

CFTC Letter No. 01-11
March 12, 2001
No-Action
Division of Trading and Markets

VIA FACSIMILE and U.S. MAIL

Alan Whiting
Executive Director for Regulation and Compliance
The London Metal Exchange Limited
56 Leadenhall Street
London EC3A 2DX
United Kingdom

Re: Sections 5 and 5a –The London Metal Exchange Limited; Request for
No-Action Relief from Contract Market Designation Requirement

Dear Mr. Whiting:

This is in response to your letter dated November 28, 2000 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("CFTC" or "Commission").¹ By this correspondence, you request, on behalf of the London Metal Exchange Limited ("LME" or "Exchange"), that the Division grant no-action relief to permit LME to make its electronic trading and order matching system, known as lme•select (referred to herein as the "System"), available to LME members² in the United States³ ("No-Action Request"). Specifically, LME wishes to make the System available to: (i) LME members who wish to trade

¹ Letter from Alan Whiting, Executive Director for Regulation and Compliance, LME, to John C. Lawton, Acting Director, Division of Trading and Markets, Commodity Futures Trading Commission (November 28, 2000).

² For purposes of the No-Action Request and the relief provided herein, references to the members of LME shall include any "affiliate" of any Exchange member that has been granted access by the Exchange member to the System. An "affiliate" of an LME member shall mean any person that: (i) owns 50% or more of the member; (ii) is owned 50% or more by the member; or (iii) is owned 50% or more by a third person that also owns 50% or more of the member. LME represents that, as a condition of access to the System, such affiliates would be required to comply with all LME Rules and that LME members will remain responsible to the Exchange for ensuring their affiliates' compliance. For purposes of this letter and the no-action relief provided herein, the terms "LME Rules" and "Exchange Rules" shall mean the rules contained in the LME Commodity Market Rulebook and the LME Rulebook.

³ For purposes of this letter and the relief provided herein, the term "United States" shall include the United States, its territories and possessions.

for their proprietary accounts⁴ through the System in the United States; (ii) LME members who are registered with the CFTC as futures commission merchants ("FCMs") or who are exempt from such registration pursuant to Rule 30.10 ("Rule 30.10 Firms")⁵ and who wish to submit the orders of United States customers⁶ for transmission to the System; and (iii) LME members who are registered with the Commission as FCMs or who are Rule 30.10 Firms and who wish to accept orders from United States customers through automated order routing systems ("AORS")⁷ for submission to the System. You request that the Division confirm that it will not recommend enforcement action to the Commission against LME or its members if LME does not seek designation as a contract market or registration as a derivatives transaction execution facility ("DTEF") pursuant to Sections 5 and 5a of the Commodity Exchange Act ("CEA" or "Act"),⁸ or comply with those Commission regulations that specifically relate to contract markets or DTEFs, in connection with the installation and use of the System in the United States.

As you know, on March 24, 1999, the Commission published proposed rules that would have governed the circumstances under which foreign futures exchanges could be accessed from

⁴ For purposes of this letter and the relief provided herein, the term "proprietary account" shall have the meaning set forth in Rule 1.3 (y). 17 C.F.R. § 1.3(y) (2000). Commission rules referred to herein are found at 17 C.F.R. Ch. I (2000).

⁵ Rule 30.10 permits a person affected by the requirements contained in Part 30 of the Commission's rules to petition the Commission for an exemption from such requirements. Appendix A to the Part 30 rules provides an interpretative statement that clarifies that a foreign regulator or self-regulatory organization ("SRO") can petition the Commission under Rule 30.10 for an order to permit firms that are members of the SRO and subject to regulation by the foreign regulator to conduct business from locations outside of the United States for United States persons on non-United States boards of trade without registering under the Commodity Exchange Act, based upon the person's substituted compliance with a foreign regulatory structure found comparable to that administered by the Commission under the Act.

Among the issues considered by the Commission in determining whether to grant Rule 30.10 relief to a foreign regulatory or self-regulatory authority are the authority's: (i) requirements relating to the registration, authorization, or other form of licensing, fitness review, or qualification of persons through whom customer orders are solicited and accepted; (ii) minimum financial requirements for those persons that accept customer funds; (iii) minimum sales practice standards, including risk disclosures, and the risk of transactions undertaken outside of the United States; (iv) procedures for auditing compliance with the requirements of the regulatory program, including recordkeeping and reporting requirements; (v) standards for the protection of customer funds from misapplication; and (vi) arrangements for the sharing of information with the United States. *Interpretative Statement with Respect to the Commission's Exemptive Authority Under § 30.10 of its Rules*, 17 C.F.R. Part 30, Appendix A (2000).

⁶ For purposes of this letter and the relief provided herein, the term "United States customers" shall have the same meaning as the term "foreign futures or foreign options customers" as it is defined in Rule 30.1 (c).

⁷ For purposes of this letter and the relief provided herein, the term "AORS" shall be defined to include any system of computers, software or other devices that allows entry of orders through another party for transmission to a board of trade's computer or other automated device where, without substantial intervention, trade matching or execution takes place.

⁸ 7 U.S.C. §§ 1 *et seq.*, as amended by the Commodity Futures Modernization Act of 2000, PL 106-554, 114 Stat. 2763 (2000).

electronic trading devices in the United States.⁹ On June 2, 1999, the Commission issued an order that withdrew those proposed rules and directed the Commission staff to begin considering requests from foreign exchanges for interim no-action relief to allow them to place trading systems in the United States on a temporary basis until the Commission itself promulgates rules or guidelines in this area ("June 2 Order").¹⁰ In accordance with this instruction, the Division has reviewed LME's No-Action Request and the materials submitted in support thereof.

In connection with its No-Action Request, LME has forwarded the following information to the Division:

- General information regarding LME (*e.g.*, a description of its organization);
- LME Rules and Regulations (which contains the rules governing commodity contracts traded on LME);
- The specification of the contracts that would be traded through the System in the United States pursuant to the no-action relief requested;
- A description of the System; and
- A description of the regulatory regime in the United Kingdom applicable to the operation of LME and the System; LME and System participants; and transactions executed through the System.

In addition, LME referred to certain information already in the possession of the Division, including but not limited to:

Selected provisions of the Financial Services Act 1986 ("FS Act"), and certain provisions of Part VII of the Companies Act 1989 and the draft Financial Services and Markets Bill ("FSM Bill")¹¹ that relate to Recognized Investment Exchanges ("RIEs"); and

- A listing of the information-sharing arrangements among LME, the Commission, and other regulatory bodies.

⁹ *Access to Automated Boards of Trade*, 64 Fed. Reg. 14159 (proposed March 24, 1999), *withdrawn*, June 2, 1999.

¹⁰ Order of the CFTC Withdrawing Proposed Rules Regarding Access to Automated Boards of Trade, Release No. 4274-99 (June 2, 1999).

¹¹ In June 2000, the FSM Bill was enacted by Parliament, without substantial revision, as the Financial Services and Markets Act 2000 ("FSMA"). It reforms the regulatory structure of the financial services industry in the United Kingdom in accordance with proposals that were announced in May 1997. The FSMA has not yet come into force, however, and is unlikely to do so prior to June 2001. In the interim, the FS Act remains the principal provision governing LME's activities as a Recognized Investment Exchange in the United Kingdom.

