



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of  
Market Oversight

CFTC letter No. 05-16  
August 26, 2005  
No-Action  
Division of Market Oversight

Mr. Nick P. Weinreb  
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Cannon Bridge House  
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London EC4R 3XX  
United Kingdom

Re: Sections 5 and 5a – Euronext Amsterdam N.V.; Request for No-Action Relief from Contract Market Designation and Derivatives Transaction Execution Facility Registration Requirements

Dear Mr. Weinreb:

This is in response to your letter dated July 1, 2004, as revised by documents received August 27, 2004 and March 4, 2005 and supplemented by correspondence dated May 5, 2005 through July 14, 2005, to the Division of Market Oversight (Division) of the Commodity Futures Trading Commission (CFTC or Commission).<sup>1</sup> By this correspondence, you request, on behalf of Euronext Amsterdam N.V. (Euronext Amsterdam or Exchange), that the Division confirm that it will not recommend enforcement action to the Commission against Euronext Amsterdam and/or its members<sup>2</sup> if Euronext Amsterdam does not obtain designation as a contract market (DCM) or registration as a derivatives transaction execution facility (DTEF) pursuant to Section 5 or 5a, respectively, of the Commodity Exchange Act (Act or CEA), or comply with those Commission regulations that specifically relate to DCMs or DTEFs in connection with the

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<sup>1</sup> Letter from N. P. Weinreb, Group Head of Regulation, Euronext, to Richard Shilts, Acting Director, Division of Market Oversight, Commodity Futures Trading Commission (July 1, 2004, revised August 2004 and March 2005).

<sup>2</sup> For purposes of the No-action request and the relief provided herein, references to the members of Euronext Amsterdam shall include any “affiliate” of any Euronext Amsterdam member that has been granted access by the Euronext Amsterdam member to LIFFE CONNECT®. An “affiliate” of a Euronext Amsterdam 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. Euronext Amsterdam represents that, as a condition of access to LIFFE CONNECT®, such affiliates would be required to comply with Euronext and Euronext Amsterdam Rules and that Euronext Amsterdam members remain responsible to Euronext Amsterdam for ensuring their affiliates' compliance.

installation and use in the United States<sup>3</sup> of LIFFE CONNECT® and/or automated order routing systems (AORS)<sup>4</sup> by Euronext Amsterdam members. (No-action request).

Specifically, Euronext Amsterdam wishes to make LIFFE CONNECT®, the Euronext electronic trading and order matching system, available to: (i) Euronext Amsterdam members who wish to trade for their own accounts through LIFFE CONNECT® in the United States; (ii) Euronext Amsterdam members who are registered with the CFTC as futures commission merchants (FCMs) or who are exempt from such registration pursuant to CFTC Rule 30.10 (Rule 30.10 Firms)<sup>5</sup> and who wish to submit orders from or on behalf of United States customers<sup>6</sup> for transmission to LIFFE CONNECT®; (iii) Euronext Amsterdam members who are registered with the CFTC as Commodity Pool Operators (CPO) or Commodity Trading Advisors (CTA), or who are exempt from such CPO or CTA registration pursuant to Commission Regulation 4.13 or 4.14, and who wish to submit orders on behalf of United States pools they operate or United States customer accounts for which they have discretionary authority, respectively, for transmission to LIFFE CONNECT®, provided that an FCM or Rule 30.10 Firm acts as clearing firm with respect to all activity conducted by such CPOs and CTAs through the submission of orders on LIFFE CONNECT®; and/or (iv) Euronext Amsterdam members who are registered with the CFTC as FCMs or who are Rule 30.10 Firms and who wish to accept orders for United States customers transmitted via AORS for submission to LIFFE CONNECT®.

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

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

<sup>4</sup> 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.

<sup>5</sup> 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 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 (2004).

<sup>6</sup> 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).

electronic trading devices in the United States.<sup>7</sup> 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 promulgated rules or guidelines in this area (June 2 Order).<sup>8</sup> In accordance with this instruction, the Division has reviewed Euronext Amsterdam's No-action request and the materials submitted in support thereof.

