

CFTC Letter No. 01-74

July 30, 2001

No-Action

Division of Trading and Markets

Philip McBride Johnson, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
1440 New York Avenue, N.W.
Washington, D.C. 20005-2111

Re: Sections 5 and 5a -- Hong Kong Futures Exchange Ltd.; Request for
No-Action Relief from Contract Market Designation Requirement

Dear Mr. Johnson:

On June 9, 2000, the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") granted to the Hong Kong Futures Exchange Ltd. ("HKFE" or "Exchange") permission to make its electronic order matching system, known as the Hong Kong Automated Trading System ("HKATS"), available to Exchange Participants in the United States.^[1] Specifically, the Division stated that it will not recommend that the Commission institute enforcement action against HKFE or its Exchange Participants solely based upon HKFE's failure to seek contract market designation under Sections 5 and 5a of the Commodity Exchange Act, if: (i) Exchange Participants trade for their proprietary accounts through HKATS in the United States; (ii) Exchange Participants who are registered with the Commission as futures commission merchants ("FCMs") or who are exempt from such registration pursuant to Rule 30.10 ("Rule 30.10 Firms") submit orders from United States customers for submission to HKATS; and/or (iii) Exchange Participants who are registered with the Commission as FCMs or who are Rule 30.10 Firms accept orders through United States automated order routing systems ("AORS") from United States customers for submission to HKATS. By letter dated February 5, 2001, on behalf of HKFE, you requested that the Division extend the above no-action relief to permit HKFE to place HKATS trading terminals in the facilities of non-Exchange Participants consistent with recent amendments to the Chicago Mercantile Exchange's ("CME's") Rules applicable to trading on GLOBEX® by non-CME members.^[2]

As you indicated, the CME amended Rule 574.C to permit: (1) CME clearing members to provide customers with GLOBEX® trading terminals; and (2) non-members to enter orders directly into GLOBEX® using a trading terminal, provided that the authorizing clearing member:

1. guarantee and assume all financial responsibility for all activity conducted through each non-member's trading terminal;

2. assist in a timely manner the CME in any investigation into potential violations of CME Rules or the Commodity Exchange Act, including, but not limited to, requiring the non-member to produce documents, to answer questions from the CME, and/or appear in connection with the investigation; and
3. suspend or terminate the non-member's GLOBEX® access if the CME determines that the actions of the non-member threaten the integrity or liquidity of any contract, or violate any Rules of the CME or the Commodity Exchange Act, or if the non-member fails to cooperate in an investigation.[\[3\]](#)

Pursuant to the authority delegated by the Commission under Commission Rule 1.41a(a)(3), the Division confirmed that amended CME Rule 574.C became effective.[\[4\]](#)

The no-action relief set forth in the June 9 Letter restricts the manner in which customers located in the United States may place orders via HKATS. In particular, the June 9 Letter requires that every order placed by United States customers be intermediated by an FCM or Rule 30.10 Firm for submission to HKATS. While the Division's prior no-action position did not permit the direct entry of orders into HKATS by non-Exchange Participants in the United States, the Division believes that compliance by Exchange Participants with conditions similar to those set forth in CME Rule 574.C will provide customers located in the United States with greater access to HKFE without sacrificing any customer protections.

Accordingly, the Division confirms that it will not recommend that the Commission institute enforcement action against HKFE or its Exchange Participants solely based upon HKFE's failure to seek contract market designation or registration as a derivatives transaction execution facility under Sections 5 and 5a of the Act, if a non-Exchange Participant located in the United States is provided direct access to HKATS via an HKATS trading terminal.[\[5\]](#) This no-action position is subject to compliance with the following conditions:

1. the non-Exchange Participant must be authorized by an Exchange Participant qualified to clear transactions on HKFE ("authorizing Exchange Participant") to enter orders directly into HKATS using an HKATS trading terminal; and
2. the authorizing Exchange Participant must:
 - a. guarantee and assume all financial responsibility for all activity conducted through each non-Exchange Participant's trading terminal;
 - b. assist in a timely manner the HKFE in any investigation into potential violations of HKFE Rules, the Commodity Exchange Act ("CEA"), or the terms and conditions set forth herein or in the June 9 Letter, including, but not limited to, requiring the non-member to produce documents, to answer questions from the HKFE, and/or appear in connection with the investigation; and
 - c. suspend or terminate the non-member's HKATS access if the HKFE determines

that the actions of the non-Exchange Participant threatens the integrity or liquidity of any contract, violates any HKFE Rules, the CEA, or the terms and conditions set forth herein or in the June 9 Letter, or if the non-Exchange Participant fails to cooperate in an investigation.

The Division notes that its no-action position does not relieve any firm from compliance with the terms and conditions set forth in the June 9 Letter, including the requirement that a firm operating pursuant to the no-action relief must be a registered FCM or Rule 30.10 Firm to engage in the offer and sale of a foreign futures contract or foreign options transaction for or on behalf of a United States foreign futures or foreign options customer. 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.

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 the HKFE's request for no-action relief. Any materially different, changed, or omitted facts or circumstances may render this letter void.

If you have any questions regarding this correspondence, please contact Andrew V. Chapin, an attorney on my staff, 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

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- [\[1\]](#) Letter from John C. Lawton, Acting Director, Division of Trading and Markets, to Philip McBride Johnson, Esq., Skadden, Arps, Slate, Meagher& Flom LLP, dated June 9, 2000 ("June 9 Letter").
- [\[2\]](#) Letter from Philip McBride Johnson, Esq., Skadden, Arps, Slate, Meagher& Flom LLP, to John C. Lawton, Acting Director, Division of Trading and Markets, dated February 5, 2001.
- [\[3\]](#) Letter from James M. Falvey, Assistant General Counsel, Chicago Mercantile Exchange, to Jean A. Webb, Office of the Secretariat, dated October 10, 2000.
- [\[4\]](#) Letter from David P. Van Wagner, Associate Director, Division of Trading and Markets, to James

M. Falvey, Assistant General Counsel, Chicago Mercantile Exchange, dated November 20, 2000. [\[1\]](#)

5 The June 9 Letter referred only to contract market designation because there was no provision in the Act or rules thereunder governing a derivatives transaction execution facility at that time. Because of the creation of that category of board of trade under the Commodity Futures Modernization Act, the Division is amending its relief accordingly.