Representations made by LME regarding the Exchange's activities in the United States, the Exchange's membership criteria, the System, the relevant regulatory regime in the United Kingdom, and the information-sharing arrangements applicable to the System are summarized in Sections I - V below. For purposes of its response to the No-Action Request, the Division has relied upon LME's representations and has not conducted an independent review to confirm their accuracy.¹²

I. GENERAL INFORMATION REGARDING LME

LME is a company limited by guarantee and a Recognized Investment Exchange ("RIE") under the laws of the United Kingdom. LME currently offers trading in futures and options contracts on non-ferrous metals, including the six primary metals – high grade primary aluminum, copper grade A, standard lead, primary nickel, tin, and zinc. LME also offers trading in futures and options contracts on silver, aluminum alloy, and the London Metal Exchange Index ("LMEX"), an index comprised of the values of the six primary non-ferrous metals. In addition, LME offers traded average price options ("TAPOs") for certain metals contracts based on the LME monthly average settlement price for the specific metal. While LME generally uses United States dollars as its major currency for each contract, members may use the pound sterling, euro, deutschmark, and Japanese yen to settle transactions. All contracts are effectuated on a principal-to-principal basis.

LME members currently may trade throughout the entire 24-hour day in one of three venues: open outcry, the inter-office market and the System. Each business day, open outcry trading for each metal takes place in one of two sessions on the trading floor, known as the Ring. During each Ring session, each metal is traded one-at-a-time for five minutes. At the close of each Ring session, members may trade any contract (including the LMEX) during a fifteen-minute closing session, known as the Kerb. At any time during the day, LME members also may execute transactions via the inter-office market. Participants in the inter-office market are required to input regularly into a centralized computer, known as the LME Market Data System, indicative price quotes, which are then disseminated to all participants and the outside world. Similar to trading in the inter-office market, trading via the System occurs continuously, but only for a portion of the trading day. When parties agree to execute a contract via open outcry, the inter-office market, or the System, both parties must enter the relevant details into the LME Matching and Clearing System ("LMEMS"). When the System becomes fully operational, it will no longer be necessary for members to enter into LMEMS the relevant details of transactions effectuated using the System. The System will input the matched trades into LMEMS automatically. LME has indicated that open outcry trading and the inter-office market will continue to exist for as long as there is sufficient interest on the part of its members.

LME represents that it does not maintain any office in the United States and that its

¹² As stated below, the no-action relief provided herein is contingent upon the accuracy of the representations made by LME in support of its No-Action Request. Any materially different, changed, or omitted facts or circumstances may render the no-action relief void or cause the Division, in its discretion, to condition further, modify, suspend, terminate, or otherwise restrict the relief.

marketing activities in the United States are limited to one-on-one meetings between its staff and current and prospective Exchange members for the purpose of describing the contracts available for trading on the Exchange. LME represents that its staff does not provide investment services nor accept, solicit, receive, or direct orders with respect to the products traded on the Exchange in the United States. LME represents further that no trade processing or clearing functions are performed by the Exchange in the United States.

II. MEMBERSHIP

A person may not trade directly on LME unless the person is a member of the Exchange. The Exchange has four active membership categories: (i) Ring Dealing Members, (ii) Associate Broker Clearing Members, (iii) Associate Trade Clearing Members, and (iv) Associate Broker Non-Clearing Members. Only Ring Dealing Members may trade in the Ring. Only Ring Dealing and Associate Clearing Members are permitted to clear and settle positions entered into by other members. LME represents that only Ring Dealing and Associate Broker Clearing Members will have access to the System. The clearing arrangements of all LME members must include arrangements regarding the maintenance of appropriate bank accounts, payment, documentation, and the provision of collateral.

All LME members are required to satisfy certain legal, financial, and technical membership criteria, on an ongoing basis. Among other things, Exchange members are required to demonstrate that they have received the requisite regulatory authorization for the type of investment business that they wish to conduct on the Exchange. LME represents that these authorization requirements would preclude retail investors from becoming Exchange members. LME members that have a permanent place of business within the United Kingdom must be authorized by the Financial Services Authority ("FSA").¹³ LME performs background checks to confirm that its members are in full satisfaction of their respective regulatory obligations.

LME members also are required to demonstrate to the Exchange that they have a capital base sufficient to conduct business on the Exchange. Pursuant to requirements established by the LME Board of Directors, Ring Dealing and Associate Clearing members are required to have net worth of at least £5,000,000 (\$7,350,000).¹⁴ Members are required to comply with the applicable financial requirements throughout the duration of their membership and must submit financial returns to LME in order to demonstrate ongoing compliance with their financial obligations. In addition, LME confers with FSA on a monthly basis to discuss, among other things, the capital inadequacy of any LME member.

LME, in its sole discretion, may refuse any application to become an Exchange member

¹³ As discussed in Section IV, the FSA is responsible for regulating the conduct of investment business and for providing investor protection in the United Kingdom.

¹⁴ For informational purposes only, the Division has noted the United States dollar equivalent of the sum of British pounds referenced herein based upon the exchange rate of March 5, 2001 (UK£1:US\$1.47). The Division notes that the financial requirements imposed upon LME members are not linked in any way to the United States dollar equivalent provided herein.

or approve any such application subject to conditions. On an ongoing basis, LME members are required to provide notice to the Exchange of all legal, financial, or regulatory events material to their respective standings as members of the Exchange.

III. OVERVIEW OF THE SYSTEM

At the outset, the Division notes that the description of the System set forth herein is based upon representations made by LME or its representatives. The Division has not performed an independent assessment of the security or soundness of the System.

A. Technical Aspects of the SYSTEM

1. Introduction

LME represents that the System is an electronic order matching trading platform developed by OM Gruppen of Sweden. The version to be used by LME consists of OM Gruppen's OM CLICK Trading System customized to fit the specific features and needs of the LME.¹⁵ LME represents that the System will be implemented in two stages: Release 1 and Release 2. Release 1, which became operational on February 9, 2001, permits trading only in a limited number of delivery months for each metal contract (including the LMEX), but does not permit trading in any options or TAPOS. Release 2, on the other hand, will be all-embracing and will allow trading in all of LME's contracts. Release 2 also will have the capability to calculate both settlement and closing prices for the purposes of margining. For the time being, however, these prices will be set by open outcry in the Ring. LME represents that the System underwent comprehensive business and technical testing before it was declared operational.

¹⁵ Currently, the following exchanges are using OM CLICK, to trade and match orders electronically: the American Stock Exchange, the Australian Stock Exchange, EL-EX (the Finnish Electricity Exchange), the Hong Kong Futures Exchange, the Italian Derivatives Exchange, the Korean Futures Exchange, Nord Pool (the Nordic Power Exchange), OM London, OM Stockholm, and ÖTOB (the Austrian derivatives market).

2. **Architecture**

The System has a three-tiered architecture. It includes: (i) the Back-End Servers; (ii) the Network ("OMnet"); and (iii) the Front-End Systems. The System operates as follows: Exchange members use Front-End Systems to access the OMnet Application Program Interface ("OMnet API"), the OMnet API provides access to OMnet, and OMnet provides access to the Back-End Servers. LME provides the Back-End Servers and the OMnet API. Exchange Members are responsible for acquiring Front-End Systems.

a. **Back-End Servers**

The Back-End Servers are located at the offices of OM Stockholm and OM Technology Customer Services in Stockholm, Sweden. They are comprised of three modular sub-systems: (i) the Common Data Base ("CDB"), (ii) Information Dissemination ("IND"), and (iii) the Central Marketplace.

