

COMMODITY FUTURES TRADING COMMISSION

Boards of Trade Located Outside of the United States and No-Action Relief from the Requirement to Become a Designated Contract Market or Derivatives Transaction Execution Facility

AGENCY: Commodity Futures Trading Commission

ACTION: Policy Statement

SUMMARY: The Commodity Futures Trading Commission is issuing a Statement of Policy that affirms the use of the no-action process to permit foreign boards of trade to provide direct access to their electronic trading systems to U.S. members or authorized participants, and provides additional guidance and procedural enhancements.¹

EFFECTIVE DATE: [Effective upon publication.]

FOR FURTHER INFORMATION CONTACT:

Robert Rosenfeld, Deputy Director, Office of International Affairs, 202-418-5423, rrosenfeld@cftc.gov; Julian Hammar, Counsel, Office of the General Counsel, 202-418-5118, jhammar@cftc.gov; or Duane Andresen, Special Counsel, Division of Market Oversight, 202-418-5492, dandresen@cftc.gov, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581.

SUPPLEMENTAL INFORMATION:**Background**

Since 1996, staff of the Commodity Futures Trading Commission (CFTC or Commission) has issued no-action letters² to foreign boards of trade stating, subject to compliance with certain conditions, that it will not recommend that the Commission take enforcement action if the foreign board of trade provides its members or participants in the United States access to its electronic trading system without seeking designation under the Commodity Exchange Act (CEA or Act) as a contract market (DCM) or registration as a

¹ Commission Rule 140.12, 17 CFR § 140.12 Disposition of business by seriatim Commission consideration.

² See Commission Rule 140.99, 17 CFR § 140.99 (2006), which defines the term "no-action letter" as a written statement issued by the staff of a Division of the Commission or of the Office of the General Counsel that it will not recommend enforcement action to the Commission for failure to comply with a specific provision of the Act or of a Commission rule, regulation or order if a proposed transaction is completed or a proposed activity is conducted by the beneficiary.

derivatives transaction execution facility (DTEF).³ In 1998 the Commission imposed a moratorium on the issuance of such no-action letters pending the development of rules governing access to automated foreign boards of trade.⁴ During this period, the Commission received extensive comment on the proposed rulemaking, as well as advice from the Commission's Global Markets Advisory Committee and a Public Round Table. Because of the general lack of consensus on many of the fundamental issues surrounding access to foreign boards of trade, the Commission withdrew the proposed rules in an order that also directed the staff:

to begin immediately processing no-action requests from foreign boards of trade seeking to place trading terminals in the United States, and to issue responses where appropriate, pursuant to the general guidelines included in the Eurex (DTB) no-action process, or other guidelines established by the Commission, to be reviewed and applied as appropriate on a case-by-case basis.⁵

Following the lifting of the moratorium in 1999, the relevant Commission operating division has issued seventeen additional no-action letters.⁶ The Commission generally has not observed regulatory problems or financial harm to participants who are accessing the foreign boards of trade pursuant to the staff no-action relief letters. Moreover, the no-action process has been resilient throughout a period of increasing global competition, technological advances, changing ownership structures and evolving business models.

In 2006, ICE Futures, a U.K. registered investment exchange that provides direct access to its U.S. members pursuant to a CFTC staff foreign terminal no-action letter, notified the Commission that it would list a contract on West Texas Intermediate light sweet crude oil whose settlement price would be linked to contracts traded on the New York Mercantile Exchange

³ These letters, hereinafter referred to generally as "no-action letters" are published on the Commission's web-site at: <http://www.cftc.gov/dea/deaforeignterminaltable.htm>. Reference to DTEFs in the no-action letters was added following the establishment of that category by the Commodity Futures Modernization Act of 2000.

Although the letters refer to the placement of "terminals," the continued use of that term does not accurately reflect advances in technology, such as open network systems accessible through the Internet.

⁴ 63 FR 39779 (July 24, 1998) (Concept Release); 64 FR 14159 (March 24, 1999) (Proposed Rules). Under the terms of a letter dated June 3, 1998 to Eurex Deutschland, the Division of Trading and Markets modified the terms of the original 1996 no-action letter to the effect that Eurex members who were not already operating U.S.-based Eurex Terminals generally were prevented from placing Eurex terminals in the U.S. absent written authorization from the Division, pending adoption of Commission rules regarding electronic access to foreign exchanges.

⁵ Commission Order dated June 2, 1999, 64 FR 32829, 32830 (June 18, 1999). The Eurex-DTB no-action process referred to by the Commission in its 1999 Order lifting the moratorium was set forth in a letter dated February 29, 1996 from Andrea Corcoran, Director, Division of Trading and Markets to Lawrence Hunt, Jr., pp. 12-13 (the DTB no-action letter). CFTC Letter 96-28, indexed at <http://www.cftc.gov/opa/summaries/opanal96.htm>; [1994-1995 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,669 at 43,795- 43,802 (February 29, 1996). On June 18, 1998, the DTB changed its name to Eurex Deutschland, a step toward a planned merger with the Swiss Options and Financial Futures Exchange. See 63 FR 39779, 39781 (July 24, 1998) at fn. 12.

⁶ The Commission's Division of Market Oversight (successor to the market supervisory responsibilities previously performed by the Division of Trading and Markets) is responsible for issuance of the direct access no-action letters.

(NYMEX). ICE's notification prompted the Commission's Division of Market Oversight (DMO) to advise ICE Futures that the "Commission will be evaluating the use of the no-action process in light of significant issues raised by the factual circumstances underlying the subject notice."⁷ Among other things, the trading of such contracts made ripe the re-examination of certain dormant issues respecting the Commission's statutory obligations to maintain the integrity of U.S. markets and to protect U.S. customers, particularly the Commission's market surveillance obligations. Accordingly, on May 3, 2006, the Commission directed its staff to initiate a formal process to define what constitutes a "board of trade, exchange, or market located outside the United States, its territories or possessions" as that phrase is used in section 4(a) of the CEA and in furtherance of that process scheduled a public hearing.⁸ The Commission also issued a related Request for Public Comment.⁹

Hearing and Request for Comment

Participants at the Commission's Hearing and comments submitted in response to the Request for Comment (all collectively the "commenters"),¹⁰ were generally supportive of the no-action process, praising the process in general for its flexibility.¹¹ Many commenters suggested that the Commission should retain in large measure the essential contours of the no-action process.¹²

⁷ See letter dated January 31, 2006 from Richard A. Shilts, Director, Division of Market Oversight to Mark Woodward, Regulation and Compliance Policy Manager, ICE Futures.
<http://www.cftc.gov/files/dea/cftclettertoicefutures.pdf>

⁸ See Sunshine Act Meeting Notice, 71 FR 30665 (May 30, 2006); corrected at 71 FR 32059 (June 2, 2006). The hearing was conducted on June 27, 2006, at the Commission's headquarters in Washington, D.C.