In connection with its No-action request, Euronext Amsterdam has forwarded the following information to the Division:

- General information regarding Euronext and Euronext Amsterdam (*e.g.*, its location and organization);
- Euronext Annual Report 2004;
- Euronext.liffe Brochure - How the Euronext.liffe Markets Work, published August 2004;
- Reference Book – Euronext Amsterdam Derivative Markets, published November 2004;
- Euronext Rules, Book I, harmonized, issued March 23, 2005;
- Euronext.liffe Trading Procedures, issued February 18, 2005;
- Euronext Notice N9-01, issued July 25, 2003 (the “Penalty Notice”);
- Euronext Rules, Book II, General Rules for Euronext Amsterdam Derivative Markets, issued November 2004;
- Euronext Amsterdam N.V. – LIFFE CONNECT® Overview, issued January 2005;
- Confirmation from the Netherlands Authority for Financial Markets with respect to information sharing, email dated May 24, 2005; and
- Survey completed by the Netherlands Authority for the Financial Markets: Assessment Methodology on the Implementation of the IOSCO Objectives and Principles of Securities Regulation, Principles Relating to Secondary Markets, 2004.

Representations made by Euronext and Euronext Amsterdam regarding the structure of Euronext Amsterdam, Euronext Amsterdam's activities in the United States, Euronext

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<sup>7</sup> Access to Automated Boards of Trade, 64 Fed. Reg. 14159 (March 24, 1999).

<sup>8</sup> Order of the CFTC Withdrawing Proposed Rules Regarding Access to Automated Boards of Trade, Release No. 4274-99 (June 2, 1999).

Amsterdam's membership criteria, Euronext, the LIFFE CONNECT® Trading System, the relevant regulatory regime in the Netherlands and in Euronext, and the information-sharing arrangements applicable to Euronext Amsterdam are summarized in Sections I - V below. For purposes of its response to the No-action request, the Division has relied upon Euronext and Euronext Amsterdam's representations and has not conducted an independent review to confirm their accuracy.<sup>9</sup>

## **I. GENERAL INFORMATION REGARDING EURONEXT AMSTERDAM**

Euronext Amsterdam, formerly known as Amsterdam Exchanges, is a corporation organized under the laws of the Netherlands and is the operator of an exchange recognized pursuant to Article 22 of the Dutch Securities Markets Supervision Act of 1995. The markets operated by the exchange are “regulated markets” for the purposes of the European Community’s Investment Services Directive (ISD). Euronext Amsterdam is a subsidiary of Euronext N.V. (Euronext) and is regulated by the Netherlands Authority for the Financial Markets (AFM).

The Amsterdam stock exchange, regarded as the oldest exchange in the world, was established four centuries ago for the trading of shares in a large shipping company that needed funds to finance the shipping of goods from the Far East. Initially only shares that could be delivered immediately were traded, but soon futures and options were being traded as well. Investors could also buy early call and put options granting them the right to buy or sell shares in the future, for which they paid a premium.

The Amsterdam Stock Exchange Association was founded in 1851 to organize and regulate share trading in the Netherlands. Only members of this association were allowed to trade directly on the stock exchange. More than a century later, in 1978, the Amsterdam Stock Exchange Association launched the European Options Exchange, the first options exchange in Europe and the second in the world. The Amsterdam Stock Exchange Association and the European Options Exchange merged in 1997 and the new company, Amsterdam Exchanges, operated both the stock market and the derivatives market. Amsterdam Exchanges compiled the AEX index, a Dutch blue chip index, and adopted a one-stop shopping model, which included clearing and settlement services, a central securities depository and data services, to provide investors with a constant flow of high-level information.

Euronext is a holding company incorporated under the laws of the Netherlands that operates through local subsidiaries. Its shares are listed on the securities markets operated, respectively, by Euronext Amsterdam, Euronext Brussels and Euronext Paris. It was formed on September 22, 2000, when the exchanges of Amsterdam, Brussels and Paris merged, and expanded at the beginning of 2002 with the acquisition of the London International Financial

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<sup>9</sup> As stated below, the no-action relief provided herein is contingent upon the accuracy of the representations made by Euronext and Euronext Amsterdam 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.

Futures and Options Exchange (LIFFE), through the purchase of LIFFE (Holdings) plc, and the merger with the Portuguese exchange BVLP (Bolsa de Valores de Lisboa e Porto). The Euronext derivatives markets are known collectively as “Euronext.liffe” and include the markets operated by Euronext Amsterdam, Euronext Brussels, Euronext Lisbon, Euronext Paris and LIFFE Administration and Management. Two of those subsidiaries (LIFFE Administration and Management and Euronext Paris, formerly Parisbourse<sup>SBF</sup> SA) previously have been granted foreign terminal no-action relief by the Division of Trading and Markets.<sup>10</sup> NQLX LLC, a U.S.-registered DCM for security futures contracts, is also a wholly-owned subsidiary (although all of its contracts were delisted in December 2004).