The CDB provides the central database for the information used in the System, including contract specifications, Accredited Dealers,¹⁶ margin requirements, and other Exchange-specific rules and information. Among other things, it validates an Accredited Dealer's authority to trade a particular product. The IND subsystem retrieves real-time information from the Central Marketplace and from other external information providers, stores such information in its internal database, and distributes the information to LME members in the form of daily trade statistics and other reports. Accredited Dealers may receive continuous access to up-to-date information, including the five best bid and ask prices, aggregate volume at the five best bid and ask prices, total volume, closing and opening prices, high and low prices, last volume, and the underlying indices of traded index futures or options. At the conclusion of each trading day, the IND subsystem gathers historical trading information that may be used to generate reports summarizing the day's trading activity. The Central Marketplace performs all of the System's order processing functions (*i.e.*, it validates requests for orders, order modifications, and order cancellations; accepts and records orders; matches orders; sends order confirmations to the parties; processes the order book; provides real-time marketplace information to the IND subsystem; and, where appropriate, activates and inactivates orders). Once a trade is matched, it is sent to the London Clearing House ("LCH") via the LMEMS where it is cleared.

b. **OMnet**

OMnet effectuates the interaction between the Back-End Servers and the Front-End Systems. It routes information between the various subsystems and the trading applications installed on the Front-End Systems.

¹⁶ Access to the System is restricted to "Accredited Dealers." The criteria for becoming an Accredited Dealer is discussed in Section III.A.3.

c. Front-End Systems

Front-End Systems are the external devices used by Accredited Dealers to access the System. An Accredited Dealer may obtain a license from LME for a pre-packaged workstation containing trading applications developed by OM Gruppen that can communicate with the OMnet API. In the alternative, an Accredited Dealer may use its own Front-End System and access the OMnet API via proprietary trading application software or trading application software that has been developed by a third-party vendor. Similarly, Exchange members can access OM SECUR through a back-office application software package that has been licensed to them by LME or a comparable proprietary or commercial software application package. LME requires that all proprietary and commercial software applications be tested on a test system prior to use on a live system in order to ensure that they are capable of connecting to the System and performing all System-related operations.

3. Access

Access to the System is restricted to Accredited Dealers. Accredited Dealers are those persons that have been authorized by an LME member to trade on behalf of the member¹⁷ and who have been licensed in that capacity by the Exchange. To become licensed as an Accredited Dealer, a person must attend and complete training courses in the use of lme•select, pass written or practical examinations prescribed by LME, be registered with the appropriate regulatory organization, and satisfy any other requirements that LME may set from time to time. Once authorized, each Accredited Dealer category is given a unique user profile that defines those transactions in which the Accredited Dealer is permitted to engage.¹⁸

The System includes security measures that have been designed to prevent unauthorized access. OMnet (and hence, the System) can be accessed only through the OMNet API. To gain access to the OMnet API, an Accredited Dealer's trading application must send a login message

¹⁷ An Accredited Dealer is required to submit all orders in the name of the LME member for whom it is trading and must trade, at all times, in the name of and on behalf of the sponsoring Exchange member. LME members are responsible for all of the activities of their Accredited Dealers, including all orders and other instructions entered and all trades made by such Accredited Dealers on the System. All trades executed on or cleared through the System by an LME member's Accredited Dealer or through a Front-End System to which any Accredited Dealer has access are binding upon the member, regardless of whether the trade was authorized by the LME member or was permitted by Exchange Rules. LME members also are responsible for ensuring that all activity on the System is conducted in accordance with Exchange Rules and applicable regulatory requirements. LME members may be held accountable financially for the behavior of their Accredited Dealers and may be subject to disciplinary action for failure to procure compliance with Exchange Rules.

¹⁸ Where approval for a particular transaction has not been obtained from LME or any relevant regulator in a particular jurisdiction, the System will prohibit an Exchange member and its Accredited Dealers from trading the instrument on the System. Accordingly, LME members and their Accredited Dealers will not be able to access products from electronic devices providing access to the System which are located in the United States unless they are authorized to do so pursuant to the no-action relief provided herein.

that includes: (i) a "username" that identifies the Accredited Dealer who wishes to access the System; and (ii) a password for the specified username. The System compares the Accredited Dealer's login message with information contained in the CDB to confirm that: (i) the Accredited Dealer exists and the password used by him is correct; and (ii) the Accredited Dealer or the LME member for whom he will be trading has not been suspended from trading. In addition, OMnet will accept information only from Front-End Systems with centrally-registered, valid network addresses.¹⁹ This prevents unauthorized equipment from injecting false transactions into the OMnet network.

LME members are responsible for taking sufficient measures to ensure the physical security of their own premises and the premises of their Accredited Dealers and to prevent unauthorized access to the System via logged-in and validated equipment. LME reviews the physical security measures taken by its members in the course of its periodic inspections of the member's firm. LME is authorized to restrict a member's access to the System and/or the Exchange if such arrangements are unsatisfactory.

Finally, each transaction that is generated by the OMnet API contains a unique message authentication code which ensures that third parties are unable to enter orders on behalf of Accredited Dealers. To prevent passive eavesdropping upon OMnet transactions, transaction data can be hardware encrypted.

4. Order Processing

The System accepts several types of orders for execution, including: (i) single orders,²⁰ (ii) standard combination orders,²¹ (iii) non-standard combination orders, (iv) trade reports, and (v) price quotation orders. Single orders and standard combination orders may be limit orders only²² -- the System does not permit the entry of market orders. LME Rules also permit the trading of flexible contracts, in accordance with specified procedures.²³ All LME members have

¹⁹ Such network addresses do not enable LME to identify the physical location of the Front-End System of an individual Accredited Dealer. However, Exchange members are required to provide LME with their updated business addresses and LME is authorized to take certain action, including terminating its relationship with the member, depending upon the significance of the change in the member's location.

²⁰ A single order is a solitary bid or ask order related to a specific futures or option series.

²¹ Combination orders are orders that are comprised of two or more individual orders that are subject to the condition that each individual order that is part of the combination order must be executed simultaneously. A standard combination order consists of up to four single orders on the same underlying instrument that, in the aggregate, comprise a unique contract series that has been predefined by LME.

²² A limit order trades at the price stated or better. Unless otherwise specified, any residual volume is retained in the order book until it is withdrawn, traded, or automatically cancelled at the end of the day.

²³ Flexible contracts are contracts in which the Exchange member may agree to limited variations on the comparable standardized contract. For example, members may agree to vary the exercise price, the expiration day, and/or the style of contract. The only variable term for a flexible futures contract is its term.

the opportunity to receive information concerning a proposed flexible contract before the contract is executed.

When placing an order or varying or canceling an order, an Accredited Dealer is required to enter all of the relevant trade details, including: (i) the instrument, (ii) whether it is a single or combination order; (iii) the series; (iv) whether it is a single or block order; (v) whether the order is to buy or to sell; (vi) in the case of an option, whether it is a put or a call; (vii) the price of the order (or the net price, if the order is a combination order); (viii) the quantity; (ix) the expiration month; (x) the validity time; (xi) the identity of the Accredited Dealer; (xii) whether the trade is for the house or for a customer; (xiii) the account to which the transaction, if executed, is to be allocated; and, (xiv) if appropriate, the customer identification code.²⁴ The System has the technical capability to impose order and price and position limits upon house and customer accounts. However, LME does not require that such limits be imposed.

All orders that have been sent to the Central Marketplace subsystem are acknowledged and are immediately checked to see whether they are matched. When an order that has been placed matches a stored order, the matched order is executed automatically. Matched orders are executed in accordance with the System's rules of priority, as set forth below. Order entry and execution times are captured, sequenced, and recorded in a log file to the nearest 1/100th of a second. Accredited Dealers receive a trade confirmation from the Central Marketplace within two seconds of the time that the trade is sent via LMEMS to LCH for clearing.

The System generally matches orders using a price/time methodology.²⁵ Priority is given to the order having the best price. Where two or more orders are entered at the same price, priority is given to the order that has been stored in the order book for the longest period of time.