⁹ See 71 FR 34070 (June 13, 2006). The Commission requested comment on the issues related to developing an objective standard establishing a threshold that, if crossed by a foreign board of trade that permits direct access, would indicate that the board of trade is no longer outside the United States and, accordingly, may be required to become registered under the CEA.

¹⁰ A transcript of the Commission's Hearing on what constitutes a board of trade located outside the United States under the Commodity Exchange Act section 4(a) (June 27, 2006), ("Hearing Tr.") as well as all comment letters ("CL"), are located in comment file 06 – 002 to 17 FR 34070 (June 13, 2006).
http://www.cftc.gov/foia/comment06/foi06--002_1.htm

¹¹ For comments supporting the no-action letter process generally, see, e.g., Comments of Nicholas Weinreb, Euronext, Hearing Tr. at 45 ("The no-action letter regime has been an extraordinarily successful one."); comments of Benn Steil, Director of International Economics, Council of Foreign Relations, in his personal capacity, Hearing Tr. at 49 ("I think it is exceptionally important to acknowledge just how successful the Commission's no-action regime has been . . ."); For favorable hearing participant comments on the flexibility of the no-action letter process, see, e.g., Comments of John Foyle, Euronext Liffe, Hearing Tr. at 46; Comments of Richard Berliand, JP Morgan Securities, Hearing Tr. at 61; Comments of Nicholas Weinreb, Euronext, Hearing Tr. at 174.

¹² See, e.g., CL 2 (New York Board of Trade) at 3; CL 3 (Council of Foreign Relations) at 2; CL 6 (ICE Futures Exchange) at 9-10; CL 7 (Minneapolis Grain Exchange) at 2; CL 8 (Bundesanstalt für Finanzdienstleistungsaufsicht) at 3; CL 16 (World Federation of Exchanges) at 1; CL 19 (Tokyo Stock Exchange) at 2; CL 22 (Federation of European Securities Exchanges) at 4; CL 23 (Eurex Deutschland) at 11; CL 24 (Euronext Liffe) at 5; CL 25 (Chicago Board of Trade) at 1; CL 28 (Futures Industry Association) at 9; and CL 45 (Committee of European Securities Regulators) at 1.

Commenters warned against any mechanistic approaches to determining whether an otherwise foreign organized exchange that permits direct electronic access by its U.S. members or participants is not located “outside” the United States for purposes of section 4(a) of the CEA, particularly questioned the use of volume as a proxy for U.S. presence (noting that its fluctuations could result in regulatory uncertainty), and stressed the need to avoid rigid or “bright line” tests.¹³ Some commenters favored a totality of circumstances approach to location,¹⁴ while others urged the Commission to look to indicators of physical location, such as the main location of an exchange’s infrastructure, its employees and headquarters.¹⁵

Market users stressed the need to maintain high levels of customer and market protections, particularly where a product might impact pricing in U.S. markets.¹⁶ Many U.S. exchanges requested that the Commission give greater attention to competitive issues, particularly when there is direct competition between a U.S. exchange and a foreign exchange’s products. U.S. exchanges in particular stressed the need for “regulatory parity.”¹⁷ Some commenters warned against taking actions that inadvertently could result in policies that may inhibit the ability of U.S. exchanges and firms to operate globally.¹⁸ Others stressed the need to provide regulatory certainty generally with respect to the applicability of the no-action process and to clarify the treatment of intermediated electronic access.¹⁹

Need for the Policy Statement

As made clear at the Hearing and by the written comments, the intensity of concerns with respect to the no-action process has been exacerbated by the global competitive environment. In particular, these concerns have called into question: (1) the Commission’s authority for the no-action process in light of Section 4(a)’s exclusion from the contract market designation requirement for foreign boards of trade, (2) the continued appropriateness of the no-action process generally, (3) whether objective threshold standards should be developed that would indicate that a board of trade is no longer located outside the United States for purposes of section 4(a) of the CEA, (4) whether enhancements to the no-action process may be necessary,

¹³ See, e.g., CL 2 (New York Board of Trade) at 2-3; CL 6 (ICE Futures Exchange) at 6-7; CL 9 (Chicago Mercantile Exchange) at 6; CL 23 (Eurex Deutschland) at 7; CL 25 (Chicago Board of Trade) at 9-10.

¹⁴ See, e.g., CL 22 (Federation of European Securities Exchanges) at 3.

¹⁵ See, e.g., CL 6 (ICE Futures) at 2; CL 9 (Chicago Mercantile Exchange) at 6.

¹⁶ See, e.g., CL 5 (New England Fuel Institute) at 2; CL 27 (Industrial Energy Consumers of America) at 1.

¹⁷ See, e.g., CL 7 (Minneapolis Grain Exchange) at 1; CL 25 (Chicago Board of Trade) at 5-6; and CL 43 (New York Mercantile Exchange) at 10.

¹⁸ See, e.g., CL 2 (New York Board of Trade) at 3.

¹⁹ See, e.g., CL 28 (Futures Industry Association) at 8.

particularly where trading may implicate domestic futures and cash markets, and (5) how the no-action process relates to perceived competitive issues.

Continued ambiguity with respect to these fundamental issues could result in an unacceptable degree of uncertainty that may hinder access by U.S. users to global products and markets, inhibit continued innovation in technology and products, and undermine the ability of U.S. markets and intermediaries to structure their business to compete globally. Accordingly, the Commission is issuing this Statement of Policy in order to provide greater regulatory certainty and transparency to issues surrounding access to foreign boards of trade.

STATEMENT OF POLICY REGARDING THE PROCESSING OF NO-ACTION REQUESTS BY FOREIGN BOARDS OF TRADE TO PROVIDE DIRECT ELECTRONIC ACCESS TO THEIR U.S. MEMBERS OR AUTHORIZED PARTICIPANTS

Since 1996, foreign boards of trade planning to permit members or other participants located in the United States to enter trades directly into that foreign board of trade's trade matching system ("direct access")²⁰ have sought staff no-action letters.

This Statement of Policy provides guidance for processing requests for no-action relief. The Commission intends that this Statement of Policy will ensure the consistent treatment of requests and the application of an appropriate degree of review, while maintaining the ability to respond to the individual factual circumstances raised by particular requests.