Euronext Amsterdam lists futures contracts and options on futures contracts on certain commodities, currencies and the AEX Index, for which no-action relief permitting the offer and sale in the United States has been granted by the Commission’s Office of General Counsel.<sup>11</sup> Euronext Amsterdam represents that it does not maintain any trade execution, clearing or settlement facilities in the U.S. and does not employ any personnel in the U.S. other than marketing personnel employed by LIFFE USA Ltd. Marketing representatives of Euronext Amsterdam may, from time to time, attend futures industry conferences sponsored by the Futures Industry Association in the U.S. Information in English published on Euronext Amsterdam’s website is accessible to, but is not designed specifically for, potential market participants in the U.S.

## **II. MEMBERSHIP**

The membership of each Euronext derivatives market is separate and distinct. Thus, a firm that wishes to trade the products offered by Euronext Amsterdam must be a member of Euronext Amsterdam and could not rely on its membership at another Euronext Derivatives Market to give it access to those products. This Euronext Rules-based restriction is reinforced by systems-based restrictions in that the architecture of LIFFE CONNECT® limits access to a market’s products to those who have trading rights by virtue of their membership at that market.<sup>12</sup>

Two broad categories of investment firms qualify to apply for membership in a Euronext derivatives market: (i) firms which are authorized by the competent authorities of a European Member State pursuant to the European Directives concerning investment services and banking (ISD firms)<sup>13</sup>; and (ii) other firms (Non-ISD firms), including (1) those which are authorized by

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<sup>10</sup> CFTC Staff Letters No. 99-31 (July 23, 1999) and 99-33 (August 10, 1999) respectively.

<sup>11</sup> CFTC Staff Letter No. 03-16, dated 7 April 2003. The AEX Index is comprised of the 25 most active securities in the Netherlands.

<sup>12</sup> As used herein, the term Euronext Rules applies to Book I, which includes the harmonized rules common to all Euronext markets.

<sup>13</sup> The Investment Services Directive (ISD) (Council Directive 93/22/EEC of May 10, 1993 on investment services in the securities field) and the Banking Directive (EU Directive 2000/12/EC of the European Parliament and of the Council of March 20, 2000 relating to the taking up and pursuit of the business of credit institutions). As part of the European Union’s Financial Services Action Plan, a revised version of the ISD (Directive 2004/39/EC on

regulatory entities located outside the European Union; and (2) European firms whose activities are excluded from the scope of the ISD (*e.g.*, locals). Firms may apply for membership as a broker, which is entitled to trade for third parties, and/or a dealer, which is entitled to trade for its own account.<sup>14</sup>

Euronext Rules set out the requirements for membership in a Euronext derivatives market, although these requirements may be augmented by specific requirements for a particular market. In the case of an ISD firm, its authorization as an Investment Firm or a Credit Institution would normally be sufficient to meet the requirements for membership in a Euronext market, and the amount of due diligence necessary by the Euronext derivatives membership department would be limited. In the case of a non-ISD firm, more extensive due diligence would be conducted. The non-ISD firm would have to demonstrate that it was authorized or otherwise licensed or permitted by competent authority to conduct business on the market or, in the absence of a requirement for authorization, licensing or permission, that it was fit and proper, and that it had business standing suitable for admission to membership. Among the membership requirements applicable to all applicants is that the applicant must ensure that its staff is suitably qualified and experienced in order to implement and maintain adequate internal procedures and controls in relation to its intended business on the market.<sup>15</sup>

With respect to the financial resource requirements of membership, Euronext Rules provide that an applicant must satisfy any other criteria, including financial requirements, which the relevant Euronext market may prescribe. In practice, however, Euronext represents that it relies upon the financial resource requirements imposed on members by the relevant regulator or supervisor of the firms concerned and, in the case of clearing members, by the relevant clearing house, which for Euronext Amsterdam is LCH.Clearnet SA. With respect to trading on the exchange, the responsibility for appropriate financial resource requirements rests with those who

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Markets in Financial Instruments, or “MiFID”) has just been adopted and will be implemented in May 2006. The broad characteristics of the current ISD will not change materially when MiFID is implemented.