An order that has been placed which does not match a stored order is stored, ranked, or cancelled, in accordance with its terms. The ranking of a stored order is not affected if the order is modified and the modification involves only a reduction in the volume or validity period of the order or a variation in the customer identity. Any variation in a stored order that involves its price, an extension of its validity period, a change from a single order to a block order, or an increase in the volume of an order is treated as a cancellation of the original order and a substitution of a new order. The time priority of the new order is determined by the time at which the new order was entered in the order book.

²⁴ Orders are required to have an identifier specific to the customer. However, an Accredited Dealer is permitted to input the customer identifier into the System after execution.

²⁵ Whether an order is transmitted electronically or via the Marketplace Service does not affect its treatment.

5. Audit Trail

All persons that have been authorized to conduct investment business in the United Kingdom are subject to the audit trail and conduct of business rules imposed by the SFA. SFA-authorized firms are required to maintain records of any written communication between the firm and its customers concerning regulated business and to retain copies of contract notes, confirmation notes, and exercise notices.

LME Rules set forth similar audit trail requirements. All dealings by Exchange members must be properly documented and then registered with LCH. For every contract traded, Exchange members must use a specific code indicating the nature of each transaction. Additionally, the System itself ensures that all material information regarding (1) the activity of Exchange participants; (2) all orders placed, varied or cancelled by Exchange members; and (3) all transactions executed by Exchange members, is recorded, processed and stored in a manner that enables the information to be reviewed by the Exchange and other entities that have a regulatory interest in the information.

LME Rules require Exchange members to permit access to their premises and to relevant records. In addition, LME members and their Accredited Dealers are required to forward information about their activity on the Exchange to LME, upon request. LME represents that the Exchange Rules specifically permit LME to share any information regarding trading or clearing conducted on the System with the Commission and that United Kingdom law would not prohibit the acquisition of any information maintained in the United Kingdom.

6. Clearing

LCH is the clearing organization that reconciles and matches all trades made on LME; marks-to-market the daily obligations of each LME member; demands margin funds, in its discretion, on an intra-day basis; imposes capital-based position limits; and guarantees the financial obligations of each LME member. Once orders are matched in LMEMS,²⁶ LCH assumes the market obligations of the participants through the process of “novation” (for each futures or option contract effected on LME, LCH is substituted as the buyer to each original seller and the seller to each original buyer). Absent default, LCH’s obligations are met from the payments made to LCH by the parties on the other side of each contract. LCH has established specific procedures to remedy a default by one of its members.

²⁶ Release 1 will not contain an interface between the System and LMEMS. Instead, System participants will be required to manually input all orders before the orders may be matched and cleared. Release 2, on the other hand, will feature an automatic interface with LMEMS resulting in straight-through processing of System transactions to LCH.

7. System & Network Response Times

All instructions transmitted to the System by Accredited Dealers are dealt with on an impartial basis and in strict accordance with the time at which the instructions were received, regardless of the membership class of the Accredited Dealer. Moreover, the System itself has been constructed to ensure that, as far as is reasonably possible, no one network connection is disadvantaged over another, the effect of differences in geographic location on the time at which orders are received is de minimis, and the order execution of all participants is equitable. LME monitors the performance of the network on a daily basis to ensure that domestic users and cross-border users are able to use the System on a sufficiently equivalent basis. Generally, the System has been designed and sized to process transactions in under two seconds, allowing for substantial growth in both product range and trading volume.

8. Reliability and Recovery

The System is located on dual sites in Sweden for redundancy purposes. The System is designed, and each site is equipped, to permit the System to function if any equipment at either site is out of service, or if either site is out of service. All vital functions have standby functionality, with automatic fail-over in the event of a failure at either site. The back-up system is used daily in normal production in order to avoid problems that might be encountered upon activating a long dormant facility.

OM Technology Systems AB ("OM Technology")²⁷ is responsible for providing user assistance and for monitoring the primary and backup computer equipment, the network, and the system interfaces. OM Technology employs specialized software that alerts the computer operator if any computer or network functionality is being lost. The System also includes a disaster detection system that automatically sends notification of possible problems to engineers who are on-call at all times. An OM Technology supervisor is in attendance at all times to answer questions and to address problems. A problem log is maintained and problems are reviewed on a daily basis.

The System incorporates a "heartbeat" mechanism, a continuously transmitted message that confirms to the Accredited Dealer that the System is functioning and that a delay in execution is due to a slow market. In the event that the connection between the System and one of its Accredited Dealers fails, the Accredited Dealer's orders are inactivated automatically. Similarly, a timer is initiated during periods of inactivity (*e.g.*, in the event that an Accredited Dealer fails to log out) and an Accredited Dealer's orders are inactivated after a prescribed period of time. Inactivated orders are kept in the Central Marketplace for the rest of the day, after which they are discarded from the System. An Accredited Dealer can prevent his orders from becoming deactivated by sending a new login transaction from the same Front-End System or from another, authorized Front-End System. Exchange members are permitted to use

²⁷ OM Technology is the company within the OM Group that is responsible for the provision of the System to LME and OM Stockholm and for the operation and maintenance of the System.

"replacement" Accredited Dealers who may trade on the member's behalf in the event that the initial Accredited Dealer is experiencing difficulties with the System. An Accredited Dealer also can prevent his orders from becoming deactivated by providing LME with instructions to this effect in advance or by placing orders through the Marketplace Service.

In the event of a system failure of significant length, the order book would be deactivated. The market would be re-opened at a later date following the procedures that are followed at the start of a normal trading day. Prior to the resumption of trading, members would be informed that trading would begin anew in a specific period of time and members would be provided with the opportunity to delete their orders.

B. Market Control

LME has established five departments to monitor and control the operation and trading of the System. These departments include: (1) the lme•select Helpdesk, (2) Market Operation, (3) IT, (4) Market Surveillance, and (5) Member Surveillance.

1. lme•select Helpdesk

The primary function of the lme•select Helpdesk is to assist participants in resolving or dealing with issues arising from the operation of the System. Issues include: (i) fault logging, evaluation and resolution, (ii) connectivity to the System, (iii) market functionality, (iv) password problems, (v) market messages and alerts, and (vi) participant feedback. Market participants may contact the lme•select Helpdesk by telephone throughout the trading day.

2. Market Operations

Market Operations is responsible for approving LME member firms as System participants. Among other duties, Market Operations oversees the training, accreditation and registration of dealers permitted to access the System.

3. IT

The IT department establishes the minimum technical requirements necessary for the hardware to be used by members to access the System. In addition, all System participants must demonstrate to IT their technical and operational readiness.

4. Market Surveillance

Market Surveillance monitors trading on the System to ensure that trading is conducted properly and that a fair and orderly market is maintained. Among other things, Market Surveillance: (i) ensures that all trading on the System takes place in accordance with the rules and regulations of LME; (ii) suspends all System orders for a participant where the participant cannot do so due to technical reasons; (iii) suspends trading on the System upon the occurrence of certain events, including but not limited to, a technical failure of the System, an electrical

power failure, or loss of communication throughout the System; (iv) deletes, corrects or cancels, as appropriate, invalid or disputed trades made on the System and broadcasts details of such actions to all counterparties and System participants; and (v) activates or inactivates Accredited Dealers for regulatory reasons.

5. Member Surveillance

Member Surveillance, on the other hand, monitors System participants for general compliance with LME rules, regulations and procedures. For example, Member Surveillance reviews the controls and procedures put in place by System participants to ensure that only Accredited Dealers access the System and that System participants maintain the necessary records in accordance with LME and SFA requirements.