²⁰ For purposes of this Statement of Policy, the term "direct access" refers to the explicit grant of authority by a foreign board of trade to an identified member or other participant of that board of trade to enter trades directly into the board of trade's trade matching system.

In contrast, the staff no-action letters generally have defined the term "automated order routing systems" (AORS) as meaning any system of computers, software or other devices that allows entry of orders through another party (an intermediary) who has been granted direct access for transmission to the trading system where, without substantial human intervention, trade matching or execution takes place.

The Commission does not view the transmission of intermediated orders via AORSs for execution on a foreign board of trade to be "direct access" to that board of trade for purposes of the no-action process.

In this regard, the Commission endorses the view that mere intermediated electronic access by AORS does not create a presence in the U.S., such that a firm exempted from registration as a futures commission merchant (FCM) pursuant to Commission Regulation 30.10, which is prohibited from establishing a U.S. presence, would be required to register as an FCM. *See, e.g.,* CFTC Staff Letter No. 05-16 [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,127 (Aug. 26, 2005) ("For example, Rule 30.10 Firms continue to be prohibited from maintaining a presence in the United States. Thus, Rule 30.10 Firms cannot provide direct access to LIFFE CONNECT® in the United States (although they would be permitted to accept orders overseas from customers located in the United States that submit such orders by telephone or through an AORS located in the United States").) (*Emphasis added*).

This position is consistent with the Commission's historical policy of addressing customer protection concerns with regard to the offer or sale of foreign futures to U.S. customers primarily through regulation of the intermediary. In this regard, nothing in the Statement of Policy is intended to alter current Commission rules that require that any person engaging in the offer or sale of a foreign futures contract or foreign futures option transaction for or on behalf of a U.S. customer must be a registered futures commission merchant or operating pursuant to a Rule 30.10 Order.

The Commission's Statement of Policy takes into account the Commission's desire to facilitate access to markets and products, foster innovation and competition and eliminate unnecessary regulatory burdens, while maintaining customer and market protections mandated by the CEA. The adoption by the Commission of such a flexible and adaptable policy is consistent with Congressional findings that accompanied the enactment of the Commodity Futures Modernization Act of 2000 (CFMA).²¹

I. The Commission's Authority for the No-Action Process

A. Relevant Statutory Considerations: The Commodity Exchange Act circumscribes the Commission's authority over foreign boards of trade.

Section 4(a) of the CEA provides that a futures contract may be traded lawfully in the U.S. only if, among other things, it is traded on or subject to the rules of a board of trade that has been designated as a contract market or registered as a DTEF.²² Section 4(a) excludes from the

²¹ Section 126(a) of the CFMA, Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000), provides:

SEC. 126. INTERNATIONAL ACTIVITIES OF THE COMMODITY FUTURES TRADING COMMISSION.

(a) FINDINGS.--The Congress finds that—

- (1) derivatives markets serving United States industry are increasingly global in scope;
- (2) developments in data processing and communications technologies enable users of risk management services to analyze and compare those services on a worldwide basis;
- (3) financial services regulatory policy must be flexible to account for rapidly changing derivatives industry business practices;
- (4) regulatory impediments to the operation of global business interests can compromise the competitiveness of United States businesses;
- (5) events that disrupt financial markets and economies are often global in scope, require rapid regulatory response, and coordinated regulatory effort across international jurisdictions;
- (6) through its membership in the International Organization of Securities Commissions, the Commodity Futures Trading Commission has promoted beneficial communication among market regulators and international regulatory cooperation; and
- (7) the Commodity Futures Trading Commission and other United States financial regulators and self-regulatory organizations should continue to foster productive and cooperative working relationships with their counterparts in foreign jurisdictions.

²² Section 4(a) of the CEA provides in part:

Unless exempted by the Commission pursuant to subsection (c) of this section, it shall be unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting or accepting any order for,

designation requirement contracts made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions.”²³

Section 4(b) of the CEA, which authorizes the Commission to adopt rules governing the offer and sale of foreign futures and options contracts, explicitly prohibits the Commission from adopting rules pursuant to that section that: (1) require Commission approval of any contract, rule, regulation, or action of any foreign board of trade, exchange, or market, or clearinghouse for such board of trade, exchange, or market, or (2) govern 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.²⁴

B. Section 4(a)’s Exclusion from contract market designation applies only with respect to “bona fide” boards of trade

The Commission interprets the section 4(a) parenthetical exclusion from contract market designation for foreign boards of trade to apply only with respect to “bona fide” boards of

or otherwise dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery (other than a contract which is made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions) (emphasis added)

unless—

(1) such transaction is conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission as a contract market or derivatives transaction execution facility. . . .

7 U.S.C. § 6(b) (2000).

²³ In the absence of no-action relief, a board of trade, exchange or market that permits direct access by U.S. persons might be subject to Commission action for violation of, among other provisions, section 4(a) of the CEA, if it were not found to qualify for the exclusion from the DCM designation or DTEF registration requirement.

²⁴ Section 4(b) of the CEA provides:

The Commission may adopt rules and regulations 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, its territories or possessions, who engages in the offer or sale of any contract of sale of a commodity for future delivery that is made or to be made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions. Such rules and regulations may impose different requirements for such persons depending upon the particular foreign board of trade, exchange, or market involved. 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 for 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.

7 U.S.C. § 6(b) (2000).

trade. The term “bona fide” in this context refers to boards of trade that, among other things, possess the attributes of established, organized exchanges, adhere to appropriate rules prohibiting abusive trading practices, have been authorized by a regulatory process that examines customer and market protections and are subject to continued oversight by a regulator that has power to intervene in the market and share information with the Commission. In reaching this conclusion, the Commission relies on legislative history found in the Report of the Senate Committee on Agriculture, Nutrition, and Forestry,²⁵ which discusses the addition of section 4(b) to the CEA. Specifically, the Report notes that:

In addition, the rules and regulations developed under this provision [section 4(b)] are not intended to place the solicitation or acceptance of orders in the United States for bona fide foreign futures contracts at a comparative disadvantage with similar solicitation or acceptance of orders for domestic futures contracts. For example, rules which require the segregation of all or part of customers’ funds in the United States would not be consistent with the intent of this provision when there is adequate evidence that such funds have been transferred to a bona fide market, clearinghouse, or market principal and are adequately safeguarded for the protection of U.S. residents. [emphasis added]

The Commission’s conclusion in this regard is harmonious with previous Commission interpretations of “bona fide” exchange.²⁶

A commenter had questioned the appropriateness of applying a “bona fide” limitation on the application of section 4(a).²⁷ However, in light of the legislative history quoted above, which the Commission previously has interpreted as limiting the exclusion from Section 4(a) to bona fide foreign boards of trade, we believe that the interpretation we adopt today is an appropriate and reasonable exercise of the Commission’s powers to interpret and apply its governing statute, particularly when it implicates domestic conduct and possible effects on domestic persons and markets that the Commission is charged with protecting.