<sup>14</sup> Members may apply to Euronext to obtain direct access to LIFFE CONNECT® for one or more affiliated companies. Euronext Rules set out the requirements for such access and define the conditions of ownership which must be satisfied in order for a firm to qualify. As the rules make clear, all business undertaken by the affiliate pursuant to the access granted will be done in the name of the member and the member retains full responsibility for the conduct of all such business.

<sup>15</sup> A streamlined process has been introduced for all Euronext.liffe markets whereby a member of one Euronext.liffe market may apply for membership at any other Euronext.liffe market by submitting a simple application form which details the additional markets for which membership is being applied and contains, among other things, a statement of the member’s consent to abide by the rules of that market. Membership approval will continue to be subject to an applicant satisfying the relevant market’s membership criteria, including a requirement for regulatory authorization, where appropriate. In particular, those firms who do not benefit from “ISD passport” rights conferred pursuant to the ISD (the right to do business in any EU country on the basis of regulatory approval in the jurisdiction in which the firm is incorporated or established) would need to ensure that they have the appropriate regulatory approval to become a market member and engage in cross-border business. In order to trade on the additional market(s), an applicant would need to make the necessary arrangements for trading including, in the case of non-clearing members, the appointment of a clearing member if their existing clearing member does not clear that market (for example, if the clearing member is a member of LCH.Clearnet Ltd, which clears for LIFFE, but not LCH.Clearnet SA, which clears for the continental Euronext derivatives markets).

bear the risk for transactions – that is, the clearing members of Euronext Amsterdam (for transactions with non-clearing firms) and LCH.Clearnet SA (for transactions with clearing firms). Accordingly it is the responsibility of (i) each clearing member to determine the appropriate level of cash/collateral which it requires from the members for whom it clears, and (ii) LCH.Clearnet SA to determine the appropriate level of cash/collateral which it requires from the clearing firms for whom it clears.

With respect to the financial resource requirements of clearing members, LCH.Clearnet SA has, pursuant to its Rules, set financial requirements based on whether the member is an individual clearing member or a general clearing member. An individual clearing member, which clears only its own proprietary and customer business, must at all times maintain capital of at least EUR 10 million.<sup>16</sup> A general clearing member, which clears business both for itself and its customers and for other members and their customers, must at all times maintain capital of at least EUR 25 million.<sup>17</sup> This requirement increases to EUR 30 million from the tenth member cleared, EUR 33.75 million from the fifteenth member cleared, and EUR 37.5 million from the twentieth member cleared.<sup>18</sup> If two or more individuals and/or entities are jointly and severally liable for the obligations of a clearing member, the capital of all such individuals and/or entities is added for purposes of the above calculations, and any cross-shareholdings are subtracted. In monitoring the financial requirements outlined above, Euronext Amsterdam and LCH.Clearnet SA may share information with each other or with other persons and entities pursuant to information sharing arrangements to which Euronext Amsterdam and/or LCH.Clearnet SA may be subject.

### **III. OVERVIEW OF THE EURONEXT AMSTERDAM TRADING SYSTEM**

At the outset, the Division notes that the description of LIFFE CONNECT® set forth herein is based upon representations made by Euronext Amsterdam or its representatives. The Division has not performed an independent assessment of the security or soundness of LIFFE CONNECT® in connection with this request. Nonetheless, it should also be noted that LIFFE CONNECT®, as the trading system used by NASDAQ LIFFE, was thoroughly examined by the Division and the Commission's Office of Information Resources Management in connection

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<sup>16</sup> Capital is defined as the shareholders' equity determined by LCH.Clearnet SA on the basis of the Capital Adequacy Directive (EU Council Directive 93/6/EEC of March 15, 1993, on the capital adequacy of investment firms and credit institutions) and is comprised of core capital and supplementary capital. As of the date of this letter, EUR 10 million = \$12,298,000.

<sup>17</sup> As of the date of this letter, EUR 25 million = \$30,745,000. A letter of credit may be accepted by LCH.Clearnet SA to cover a shortfall in the above requirements, provided that, without taking into account such letter of credit, an individual clearing member has at least EUR 5 million (\$6,149,000) and a general clearing member has at least EUR 15 million (\$18,447,000) in capital at any time. For purposes of the calculation of the clearing members' capital, any letter of credit issued by one clearing member to satisfy the financial requirements of another clearing member reduces the capital of the issuer of such letter of credit proportionately.