C. Demarcation of Responsibilities and Liability

LME Rules limit the Exchange's liability to members with respect to its operation of the System. For example, in the absence of gross negligence, LME may not be held liable to any member, customer, or other party for any loss or damage that may result (directly or indirectly) from any technical problem affecting or interfering with the provision of the System by LME. LME generally may not be held liable for loss or damage that arises in other circumstances, unless the loss or damage is attributable to negligence on the part of the Exchange.²⁸

D. Adherence to IOSCO Principles

LME represents that it has satisfied the FSA that the features and facilities provided by the System and the use of the technology provided by the System are satisfactory in light of the Principles for the Oversight of Screen-Based Trading Systems for Derivative Products developed by the Technical Committee of the International Organization of Securities Commissions ("IOSCO Principles").²⁹ The FSA's predecessor, the Securities and Investments Board ("SIB"),

²⁸ LME Rules also provide that the Exchange may not be held liable, in any way, for loss or damage resulting from specified circumstances (*e.g.*, legislative enactments in the United Kingdom or abroad).

²⁹ The United Kingdom was one of eight jurisdictions that participated in Working Party 7 of IOSCO ("Working Party") whose mandate included, among other things, the identification of issues related to screen-based trading systems for derivative products. In considering the special concerns for screen-based trading systems, the Working Party identified and addressed the following issues: transparency, order execution algorithms, operational issues, security and system vulnerability, access, financial integrity, disclosure, and the role of system providers. The Working Party considered these issues and articulated for each a broad principle to assist regulatory authorities in overseeing screen-based trading systems. The IOSCO Principles were adopted by IOSCO on November 15, 1990 and set out in broad terms the international consensus as to the regulatory considerations to be addressed in reviewing mechanisms for cross-border screen-based trading. The Commission adopted the IOSCO Principles as a statement of regulatory policy for the oversight of screen-based trading systems for derivative products on November 21, 1990. *Policy Statement Concerning the Oversight of Screen-Based Trading Systems*, 55 Fed. Reg. 48670 (Nov. 21, 1990).

endorsed the IOSCO Principles in April 1991.³⁰ LME represents further that it will continue to comply with the IOSCO principles in the provision of electronic trading and clearing facilities.

IV. OVERVIEW OF THE REGULATORY STRUCTURE IN THE UNITED KINGDOM

A. Introduction

LME is subject to a comprehensive regulatory regime in the United Kingdom. This regulatory structure includes, among other things: financial and other fitness criteria for industry participants; reporting and recordkeeping requirements; procedures governing the treatment of customer funds and property; sales practice and other conduct of business standards; provisions designed to protect the integrity of the markets; and statutory prohibitions on fraud, abuse, and market manipulation. Responsibility for financial services legislation and broad policy in the United Kingdom lies with Her Majesty's Treasury, which is answerable to Parliament. Responsibility for regulating the conduct of investment business and for providing investor protection in the United Kingdom rests with the FSA. Additional authority to prevent and prohibit market manipulation rests with the United Kingdom's Department of Trade and Industry and its Serious Fraud Office.

The principal legal provisions for investor protection in the United Kingdom's financial services sector currently³¹ are contained in, or derived from, the FS Act and the FSA fulfills its regulatory responsibilities within the framework established by that Act and related legislation.³² The FSA also has established Statements of Principle ("FSA Principles") that set forth universal standards of practice, including standards relating to internal organization; the financial resources, integrity, skill, care, and diligence of market participants; customer assets; conflicts of interest; market practice; information about customers; information for customers; and relationships with regulators.

The Division notes that the Commission previously reviewed the regulatory regime administered and enforced by the FSA applicable to transactions on United Kingdom exchanges in connection with the relief it granted to the Securities and Futures Authority's ("SFA's") predecessors in 1989. On May 19, 1989, the Commission issued orders pursuant to Rule 30.10 that granted exemptive relief to the members of the Association of Futures Brokers and Dealers ("AFBD"), The Securities Association ("TSA"),³³ the Investment Management Regulatory

³⁰ SIB Endorsement of IOSCO's Principles for the Oversight of Screen-Based Trading Systems for Derivative Products, Guidance Release 2/91 (April 1991).

³¹ As discussed in footnote no. 11, the FS Act will be replaced in 2001 by the FSMA and by secondary legislation enacted pursuant to the FSMA. The FSMA is substantially similar to the FS Act with respect to the regulation of RIEs and their participants.

³² Violations of the FS Act are criminal offenses.

³³ On April 5, 1991, the Commission issued a supplemental order confirming the continued validity of such previous orders following the merger of the AFBD and the TSA into the SFA. On March 7, 1997, the Commission

Organization (IMRO"), and the SIB to permit such members to solicit and accept orders from United States customers for otherwise permitted transactions on non-United States exchanges that are "Designated Investment Exchanges" ("DIEs").³⁴ In each of these orders, the Commission noted that the standards for relief set forth in Rule 30.10 generally had been satisfied by each of the petitioning regulatory authorities, and compliance by the Rule 30.10 Firms with applicable United Kingdom law and the rules of the respective petitioning authority could be substituted for compliance with certain provisions of the CEA and the Commission's rules set forth in the Commission's orders.³⁵

B. Regulation of LME as an RIE

Under the FS Act, LME is an RIE. As an RIE, LME is exempt from the requirement that it be "authorized" to conduct "investment business"³⁶ in the United Kingdom with respect to the operation of its markets.³⁷ However, to acquire recognition status, LME was required to satisfy several statutorily-prescribed recognition requirements. LME must continue to fulfill these obligations in order to maintain its recognition status. Among other things, LME is required to: retain sufficient financial resources for the performance of its functions as an RIE; operate its markets with due heed to the protection of investors; ensure that trading is conducted in an orderly and fair manner; maintain suitable arrangements for trade reporting; maintain suitable arrangements for the clearing and settlement of contracts; monitor compliance with its rules; enforce its rules; investigate complaints with respect to its business; maintain rules to deal with the default of its members; cooperate with other regulatory bodies through the sharing of information or otherwise;³⁸ maintain high standards of integrity and fair dealing; and prevent abuse. The FSA has provided guidance on some of the statutory recognition requirements that sets forth the FSA's interpretation of those

issued an additional order to the SFA clarifying the procedures set forth in its prior orders regarding United Kingdom exchanges and their members.

³⁴ DIEs are those non-United States exchanges that have been identified by the SIB to the Commission in connection with the CFTC's grant of exemptive relief pursuant to Rule 30.10. As an RIE, LME is included in the SIB's (now the FSA's) list of DIEs.

³⁵ As stated below, the Division notes that nothing in the no-action relief provided herein abrogates or otherwise alters the obligations of FCMs or Rule 30.10 Firms under the CEA, Commission rules, or relevant Part 30 orders.

³⁶ The FS Act defines investment activities to include, among other things, dealing, arranging deals, managing, giving investment advice, and establishing or operating a collective investment scheme in or in relation to a range of investments, including securities, options, and futures.

³⁷ The FS Act prohibits individuals and entities from carrying on "investment business" in the United Kingdom unless they are either "authorized" to do so or are eligible for an exemption from the authorization requirement. The FS Act imposes criminal sanctions on persons who violate this requirement. While agreements made by or through persons who have not been authorized to conduct investment business as required may be enforced by customers, they are not enforceable on the part of the unauthorized person.

³⁸ An RIE's obligation to cooperate with other regulatory bodies is not limited to cooperation with regulatory authorities in the United Kingdom. The SIB's Guidance Release entitled "Standards for regulation of RIEs" specifically provides, among other things, that an RIE should cooperate with appropriate regulators (including overseas regulators and authorities), market authorities, and other relevant bodies.

obligations in practical terms. The FSA intends to publish an FSA Sourcebook that will provide more expansive guidance on the FSA's interpretation of equivalent requirements under the FSMA.