II. The appropriateness of the no-action process

A. The Commission endorses the no-action process.

The Commission endorses the continued use of the no-action process as an appropriate and flexible mechanism that should be used prospectively to facilitate direct access to the

²⁵ S. Rep. 97- 384, 97th Cong. 2d Sess. 46 (1982).

²⁶ See 63 FR 39779, 39788 (July 24, 1998). See also Compl. Count I, CFTC v. Topworth Int’l, Ltd., (No. 94-1256) (C.D. Cal.) (Feb. 2, 1994.)

²⁷ CL 9 (Chicago Mercantile Exchange) at 5.

electronic trading system of a foreign board of trade by its U.S. members or authorized participants.²⁸

The no-action process is appropriate because it gives staff the flexibility to address the factual circumstances presented in the future, and to apply a consistent approach to reviewing applications for no-action relief in light of innovations in electronic trading and technology, evolving regulatory standards, and specific customer protection and market integrity concerns. This approach is consistent with the CFMA's goal of adopting a flexible regulatory policy that can account for rapidly changing derivatives industry business practices, a theme that also was voiced at the Commission's hearing and in the written comments. Among other things, Congress found in the CFMA that "financial services regulatory policy must be flexible to account for rapidly changing derivatives industry business practices." CFMA Section 126(a)(3). Moreover, Section 126(b) of the CFMA expresses the sense of Congress that the Commission coordinate with foreign regulatory authorities to encourage "the facilitation of cross-border transactions through the removal or lessening of any unnecessary legal or practical obstacles."

B. The Commission endorses the scope of review of the no-action process.

The scope of review that was established by Commission staff in the DTB no-action letter and refined in subsequent no-action letters²⁹ focuses on establishing the "bona fide" status of the foreign board of trade and finding that no public interest would be adversely affected by persons in the U.S. directly accessing the foreign board of trade.³⁰

²⁸ We believe the no-action process to be an appropriate exercise of discretion committed to Commission staff, subject to appropriate Commission oversight. See Board of Trade of the City of Chicago v. SEC, 883 F.2d 525, 530 (7th Cir. 1989); 17 CFR §140.99. In this connection, the Commission is directing staff to continue to circulate through the Secretariat for the Commission's review on an "absent objection" basis, prior to issuance, all staff foreign board of trade no-action letters.

²⁹ Letter dated February 29, 1996 from Andrea Corcoran, Director, Division of Trading and Markets, to Lawrence Hunt, Jr., pp. 12-13 (the DTB no-action letter.) CFTC Letter 96-28, indexed at <http://www.cftc.gov/opa/summaries/opanal96.htm> ; [1994-1995 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,669 at 43,795- 43,802 (February 29, 1996).

³⁰ In the 1996 DTB no-action letter staff concluded that the "the mere presence of terminals in the United States would not cause the Commission to deem any bona fide foreign exchange for which products are listed through that system to be a domestic exchange, that is, a board of trade designated as a contract market by the Commission pursuant to section 5 of the Act." (emphasis added)

In order to conclude that the DTB was a "bona fide" foreign board of trade, and therefore appropriately subject to the parenthetical exclusion for foreign boards of trade in section 4(a) of the CEA, staff generally examined the DTB's rules and the overall regulatory environment. The text of the DTB letter makes clear that staff recognized the prohibitions set out in section 4(b) of the CEA, but noted that "the relationship or interface between DTB's computer terminals and persons located in the United States may raise regulatory concerns that are unrelated to the internal operations of the DTB or its computer terminals in the United States." Accordingly, the review set forth in the DTB letter also focused narrowly on the domestic implications for U.S. persons using the DTB direct access terminals (*i.e.*, the system integrity and clearing review).

In general, staff reviews information and representations provided by the applicant that relate to, among other things, the rules and structure of the applicant exchange (with an emphasis on the exchange's financial integrity, market surveillance, trade practice and rule enforcement regime), various system integrity protections that govern the foreign board of trade's electronic trading system (using as a template the 1990 Principles for the Oversight of Screen-Based Trading Systems),³¹ the system's related clearing and customer default protections, and information concerning the regulatory structure in the applicant's jurisdiction, with a specific emphasis on market regulation.³² The staff also reviews the adequacy of information sharing with the Commission by the market and its regulator. Based upon its review of the documents and representations submitted by the applicant, and subject to compliance with various conditions (e.g., representations governing access to books and records and the appointment of a U.S. agent for service of process), staff might conclude that granting no-action relief would not be contrary to the public interest.

Essentially, as it has evolved, the staff review seeks to determine that the applicant foreign board of trade is subject to governmental authorization, appropriate rules prohibiting abusive trading practices, and continuing oversight by a regulator that has powers to intervene in the market and share information with the Commission. This review generally reflects the internationally accepted approaches used by many developed market jurisdictions to govern access to foreign electronic exchanges. These approaches generally are based upon a review of, and ongoing reliance upon, the foreign market's "home" regulatory regime, and are designed to maintain regulatory protections while avoiding the imposition of duplicative regulation.³³

³¹ The 1990 IOSCO Principles for the Oversight of Screen-Based Trading Systems (Screen-Based Principles) were developed by IOSCO Working Party 7 on futures, which was chaired by the CFTC. The IOSCO Screen-Based Principles set out in broad terms the international consensus as to the regulatory considerations to be addressed in reviewing mechanisms for screen-based trading. The Commission adopted the IOSCO Screen-Based Principles as a statement of Commission policy. See 55 FR 48670 (November 21, 1990). In adopting the IOSCO Screen-Based Principles, the Commission made clear that they establish general policy goals that will guide the Commission in resolving issues arising from screen-based trading systems, but would not mandate a particular substantive response.

³² The Commission previously summarized the scope of the staff's foreign board of trade (FBOT) inquiry as follows:

"Currently, Commission staff generally examines the following when reviewing an FBOT's request for terminal placement no-action relief: General information about the FBOT, as well as detailed information about: (i) membership criteria (including financial requirements); (ii) various aspects of the automated trading system (including the order-matching system, the audit trail, response time, reliability, security, and, of particular importance, adherence to the IOSCO principles for screen-based trading); (iii) settlement and clearing (including financial requirements and default procedures); (iv) the regulatory regime governing the FBOT in its home jurisdiction; (v) the FBOT's status in its home jurisdiction and its rules and enforcement thereof (including market surveillance and trade practice surveillance); and (vi) extant information-sharing agreements among the Commission, the FBOT, and the FBOT's regulatory authority. When issued, the terminal placement no-action letters conclude with a standard set of terms and conditions for the granting of the relief which include, among other things, a quarterly volume reporting requirement."