<sup>18</sup> As of the date of this letter, EUR 30 million = \$36,894,000, EUR 33.75 million = \$41,505,750 and EUR 37.5 million = \$46,117,500.

with NASDAQ LIFFE's application to become a DCM.<sup>19</sup> Furthermore, Commission staff undertook an examination of LIFFE CONNECT® during its review of the e-cbot System in connection with the Chicago Board of Trade's October 31, 2003, self-certification to the Commission of a set of rule changes to replace its a/c/e electronic trading system with the e-cbot electronic trading system using LIFFE CONNECT®. Finally, Commission staff has previously described LIFFE CONNECT® in connection with the granting of foreign terminal no-action relief to LIFFE Administration and Management and, more recently, described the e-cbot electronic trading system using LIFFE CONNECT® in connection with the granting of foreign terminal no-action relief to the Winnipeg Commodity Exchange, Inc.<sup>20</sup>

#### A. Introduction

The Rules, procedures and arrangements for trading derivative products are modeled on the LIFFE precedents, though there are local differences with respect to certain provisions.<sup>21</sup> Trading takes place through the submission of orders via a front end trading application to the LIFFE CONNECT® central order book. Traders place orders for individual contracts or specified strategies and are able to view and, in turn, trade in depth against other orders in the book. These features enable traders, using their trading applications, to continuously track full market depth. An order is firm only when received by the Trading Host and may be traded against at any time thereafter. At any time before being traded against, traders have the ability to withdraw or revise their orders. When changes occur to the order book (such as new orders, revisions to orders, or trades), the system disseminates those changes to all traders who have subscribed to (*i.e.*, indicated an interest in) the relevant contract or strategy. Using their trading application, traders may also request, at any time, to see all available prices (including those outside the best bid and offer) plus aggregate volume in a given contract month, series, or strategy.

#### B. The Order System

Traders may submit orders at any time from the pre-open period until market close. Orders may be for any outright or strategy market and may be submitted either singly or (subject to contract restrictions) in batches. When an order is submitted to the Trading Host, it is considered firm once the host has checked and confirmed it as valid, at which point it is timestamped. Orders must specify, among other things, the price, the contract month, series or strategy, and the volume to be bought or sold at that price. Orders that are not completely filled

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<sup>19</sup> The Commission approved NASDAQ LIFFE, LLC, a joint venture of the NASDAQ Stock Market and LIFFE, as a DCM on August 22, 2001. On July 24, 2003, NASDAQ LIFFE ended its relationship with NASDAQ and the DCM was renamed NQLX.

<sup>20</sup> CFTC Staff Letters No. 99-31 (July 23, 1999) and 04-35 (December 15, 2004) respectively.

<sup>21</sup> The Euronext Rules set out the high-level provisions with respect to derivatives trading, while the Euronext.liffe Trading Procedures contain the more detailed requirements. These Rules and Procedures may be interpreted or implemented by Euronext Notices. Rules, procedures and arrangements that are national in nature and not common to all Euronext markets are contained in the respective Book II of the Rules for each market and in Part II of the Euronext.liffe Trading Procedures.

may, unless otherwise specified, be stored in the central order book. Members may either execute business on their own behalf and/or on behalf of clients according to their authorized status. The Trading Host provides a facility to allow members executing business on behalf of another member to allocate the business done directly to the originating member.

Orders that may be entered into LIFFE CONNECT® include limit orders, market orders, market on open (MOO) orders and contingent multiple orders (CMO). Limit orders are executed at the price stated or better. Unless otherwise specified, any residual volume left after part of the limit order has been executed is retained in the Order Book until withdrawn or executed (or cancelled automatically at the end of the day).<sup>22</sup> Market orders are executed at the best price available at order receipt until all volume at that price has been traded. The order then is executed at the next best price and so on, until all the order volume has been filled. Any residual volume from an incomplete market order is immediately cancelled.<sup>23</sup> MOO orders may be submitted during the Pre-Open period and are executed at the calculated opening price. Any residual volume converts to a limit order. If no bid or offer exists at market open, the MOO order will be cancelled. CMO orders permit intra- and inter-contract spread trading without legging risk in that if the criteria for any of the orders cannot be met, then none of the orders will execute. CMOs can include both limit and market orders and cannot be submitted in the pre-open period.