The FSA is the authority charged with ensuring that RIEs, such as LME, continue to comply with the recognition criteria and is authorized to de-recognize any RIE that fails to meet the statutory recognition requirements. Accordingly, LME is subject to the oversight of the FSA. The FSA exercises its supervisory responsibility by conducting an ongoing assessment of whether LME's rules, procedures, and practices are adequate for the protection of investors and for the maintenance of an orderly market. For this purpose, the FS Act requires LME to report changes in its rules and procedures to the FSA within seven days of such amendments becoming effective. In practice, LME notifies the FSA of significant changes to its rules or procedures before such changes become effective. LME is also required to produce an annual regulatory plan detailing its intended regulatory activities over the succeeding twelve months. LME has never been declared to be in breach of its regulatory responsibilities.

C. Regulation of LME Members

Because trading on LME, including trading and clearing through the System, constitutes the carrying on of investment business in the United Kingdom, most United Kingdom-based members of LME that trade through the System³⁹ will be required to be authorized under the FS Act. To obtain authorization, an applicant must satisfy the FSA that it is "a fit and proper

³⁹ EU law permits investment firms, banks, and other institutions that are authorized to engage in certain types of investment business in one EU member state to conduct such business in other EU member states, pursuant to the EU's Investment Services Directive and the Second Banking Co-ordination Directive, which provide the regulatory foundation for cross-border activity within the EU. Accordingly, non-United Kingdom EU institutions doing business in the United Kingdom via this "European Passport" are not required to be authorized under the FS Act or to have the benefit of an exemption from the authorization requirement in order to conduct investment business there. Institutions using the "European Passport," however, must comply with the sales practice and other conduct of business rules in the institutions "host state" when selling investment products to investors in that state.

Dealings by a person who does not carry on investment business from a permanent place of business in the United Kingdom (an "Overseas Person") with a person who has been authorized to conduct investment business in the United Kingdom or who has been exempted from that requirement are among the "excluded activities" that are not regarded as "investment business in the United Kingdom" under the FS Act. Accordingly, an Overseas Person is able to deal with a regulated firm in the United Kingdom without being required to be licensed in the United Kingdom. LME members dealing on LME from outside of the United Kingdom through the System ("Remote Members") can take advantage of this exclusion and, therefore, do not need to be licensed under the FS Act.

Before LME will agree to allow a member to operate in a "remote" manner, however, it must be satisfied that both the Exchange and the FSA have good working relationships, including information-sharing arrangements, with the regulator that is responsible for authorizing and supervising the member. In any event, as noted, LME members transacting business with United States customers are required to be registered as FCMs or operating pursuant to Rule 30.10 orders or other applicable exemptive relief whether such members are based within the United Kingdom or outside of the United Kingdom.

person" to carry on investment business and to provide the financial services in which it intends to engage. In addition, most LME members that trade through the System are subject to the rules of an SRO.⁴⁰ The majority of LME members are subject to rules imposed by the SFA.⁴¹ By virtue of the SFA's recognition status, SFA membership confers the status of authorization for purposes of the FS Act. The SFA evaluates applications for membership to ensure that applicants are "fit and proper persons" to carry out investment business. In evaluating an applicant's fitness, the SFA may consider a variety of factors, including the applicant's integrity, honesty, competence, and financial soundness. The SFA has also promulgated other fitness criteria, financial resource requirements (which are designed to reflect, among other things, the firm's position risk and its exposure to counterparties), sales practice rules, and rules designed to ensure the integrity of the market (*e.g.*, rules regarding best execution, customer order priority, and customer order allocation; restricting the offer of illiquid or off-market investments; prohibiting members from trading ahead of customers; and prohibiting the churning of accounts and switching of contracts). SFA further requires adherence to recordkeeping and audit trail requirements. Violations of the SFA's requirements may result in fines and/or other disciplinary actions imposed by the FSA.

D. Exchange Rules

In addition to the regulatory requirements set forth above, all LME members and their Accredited Dealers are required to comply with Exchange rules and any guidance that LME may issue concerning the application or interpretation of such rules. LME Rules are applicable to all such persons because those rules are based in contract rather than statute and are not, therefore, constrained by jurisdictional boundaries.

LME Rules require Exchange members to permit access to their premises and to relevant records to satisfy LME that the members are in full compliance with Exchange Rules. LME members and their Accredited Dealers also are required to forward information about their Exchange-related activity to LME, upon request, and to cooperate with the Exchange in providing information to the home country regulator of the member.⁴²

LME Members and their Accredited Dealers are subject to disciplinary action for failure to comply with Exchange Rules. Disciplinary action may result in a written reprimand, fine, suspension, exclusion from trading for a specified period, exclusion from trading in certain instruments or in certain capacities, other conditions or restrictions on the member's activity, or expulsion. Exchange Rules permit LME to use the services of the SFA or any other appropriate regulatory organization in any investigation undertaken by the LME pursuant to Exchange Rules.

⁴⁰ Market participants apply for membership in one or more SROs, depending upon the nature of the business that they undertake.

⁴¹ The FSA is now operationally responsible for monitoring compliance with SFA rules.

⁴² All LME members are based in countries whose regulators have information-sharing arrangements with the appropriate regulatory bodies in the United Kingdom.

LME Rules are designed to enable the Exchange to fulfill its recognition obligations, including the requirement that the Exchange ensure that its market is fair and orderly and is operated with due regard to the protection of investors. LME Rules incorporate those FSA Principles and other regulatory guidance issued by the FSA that are relevant to LME's business. The Exchange Rules contain both substantive provisions relating to membership requirements and trading and procedural provisions relating to discipline, arbitration, and the default of members. Among other things, Exchange Rules include: (i) contract specifications; (ii) the information required to be provided when an order is placed; (iii) the procedures to place, vary, and cancel orders; (iv) order ranking and processing rules; (v) prohibitions against market manipulation; (vi) proscriptions against any action that might distort the market; (vii) prohibitions upon the distribution of inaccurate or misleading information that might affect the price of an Exchange-traded instrument; (viii) market closure circumstances and procedures; (ix) clearing procedures; (x) collateral requirements; and (xi) the payment of fees. They also require Exchange members to cooperate with LME in the promotion of high standards of fair dealing and integrity in trading.

Finally, United Kingdom law requires that RIEs maintain rules that allow the RIE to declare a member to be a defaulter and to close out all open positions on the market. Market authorities are not required to wait for the commencement of formal insolvency proceedings to declare a default if they possess a good faith belief that the member will be unable to meet its future obligations under market contracts.⁴³ Accordingly, LME has promulgated rules that delineate the procedures to be followed by the Exchange in the event of default. The default rules set forth, among other things, the circumstances under which the Exchange may declare a member to be in default, the actions that the LME may take in the event of default, the type of resources that may be used to satisfy the defaulting member's obligations, and the sequence in which such resources may be used.

⁴³ All good faith actions taken by RIEs under their respective default rules (*e.g.*, closing out positions) are protected from the normal workings of United Kingdom insolvency law. That is, while an RIE's action in the event of a default may be challenged by a liquidator or insolvency official, the RIE generally will be granted immunity if the action was taken in good faith.