See 71 FR 34070, 34071 (June 13, 2006).

³³ See, e.g., United Kingdom Financial Services Authority, Financial Services Handbook, Recognised Overseas Investment Exchanges (ROIE) and Recognised Overseas Clearing Houses (ROCH), Section 6. (In comparison with full authorisation as a domestic exchange, ROIE status "reduces the involvement which UK authorities need to have

The Commission finds that the staff review appropriately addresses the Commission's concern that relief will only be granted with respect to bona fide foreign boards of trade.³⁴ The Commission also finds that the staff's review of foreign board of trade representations and the related information submitted with respect to system integrity, clearing procedures and default protections is appropriately focused and respects the prohibitions of section 4(b). Finally, the various terms and conditions that have been imposed in the no-action letters have been reasonably and appropriately tailored to the factual circumstances raised by the applications for no-action relief.

Accordingly, the Commission endorses the general scope of review that was established in the DTB no-action letter, and as it has evolved in subsequent staff letters. The Commission also reconfirms its prior endorsement of the use of the IOSCO Screen-Based Trading Principles as a general template to guide its inquiry into the foreign board of trade's electronic trading system. The Commission notes that in 2000 IOSCO reaffirmed the continuing appropriateness of the Screen-Based Trading Principles, concluding that they retained their relevancy despite the evolution and increasing sophistication of electronic systems ten years after their adoption, and that they constitute an internationally accepted framework for the oversight of screen-based derivatives trading systems.³⁵

In this connection, staff's discretionary, selective reference to broad regulatory objectives, such as those contained in the CEA's Core Principles and in internationally-accepted standards,³⁶ deemed by staff in its discretion to be reflective of a bona fide regulatory regime,³⁷

in the day-to-day affairs of an overseas recognised body because they are able to rely substantially on the supervisory and regulatory arrangements in the country where the applicant's head office is situated." See FSA Handbook, REC 6.1.2 <http://fsahandbook.info/FSA/html/handbook/REC/6/1.>"); Australian Securities and Investments Commission (ASIC) Policy Statement 177.8 describing alternative licensing for overseas markets ("the alternative licensing route in s795B(2) for overseas markets is intended to facilitate competition and avoid regulatory duplication while maintaining investor protection and market integrity."); Ontario Securities Commission Staff Notice 21-702: Regulatory Approach for Foreign-Based Stock Exchanges (exemption from recognition under section 147 of the Securities Act (Ontario); Autorite des marches financiers (Quebec): Policy Statement Respecting the Authorization of Foreign-Based Exchanges; the German Bundesanstalt für Finanzdienstleistungsaufsicht (BAFIN) authorizes the placement of terminals in Germany under Sections 37i et seq. of the German Securities Trading Act.

³⁴ See Section I supra.

³⁵ Principles for the Oversight of Screen-Based Trading Systems for Derivative Products –Review and Addition, IOSCO Technical Committee (2000) at p. 5, section III, Part 1. <http://www.iosco.org/library/index.cfm?section=pubdocs&year=2000>. In this "Review and Addition," IOSCO adopted four additional principles that encouraged regulatory authorities to develop cooperative arrangements to address risks that arise from cross-border derivatives markets, to share relevant information in an efficient and timely manner, to maintain a transparent framework for regulatory cooperation, and to take into account a jurisdiction's application of the IOSCO Objectives and Principles of Securities Regulation.

³⁶ See, e.g., Objectives and Principles of Securities Regulation, International Organization of Securities Commissions (IOSCO); and the Tokyo Communiqué on Supervision of Commodity Futures Markets (1997), Annex B: Guidance on Components of Market Surveillance and Information Sharing. Annex B of the Tokyo Communiqué establishes a non-prescriptive framework for undertaking market surveillance, the types of information to which market authorities should have access and collect, the appropriate analysis of information, the type of powers and

is an appropriate, non-prescriptive means to structure its review for the purposes of determining the bona fide status of a foreign board of trade. This observation is not intended to suggest that the review should require substituted compliance with CEA market designation or registration requirements, apply any prescriptive approach,³⁸ or otherwise be expanded into a quasi-designation process.³⁹

C. The Commission intends to preserve the flexibility and adaptability of the no-action process.

The Commission's endorsement of the no-action process's overall approach and scope of review is not intended to limit the staff's ability to adapt or modify its review as it deems necessary to determine the bona fide status of a foreign board of trade, or to address any particular U.S. customer protection or market integrity concerns, as identified in Section 3(b) of the CEA, that might be raised by a request for no-action relief. The Commission understands that staff potentially may need to adapt its analysis, as well as the scope and depth of its inquiry, to address changing factual circumstances and any specific regulatory concerns.⁴⁰

Similarly, there should be broad discretion under the no-action process to determine, based on the totality of factors, that the foreign exchange and the applicable regulatory regime meet relevant regulatory objectives, notwithstanding that a particular aspect of the foreign jurisdiction's approach is not identical to that of the Commission's regulatory program.⁴¹ In this regard, the Commission recognizes that in an international context, common regulatory

capacity to investigate market abuse, the appropriate powers to intervene in the market to address abusive practices or disorderly conditions, the need for powers to impose disciplinary sanctions against members of the market as well as non-members, and the components of effective information sharing.

³⁷ See, e.g., CEA Core Principle 4, section 5(b) of the CEA, for designated contract markets, which requires the monitoring of trading to prevent manipulation, price distortion, and disruption of the delivery or cash settlement process. Principle 28 of the IOSCO Objectives and Principles of Securities Regulation states that "regulation should be designed to detect and deter manipulation and other unfair trading practices."

³⁸ In adopting the 1990 IOSCO Screen-Based Principles, the Commission made clear that "they establish general policy goals that will guide the Commission in resolving issues arising from screen-based trading systems, but do not mandate a particular substantive response." 55 FR 48671, 48672 (November 21, 1990).

³⁹ See generally, footnote 30.

⁴⁰ See, e.g., CL 25 (Chicago Board of Trade) at 1: "We do believe that the analysis preceding the issuance of no-action letters must constantly be re-evaluated and updated to reflect changes and developments in today's dynamic marketplace."

