close contact with all U.S. exchanges, particularly the New York Mercantile exchange, all domestic financial regulators, and our international counterparts since yesterday. We continue to monitor the situation closely."

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