V. INFORMATION-SHARING

As set forth more fully below, pursuant to the terms and conditions of the no-action relief provided herein, the Division will be entitled to receive certain specified information regarding the System directly from LME. Additional information relevant to LME, the System, and System participants will be available to the Commission and its staff through certain information-sharing arrangements to which both the CFTC and the FSA (or the SIB, its predecessor in interest) are parties. These include, without limitation, the *Memorandum of Understanding on Mutual Assistance and the Exchange of Information between the United States SEC and the CFTC, and the United Kingdom Department of Trade and Industry and the SIB dated September 25, 1991* and the *Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations, as amended, March 1998* (commonly known as the "Boca Declaration").⁴⁴

VI. CONCLUSION

Consistent with the Commission's June 2 Order,⁴⁵ the Division has reviewed and considered LME's No-Action Request and the information and documentation forwarded to the Division in support thereof. Among other things, the materials furnished by LME indicate that LME does not: maintain any office or staff in the United States; provide investment advice, solicit orders, or direct trading from within the United States; or maintain any order matching or clearing facilities in the United States. The materials also indicate that: LME is an RIE under the laws of the United Kingdom; LME, the System, and LME members are subject to oversight in the United Kingdom by a legitimate regulatory authority that is responsible for ensuring their compliance with an extensive regulatory regime; the System adheres to the IOSCO Principles; and the CFTC and the FSA are parties to various information-sharing arrangements applicable to LME members and the activities of the System.⁴⁶

Based specifically upon these and other representations made by LME in support of its No-Action Request, the Division has determined that granting no-action relief to LME and its Members, pending the adoption by the Commission of rules or guidelines regarding access to foreign boards of trade from electronic trading devices in the United States, would not be contrary to the public interest. Accordingly, subject to compliance with the terms and conditions

⁴⁴ The Division notes that the FSA has confirmed that these information-sharing arrangements would extend to information requested by the CFTC in connection with the no-action relief provided herein. Letter from Matthew Elderfield, to I. Michael Greenberger, Director, Division of Trading and Markets, Commodity Futures Trading Commission (July 23, 1999).

⁴⁵ Order of the CFTC Withdrawing Proposed Rules Regarding Access to Automated Boards of Trade, Release No. 4274-99 (June 2, 1999).

⁴⁶ The Division notes that the foregoing is not intended to be an exhaustive list of the factors relevant to its decision to grant the no-action relief requested by LME nor of the factors that the Division might consider when analyzing no-action requests from other exchanges. No-action requests, by their nature, require case-by-case evaluation and the Division's conclusion regarding any particular no-action request will be based upon the facts and circumstances presented at the time of its review of that request.

stated herein, the Division will not recommend that the Commission institute enforcement action against LME or its members solely based upon LME's failure to obtain contract market designation or DTEF registration pursuant to Sections 5 and 5a of the CEA if: (i) LME members trade for their proprietary accounts through the System in the United States; (ii) LME members who are registered with the Commission as FCMs or who are Rule 30.10 Firms submit orders from United States customers for transmission to the System; and (iii) LME members who are registered with the Commission as FCMs or who are Rule 30.10 Firms accept orders through AORSS from United States customers for submission to the System.

The Division's no-action position shall become effective immediately with respect to the following contracts:

- Primary Aluminum futures, and options and TAPOS thereon,
- Aluminum Alloy futures and options thereon,
- Copper futures, and options and TAPOS thereon,
- Lead futures, and options and TAPOS thereon,
- Nickel futures, and options and TAPOS thereon,
- Silver futures and options thereon,
- Tin futures, and options and TAPOS thereon,
- Zinc futures, and options and TAPOS thereon, and
- LMEX index futures and options thereon.

If additional futures and option contracts become available for trading through the System, LME may make such futures and option contracts available for trading through the System in the United States without obtaining written, supplemental no-action relief from Commission staff in accordance with the terms, conditions, and exceptions of the Commission's Statement of Policy regarding the listing of new futures and option contracts by foreign exchanges that are operating electronic trading devices in the United States pursuant to Commission staff no-action relief.⁴⁷

The scope of the Division's no-action position is restricted to providing relief from the requirement that LME obtain contract market designation or DTEF registration pursuant to Sections 5 and 5a of the CEA and regulatory requirements that flow specifically from the contract market designation and DTEF registration requirements if the above-referenced contracts are made available in the United States for trading through the System, in the manner set forth herein. The Division's no-action position does not extend to any other provision of the CEA, any other Commission regulations, or to any registered futures association rules and does not excuse LME or its members from compliance with any applicable requirements thereunder. Nor does the no-action position alter, restrict, or expand the coverage of existing Commission exemptions for particular products.

⁴⁷ Notice of Statement of Commission Policy Regarding the Listing of New Futures and Option Contracts by Foreign Boards of Trade that Have Received Staff No-Action Relief to Place Electronic Trading Devices in the United States, 65 Fed. Reg. 41641 (July 6, 2000).

The Division specifically notes that its no-action position does not alter the requirement that a firm operating pursuant to the no-action relief provided herein must be a registered FCM or be operating pursuant to Rule 30.10 relief to engage in the offer or sale of a foreign futures contract or a foreign options transaction for or on behalf of a United States foreign futures or foreign options customer. For example, nothing in this letter is intended to alter current Commission rules and staff interpretations that require generally that any foreign firm that clears trades on a fully-disclosed basis on behalf of United States persons (including where the United States person is a non-clearing member of a foreign board of trade trading solely for its proprietary account) be a registered FCM or a Rule 30.10 Firm unless the foreign firm solely carries accounts on behalf of United States customers that are its proprietary accounts (as defined in Rule 1.3(y)) of the foreign firm.⁴⁸ If a foreign firm is either a member of the relevant foreign board of trade or is a foreign affiliate of a registered FCM in the United States and its sole contact with a United States customer is that it carries the FCM's omnibus account, then the firm need not register under Rule 30.4.⁴⁹

Moreover, the Division's no-action position does not amend, revise, or negate the obligations of FCMs and Rule 30.10 Firms under the CEA, Commission regulations, or Rule 30.10 orders. 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 the System 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). FCMs or Rule 30.10 Firms who solicit or accept orders from United States customers for trading on the System remain responsible for, among other things, complying with risk disclosure, the handling and allocating of customer orders, and the segregation of customer funds.

The Division's no-action position does not affect the Commission's ability to bring appropriate action for fraud or manipulation. The Division specifically notes that the use of AORSs to transmit orders to the System shall be subject to all existing Commission rules and regulations and to any future rules or guidance propounded by the Commission or the Division. Finally, this letter does not address issues that might arise under the Securities Act of 1933, the Securities Exchange Act of 1934, and other applicable federal securities laws or rules promulgated thereunder.

The Division's no-action position is subject to compliance with the following conditions:

- LME will continue to satisfy the criteria for designation as an RIE under the applicable laws of the United Kingdom with respect to transactions effected through the System.

⁴⁸ See CFTC Staff Letter No. 88-15, Comm. Fut. L. Rep. (CCH) ¶24,296 (Aug.10, 1988).

⁴⁹ See CFTC Staff Letter No. 87-7, Comm. Fut. L. Rep. (CCH) ¶23,972 (Nov. 17, 1987).