⁴¹ Compare Appendix A, Part 30 Interpretative Statement with Respect to the Commission's Exemptive Authority under §30.10 of Its Rules, 17 C.F.R. Part 30, Appendix A: "In this connection, the Commission would have broad discretion to determine that the policies of any program element generally are met, notwithstanding the fact that the offshore program does not contain an element identical to that of the Commission's regulatory program and conversely may assess how particular elements are in fact applied by offshore authorities."

objectives can be attained through different regulatory means.⁴² The mere fact that a foreign jurisdiction has determined to achieve a regulatory objective in a manner that is different than the Commission's approach often is the result of varied business histories, experiences and legislative choices. The determinative factor in the review should be an affirmative conclusion that the regulatory structure in question addresses the particular regulatory objective deemed to be most relevant.⁴³

III. Whether objective threshold standards should be developed that would indicate that a board of trade is no longer located outside the United States for purposes of section 4(a) of the CEA such that the Commission should require DCM designation or DTEF registration.

In its release issued in advance of the June 2006 public hearing, the Commission requested comment on, among other things, what level of presence by a foreign board of trade would be a reasonable threshold for determining whether to require DCM/DTEF registration and in particular whether volume should be a determinative factor.⁴⁴ The Commission also requested comment on whether it would be appropriate for the Commission to exercise jurisdiction over foreign boards of trade that permit direct access when they list contracts with underlying products that are integral to the U.S. economy.⁴⁵

A. The Commission is not developing objective standards establishing a threshold test of U.S. location.

As noted above in the summary of comments and hearing discussions, most commenters rejected any wholesale, mechanistic adoption of threshold indicators of U.S. location. A theme voiced by many commenters was that the Commission should not attempt to formalize any objective "bright line" test of U.S. location, particularly during a period of rapid changes in the technology of direct access and market communication, as well as in global business structures and relationships.⁴⁶ Among the reasons noted by U.S. industry commenters in particular for not adopting objective standards establishing a threshold test of U.S. location at this time were: the difficulty of developing threshold criteria that would not be viewed as arbitrary,⁴⁷ the difficulty

⁴² See IOSCO Principles and Objectives of Securities Regulation at 3: "There is often no single correct approach to a regulatory issue. Legislation and regulatory structures vary between jurisdictions and reflect local market conditions and historical development."

⁴³ This can be confirmed through the applicant's submission of representations and relevant statutes, rules and statements of policy, regulatory and self-regulatory oversight reports, confirmations of good standing by the oversight regulator, and informal staff discussions with relevant officials of the exchange and its oversight regulator. The Commission understands the term "regulatory structure" broadly to include the regulations and policies of the exchange, its regulator or another self-regulatory organization, as well as relevant laws and regulations.

⁴⁴ 71 FR 34073 (June 13, 2006).

⁴⁵ Id.

⁴⁶ See, e.g., CL 3 (comments of Ben Steil, Director of International Economics, Council on Foreign Relations) at 2.

⁴⁷ See CL 2 (New York Board of Trade) at 2; and CL 28 (Futures Industry Association) at 11.

of determining primary location in a period of rapid structural change in the futures industry,⁴⁸ the possible inhibition of structural and technological innovation,⁴⁹ and the danger that an overly-inclusive criterion could result in duplicative regulation⁵⁰ as well as a protectionist response in other jurisdictions that might inhibit the ability of the U.S. futures industry to compete effectively on a global basis.⁵¹

For the reasons noted above, the Commission has decided not to adopt any objective standards establishing a threshold test of U.S. location. Commission staff will continue to assess the legitimacy of any particular applicant to seek relief as a “foreign” board of trade by considering the totality of factors presented by an applicant. This flexible, case-by-case approach will permit staff, during a period of evolving market structure, to consider the unique combination of factual indicators of U.S. presence that may be presented by an applicant for relief.⁵²

B. Volume is not a determinative indicator of U.S. location.

The relevancy of U.S.-originating volume as a means to determine whether a foreign-organized electronic exchange is “located” in the United States for purposes of CEA section 4(a) has been a long-standing, unresolved issue since the issuance of the DTB no-action letter.⁵³

⁴⁸ See CL 25 (Chicago Board of Trade) at 9: “...with cross-border joint ventures and mergers between boards of trade both existing and proposed, it is likely to become more and more difficult to determine the primary location of an exchange.”

⁴⁹ See CL 2 (New York Board of Trade) at 2: “Similarly, we do not believe that defining “location” on the basis of management, ownership arrangements or the location of offices and technology of an exchange is instructive, as they are likely to change over time and certain functions, such as clearing and technology services, lend themselves to outsourcing.” See also CL 9 (Chicago Mercantile Exchange) at 7: “For example, a U.S. exchange serving EU customers is likely to maintain an EU sales office and sales representatives, an EU technical office or outsourced technical services to install and service networks, routers and terminals, banking connections, delivery facilities and data centers and/or communication hubs. In the near future, if distributed computing makes trade matching more effective, some part of the matching operations may occur in the EU. It is not difficult to imagine the adverse consequences if each of the jurisdictions in which these operations take place were to assert its right to regulate.”

⁵⁰ See CL 9 (Chicago Mercantile Exchange, Inc.) at 7.

⁵¹ See CL 2 (New York Board of Trade) at 2: “such an approach runs the risk of creating barriers to U.S. exchanges as they attempt to expand business abroad;” CL 7 (Minneapolis Grain Exchange) at 2; CL 25 (Chicago Board of Trade) at 7; CL 9 (Chicago Mercantile Exchange, Inc.) at 6; CL 28 (Futures Industry Association) at 11; CL 43 (New York Mercantile Exchange) at 8; and NC 4 (Chicago Mercantile Exchange Holdings Inc) at 2.

⁵² See CL 43 (New York Mercantile Exchange) at 6. “Accordingly, while the Commission may want to reserve for the future the possibility to revisit this area, we believe by far the best approach at this point in time would be to provide guidance to Commission staff in the continuation of the ongoing staff no-action letter process.”

⁵³ The Commission had noted in its 1998 Concept Release that “by conditioning its letter on the DTB providing the Division [staff] with quarterly updates of DTB’s U.S.-originating trading volume, the Division 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.” See 63 FR 39779, 39781 (July 24, 1998).

Notwithstanding the intuitive appeal of using volume as a proxy for U.S. presence, neither the Commission nor the futures industry in its extended consideration of this issue during the Commission's 1998-1999 rulemaking on access to automated boards of trade could reach consensus on the specific manner in which volume could be usefully applied to determine when a foreign board of trade's U.S. presence required contract market designation.⁵⁴

Comments submitted in response to the Commission's recent Request for Comment, as well as statements made at the related public hearing, reiterated the various problems associated with the use of volume, such as the regulatory uncertainty that would result from using a constantly fluctuating variable such as volume, the arbitrary nature of any fixed percentage, the difficulties in accurately measuring U.S.-based volume, and the possible inhibiting effect on exchanges' global activities.⁵⁵ Significantly, all of the U.S. futures exchanges agreed, as did foreign exchanges, that volume was not a stable indicator of U.S. presence for the purpose of requiring DCM designation or DTEF registration.⁵⁶

Accordingly, the Commission agrees that volume is not determinative of U.S. location. This conclusion does not mean, however, that volume statistics should no longer be required from boards of trade operating under a staff no-action letter, as the submission of volume data may serve other regulatory interests. The Commission expects that any data collection requirement would be tailored carefully to provide meaningful information.

C. Nature of the underlying contract is not determinative of designation.

Some commenters have suggested that the Commission should require foreign boards of trade that list contracts based on a U.S. produced or economically important commodity to obtain contract market designation rather than be permitted to operate under a staff no-action letter.⁵⁷ In effect, such proposals would make the application of the parenthetical exclusion from designation in CEA section 4(a) for boards of trade located outside the U.S. dependent upon the nature of the commodity underlying a particular futures contract.

⁵⁴ See 64 FR at 14170.

⁵⁵ As noted at the Commission's Hearing, it is inevitable that as exchanges consolidate, they will list contracts that are of great economic interest in other jurisdictions and attract enormous participation from other jurisdictions. See Hearing Tr. at 100 (Ben Steil). If significant volume denoted grounds for exchange licensing, then such an exchange potentially would be subject to duplicative and burdensome regulation.

⁵⁶ See CL 2 (New York Board of Trade) at 2; CL 7 (Minneapolis Grain Exchange) at 1; CL 9 (Chicago Mercantile Exchange) at 6; CL 25 (Chicago Board of Trade) at 9-10; CL 43 (New York Mercantile Exchange) at 7. See also CL 21 (Tokyo Financial exchange) at 1; CL 22 (Federation of European Securities Exchanges) at 3; and CL 23 (Eurex Deutschland) at 7-8 for representative foreign exchange comment. Letter available at: <http://www.cftc.gov/dea/deaforeignterminaltable.htm>

⁵⁷ See CL 25 (Chicago Board of Trade) at 10-11: The statement of Policy should exclude U.S. Government Securities. See also letter dated January 27, 2006 from the NYMEX to Reuben Jeffery III: "The core regulatory policy question is, of course, whether the WTI crude oil futures contract is a foreign contract or whether it is a US futures contract requiring ICE Futures to become a US designated contract market.... NYMEX believes that the new WTI futures contract is a US product ... drilled and produced in the US."

However, the nature of the underlying commodity is not probative of the “location” of a board of trade for purposes of CEA section 4(a). Such an approach would lead to the anomalous result of a board of trade being characterized as “foreign” for some contracts, but considered a “U.S.-based” exchange for a single contract and therefore required to seek contract market designation. In addition, several U.S. contract markets list futures contracts on commodities that are produced or delivered in foreign jurisdictions. Were the Commission to endorse using such criteria to require designation, such a policy could be cited by foreign jurisdictions as a rationale to subject U.S. markets to regulation.⁵⁸

IV. Enhancements to the no-action process.

Notwithstanding its endorsement of the no-action process, the Commission has identified additional enhancements that are intended to ensure the availability of necessary information, and to ensure that staff will carefully consider proposals for trading contracts that potentially could have an adverse effect on the ability of the Commission to carry out its regulatory responsibilities.

A. The trading of contracts that may adversely affect the Commission’s regulatory responsibilities should be addressed.

Should staff become aware that the trading of products listed on a foreign board of trade that has been granted no-action relief:

- Affects adversely the pricing of contracts traded on any registered entity as defined in Section 1a(29) of the CEA, or of contracts traded on any cash market for commodities subject to the CEA;
- Creates unacceptable systemic risks or disruptions in those markets or the U.S. financial system, including capital markets; or
- Facilitates abusive trading practices on U.S. markets or otherwise interferes with the ability of the Commission to carry out its regulatory responsibilities, in particular market surveillance,

staff may exercise its discretion and consider a full range of responses, such as imposing conditions and requiring enhanced information sharing arrangements and surveillance procedures (see below), or other appropriate action. In this regard, the Commission retains plenary authority to address manipulative or abusive trading practices that affect U.S. futures and cash markets and market users,⁵⁹ and will use that authority when necessary and appropriate.

⁵⁸ See generally CL 2 (New York Board of Trade.)

⁵⁹ See, e.g., CEA Section 9(a)(2), 7 U.S.C. § 13(a)(2) and CEA section 8a(5), 7 U.S.C. § 12a(5).

B. Enhanced information sharing procedures should be adopted.

In a global market environment, where conduct that takes place on markets located outside the United States may have an impact on U.S. futures and cash markets, as well as the members and users of those markets, the Commission needs to cooperate closely with foreign market authorities in order to ensure that the Commission can carry out its regulatory responsibilities. The Commission therefore endorses the existing practice of requiring information sharing assurances as a condition to issuance of a no-action letter and continued activities pursuant to the granted relief. However, in light of the Commission's experiences in this area, as well as the development of internationally accepted information sharing arrangements and standards, the following enhancements are appropriate.

1. Exchange and its regulator should have power, authority and willingness to share needed information.

In negotiating information sharing arrangements, staff should confirm that the market and its regulator have the power to obtain the specific types of information that may be needed by the Commission, as well as the authority to share that information with the Commission on an "as needed" basis. Moreover, staff should obtain evidence of the market's and regulator's willingness to share information (*e.g.*, through explicit undertakings). In this regard, staff should note whether the applicant's regulator has signed the IOSCO Multilateral Memorandum of Understanding (MMOU), which requires as a condition to executing the MMOU a demonstration of power, authority and willingness to share information. If the applicant's regulator is not a signatory of the IOSCO MMOU, staff should ascertain whether any prohibitions to information sharing exist.

2. Applicants for no-action relief should sign the *Exchange International MOU*.

When exchange member firms and market participants trade on multiple global exchanges, no one regulator or market authority will have all of the information necessary to evaluate the risks to its markets. The Exchange International Information Sharing Memorandum of Understanding and Agreement (Exchange International MOU)⁶⁰ and the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations (Declaration),⁶¹ a companion arrangement for regulators, were developed in 1996 as an

⁶⁰ The development of the Exchange International MOU was one of the achievements that resulted from the FIA sponsored Global Task Force on Financial Integrity, which was convened to address the cross-border issues that were identified in connection with the failure of Barings Plc. To date, fifty-six global derivatives exchanges have signed the MOU.