- The laws, systems, rules, and compliance mechanisms of the United Kingdom applicable to LME will continue to require LME to maintain fair and orderly markets; prohibit fraud, abuse, and market manipulation; and provide that such requirements are subject to the oversight of the FSA.
- LME and the System will continue to adhere to the IOSCO Principles, as updated, revised, or otherwise amended.
- Only members of LME will have direct access (*i.e.*, not through an AORS) to the System and LME will not provide, and will take reasonable steps to prevent, third parties from providing such access to the System to persons other than LME members.⁵⁰
- All orders that are transmitted through the System by a member of LME that is operating pursuant to the no-action relief provided herein and that is not registered with the Commission as an FCM or that is not a Rule 30.10 Firm will be solely for "proprietary accounts," as defined herein, of such LME member.
- All orders for United States customers accepted through an AORS and/or transmitted by LME members through the System will be intermediated by an LME member that is either registered with the Commission as an FCM or is a Rule 30.10 Firm.
- LME will require each current and future Exchange member that is not registered with the Commission as an FCM to file with LME a written representation, executed by a person with the authority to bind the member, stating that as long as the LME member operates pursuant to the no-action relief provided herein, the Exchange member agrees to and submits to the jurisdiction of the Commission with respect to activities conducted pursuant to the no-action relief. LME will obtain the foregoing representation before it permits the relevant Exchange member to operate pursuant to the no-action relief and will maintain the representation as long as the member is operating pursuant to the relief. LME will make such representations available to the Commission upon the request of a Commission representative.
- LME will require each current and future Exchange member that is not registered with the Commission as an FCM to file with LME a valid and binding appointment of a United States agent for service of process in the United States pursuant to which the agent is authorized to accept delivery and service of "communications"⁵¹ that are issued by or on behalf of the Commission. LME will obtain the foregoing appointment before it permits the relevant Exchange member to operate pursuant to

⁵⁰ As stated above, "members" includes those persons identified in footnote 2 for the purposes of this no-action letter and the conditions imposed upon the relief provided herein.

⁵¹ For purposes of these conditions, "communications" is defined to include any summons, complaint, order, subpoena, request for information, or notice or any other written or electronic documentation or correspondence issued on behalf of the Commission.

the no-action relief and will maintain the appointment as long as the relevant member is operating pursuant to that relief. LME will make such appointments available to the Commission upon the request of a Commission representative.

- LME will require each current and future Exchange member who is not registered with the Commission as an FCM to file with LME a written representation, executed by a person with the authority to bind the Exchange member, stating that, as long as the Exchange member operates pursuant to the no-action relief provided herein, the member will provide, upon the request of the Commission, the United States Department of Justice, and, if appropriate, the National Futures Association (“NFA”), prompt access to original books and records maintained at their United States offices as well as to the premises where the System is installed or used in the United States. LME will obtain the foregoing representation before it permits the relevant Exchange member to operate pursuant to the no-action relief and will maintain the representation as long as the relevant member is operating pursuant to the no-action relief. LME will make such representations available to the Commission upon the request of a Commission representative.
- LME will file with the Division a valid and binding appointment of a United States agent for service of process in the United States, pursuant to which the agent is authorized to accept delivery and service of "communications," as defined above, that are issued by or on behalf of the Commission. LME will maintain the foregoing representation as long as LME or the System operate pursuant to the no-action relief.
- LME will maintain the following updated information and submit such information to the Division on at least a quarterly basis, and at any time promptly upon the request of a Commission representative:
 - For each contract available to be traded through the System, the total trade volume originating from electronic trading devices providing access to the system in the United States compared with total trade worldwide volume for such products traded through the system and the total worldwide trade volume for such products traded on LME generally; and
 - A listing of the names, NFA ID numbers (if applicable), and main business addresses in the United States of all LME members that have access to the System in the United States.
- LME will promptly provide the Division with written notice of the following:
 - Any material change in the information provided in its No-Action Request, including any information contained in the documents submitted in support

thereof;⁵²

- Any material change in LME Rules or the laws, rules, and regulations in the United Kingdom relevant to futures and options;
- Any matter known to LME or its representatives that, in LME's judgment, may affect the financial or operational viability of LME, including, but not limited to, any significant system failure or interruption;
- Any default, insolvency, or bankruptcy of any LME member known to LME or its representatives that may have a material, adverse impact upon the condition of the System or upon any United States customer or firm;
- Any known violation by LME or any LME member of the terms or conditions of the no-action relief provided herein;
- Any LME disciplinary action against any LME member operating pursuant to the no-action relief provided herein that involves any market manipulation, fraud, deceit, conversion or that results in suspension or expulsion; and
- Any LME disciplinary action against any LME member operating pursuant to the no-action relief provided herein that involves the use of the System or an AORS to submit orders to the System and either: (a) the LME member against whom the disciplinary action is taken is located or based in the United States, or (b) the disciplinary action results, in whole or in part, from conduct that: (1) involves the use of an electronic trading device or an AORS that is located in the United States to accept or submit an order for trading through the System; (2) involves a United States customer or firm or a registered FCM; or (3) might have a material, adverse impact upon any United States customer or firm.⁵³
- Satisfactory information-sharing arrangements between the Commission and the FSA will remain in effect.
- The Commission will be able to obtain sufficient information regarding LME, the

⁵² The Division notes that "material" changes in the information provided to it in support of this No-Action Request would include, without limitation, a modification of: LME's membership criteria; the location of LME's management, personnel, or operations (particularly changes that may suggest an increased nexus between LME's activities and the United States); the basic structure, nature, or operation of the System; or the regulatory or self-regulatory structure applicable to LME, the System, or LME members.

⁵³ The Division notes that the language of this condition incorporates the language contained in the Division's letter to the FSA clarifying the conditions imposed upon similar relief that the Division granted to LIFFE Administration and Management by letter dated July 23, 1999. Letter from John C. Lawton, Acting Director, Division of Trading and Markets, Commodity Futures Trading Commission, to Gay Wisbey, Director, Markets and Exchanges Division, The Financial Services Authority (Sept. 30, 1999) ("Sept. 30 Letter").

System, and the members of LME operating pursuant to the no-action relief provided herein necessary to evaluate the continued eligibility of LME or its members for the relief, to enforce compliance with the terms and conditions of that relief, or to enable the Commission to carry out its duties under the CEA and Commission regulations.⁵⁴

- LME will provide directly to the Commission information necessary to evaluate the continued eligibility of LME or its members for the relief, to enforce compliance with the terms and conditions of that relief, or to enable the Commission to carry out its duties under the CEA and Commission regulations.⁵⁵
- LME will employ reasonable procedures, to be determined by LME, for monitoring and enforcing compliance with the terms and conditions of the no-action relief provided herein.

The no-action position taken herein is taken by the Division only and does not necessarily reflect the views of the Commission or any other unit or member of the Commission's staff. It is based upon the information and representations contained in LME's No-Action Request and the materials submitted in support thereof. Any materially different, changed, or omitted facts or circumstances may render this letter void. The Division specifically notes that it will examine the volume information submitted as a condition to the no-action relief provided herein as well as any changes in the nature or extent of LME's activities in the United States to ascertain whether LME's presence in the United States has increased to a level that might warrant reconsideration of the no-action relief.

As with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion. Finally, the Division wishes to emphasize that the no-action position set forth herein is intended to provide immediate, interim relief to LME and its members, pending any adoption of rules or guidelines by the Commission regarding the use and placement in the United States of automated trading systems or AORSs that provide access to the products of foreign boards of trade. Thus, this letter will cease to be effective in the event that the Commission or its staff adopts generally applicable rules or general guidelines regarding the issues addressed herein, and LME will be subject to those rules or guidelines in that event.

⁵⁴ The Division notes that it will request information referenced in this provision, in the first instance, from the FSA, and that this condition will be satisfied if the FSA provides the Commission with all information requested. *See* Sept. 30 Letter.

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Mr. Alan Whiting
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If you have any questions regarding this correspondence, please contact me or Andrew V. Chapin at (202) 418-5430.

Very truly yours,

John C. Lawton
Acting Director

cc: Gregory C. Prusik, Vice-President Compliance and Registration, NFA
Branch Chief, Audit and Financial Review Unit, Division of Trading and Markets,
Chicago Regional Office