⁶¹ The Declaration was developed through discussions at the CFTC's international regulators conference, and was motivated by work recommendations issued from the Windsor Conference and Tokyo Conference, which were convened by the CFTC, the U.K. FSA and Japanese regulators (Ministry of International Trade and Industry (MITI) and the Ministry of Agriculture, Forestry and Fisheries (MAFF)) to respond to the cross-border issues raised by the failure of Barings Plc. The Declaration was developed to address instances in which an exchange would not be able to share information directly with another exchange under the Exchange International MOU. Twenty-eight regulators have signed the Declaration. Copy available at: <http://www.cftc.gov/oia/ojabocadec0398.htm>

international response to address such gaps in information. These arrangements facilitate the identification of large exposures by firms that could have a potentially adverse effect on multiple markets.

Applicants for staff no-action relief should execute, or commit to execute, the Exchange International MOU because it demonstrates a commitment to share information between exchanges that is needed to ensure the integrity of markets and to address systemic risks. In circumstances where a foreign board of trade is unable to share information directly with another exchange, its regulator should sign the Declaration (or commit to share such information pursuant to an existing MOU or other arrangement with the Commission).

3. Arrangements to obtain and share information required to carry out the Commission's domestic market surveillance responsibilities should be a condition to no-action relief.

When an applicant for, or recipient of, no-action relief trades or will trade contracts that staff in its discretion determines may affect the Commission's ability to carry out its surveillance responsibilities (e.g., an economically linked contract), the foreign board of trade should be required to provide directly to the Commission and in a timely manner, appropriate trade and position data as deemed necessary by Commission staff. Alternative arrangements may be acceptable where local law or regulatory policies require the interposition of the market regulator, provided that such arrangements supply the Commission on a timely basis with the market information that the Commission's staff determines is necessary to carry out the Commission's market surveillance responsibilities.

C. The continuing good standing of the foreign board of trade should be verified.

Although the no-action letters require that the foreign board of trade submit to staff and keep updated on a quarterly basis certain material information, staff should develop a non-burdensome and efficient means to confirm the board of trade's continued "good standing" in its authorizing jurisdiction. This could take the form of an annual or biannual confirmation by the relevant oversight regulator of the foreign board of trade's authorized status and the continuing validity of any relevant representations that had been made by the foreign board of trade in its initial application.

V. The no-action process is not the appropriate means to address competitive issues.

In their comments, U.S. futures exchanges essentially encouraged the Commission to review its regulations to consider the competitive impact of differences between its regulations and those of other jurisdictions.⁶² Some exchanges suggested that the Commission should

⁶² See, e.g., (Chicago Mercantile Holdings, Inc.) Request to Appear at the Public Hearing at 2; CL 7 (Minneapolis Grain Exchange) at 1; CL 43 (New York Mercantile Exchange) at 2, 10-12.

address perceived regulatory disparities in connection with the no-action process,⁶³ particularly where the exchanges trade similar products.⁶⁴

The Commission does not believe that it should address competitive concerns within the context of any individual request for a staff no-action letter. Claims of competitive advantage or disadvantage are exceedingly difficult to prove. An exchange's competitive status reflects an array of contributing factors, such as its overall rule structure, its governance and business policy determinations, its fee structure, type of contracts offered, the method of trading, the efficiency of its technology and clearing systems, as well as external factors such as statutory restrictions, tax structure and the overall legal system.⁶⁵ Rather, the appropriate focus of the no-action review should be on addressing the bona fide status of, and domestic regulatory concerns raised by, an applicant for a no-action letter.

The CFMA has materially improved the competitive status of the U.S. futures industry.⁶⁶ Nonetheless, the Commission takes seriously the CFMA findings, among others, that "financial services regulatory policy must be flexible to account for rapidly changing derivatives industry business practices," and "regulatory impediments to the operation of global business interests can compromise the competitiveness of United States businesses."⁶⁷ The Commission will continue to address these policy goals through ongoing review of its regulatory program.

Conclusion

The U.S. futures industry is undergoing a period of dynamic change, marked by technological innovation, consolidation, evolving business relationships, and increasing global

⁶³ See CL 25 (Chicago Board of Trade) at 1.

⁶⁴ See Hearing Tr. (NYMEX Chairman James Newsome) at 72, 82.

⁶⁵ In a 1999 report, the Commission's Division of Economic Analysis attributed changes in market activity since the 1980s to the continued market maturation process, nonregulatory cost considerations and technological change rather than international regulatory differences.

In sum, neither trends in the locus of trading activity nor regulatory developments over the last five years suggest an erosion of U.S. futures markets' global competitive position. However, to the extent that the movements toward electronic trading systems and exchange consolidation that were observed over the period of this study continue into the future, the competitive structure of global futures markets is likely to change significantly. The Commission is committed to continued regulatory flexibility in the face of these trends. However, it is likely that the potential cost savings generated by these trends, and not the nature of the differences among the regulatory systems of various nations, will be most important in shaping the composition and trading interest of the global futures industry in the twenty first century.

The Global Competitiveness of U.S. Futures Markets Revisited, the Commission's Division of Economic Analysis (November 1999), http://www.cftc.gov/dea/compete/deaglobal_competitiveness.htm

⁶⁶ See, e.g. CL 9 (Chicago Mercantile Exchange): "CFMA greatly improved the competitive environment in the U.S. and eliminated many of the legitimate concerns of U.S. based futures exchanges."

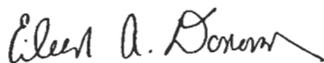
⁶⁷ CFMA Sections 126(a)(3), 126(a)(4).

competition. The Commission does not presume to be able to predict the course of ongoing industry evolution in these areas.

The Commission's appropriate role during such a period of rapid change is to construct policies that will foster achievement of the Act's section 3 objectives of ensuring market and financial integrity, addressing systemic risks, and protecting market participants, but to do so in a flexible manner that avoids inadvertently inhibiting technological innovation or the ability of the U.S. futures industry to compete effectively in a global environment.

This Statement of Policy has been developed as a means for the Commission to respond flexibly to the challenges posed by the ongoing evolution in electronic access to global markets. The Commission will continue to monitor carefully, and review the Policy Statement as necessary in light of, the ongoing evolution of cross-border electronic direct access and intermediation in order to ensure that it does not adversely affect U.S. cash and futures markets, market participants and customers, as well as the consumers affected by those foreign market transactions.

Issued in Washington, DC on October 27, 2006 by the Commission.

A handwritten signature in cursive script, reading "Eileen A. Donovan".

Eileen A. Donovan
Acting Secretary of the Commission