### C. The Trading Day

The trading day at Euronext Amsterdam is divided into four consecutive periods: (i) pre-open; (ii) open; (iii) pre-close; and (iv) close. During the pre-open period, certain types of orders, including limit and MOO orders, can be submitted. The state of the market can be observed and, although no actual trading takes place, indicative opening prices are generated and displayed for users. The open is the main trading period, and all types of orders other than MOO orders can be entered into the system.<sup>24</sup> The Trading Host matches orders in the central order book with priority being determined by price and time. Where orders have an equal price, priority is given to the earliest orders entered at that price. For price priority, the highest bid or lowest offer has priority over other orders in the same market. For time priority, older orders have priority over more recent orders at the same price and will trade according to the time that the Trading Host accepted them. When orders match, the Trading Host executes trades, informs

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<sup>22</sup> Limit orders can be designated as good till cancelled (GTC) (the order remains in the central order book until either the order is executed, withdrawn, or the contract expires); immediate and cancel (IC) (the order is immediately executed against any matching orders, up to the volume of the IC, and any residual volume is automatically cancelled); complete volume (CV) (the order is executed only if sufficient volume is available for the order to be fully executed, at the specified price or better, otherwise the entire order is cancelled); and minimum volume (MV) (the order is executed only if the specified minimum volume is immediately available to trade, at the specified price or better, or the whole order is cancelled. Any residual volume from an incomplete MV order remains in the Order Book and trades with no further minimum volume constraints).

<sup>23</sup> Market orders are automatically designated as IC if no other designation is specified. Market orders can also be designated as CV or MV, although the restriction applicable to limit orders, at the specified price or better, does not apply.

<sup>24</sup> For some contracts, the market will only move from pre-open to open if an underlying price has been determined before the standard opening time, resulting in what is known as a conditional opening.

the respective traders and other participants in the same market, and transmits the trade details to the appropriate Post Trade/Clearing System. The traded price and volume are sent by the Trading Host via the Connect Feed Handlers to the LIFFE Market Feed (LMF) for subsequent dissemination to third parties including Quote Vendors.

The pre-close is the period shortly before the close of trading in a contract when the system sends a message to all customers subscribed to a market to notify them that the market is about to close. In other respects, trading during the pre-close period is the same as during the open period. Finally, at the close, trading ceases and all outstanding orders, other than those designated as GTC, are deleted from the Order Book. No new orders, editing of outstanding orders, or withdrawals are accepted. As more fully discussed below, executed orders are cleared by LCH.Clearnet SA, which becomes the central counterparty between the clearing members of the buyer and the seller in a given transaction. Settlement prices are calculated and distributed, along with other market data, in real-time, direct to customers via the LIFFE CONNECT® API. LIFFE CONNECT® distributes market data for onward dissemination via a network of Quote Vendors.

#### D. Trade Registration / Audit Trail

Every event is timestamped by the Trading Host. Euronext Rules require that each order received from a client be recorded and timestamped immediately upon receipt. Orders must also be timestamped upon execution and at the time of cancellation of the order by the client. Order records may be prepared on order tickets or in electronic format. Order records must contain the following information: (i) member identification; (ii) identity of the member submitting the order and the Individual Trading Mnemonic (ITM) under which it is submitted; (iii) identity of the individual completing the order record; (iv) client identification; (v) buy/sell; (vi) volume; (vii) contract; (viii) put/call and exercise price (for options); (ix) delivery or expiry month; (x) price or price limit; price range or strategy prices; (xi) special instructions; and (xii) strategy type indicator (if applicable). All order records must be secure and not subject to alteration and be retained by members for a period of no less than five years after the date of the transaction. A full audit log of all Trading Host communications is maintained for at least five years.

#### E. System Response Time

The AFM represents that Euronext Amsterdam is responsible for maintaining a fair and orderly market and meets the following requirements concerning fair and objective access to LIFFE CONNECT®: (i) response time is equivalent for all system participants; (ii) all system users have an equal ability to connect and to maintain the connection to the system; (iii) all equivalent inputs (*e.g.*, volume and order type) by system users are treated fairly and equally; and (iv) links or interfaces with other systems (*e.g.*, clearing systems, order routing systems, quotation vendors) are treated fairly.<sup>25</sup> The exchange recognition states that Euronext

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<sup>25</sup> LIFFE CONNECT® employs technology known as Reliable Multi-Cast (RMC) which distributes essential trading data in a fair and equitable manner to all eligible market participants in order to ensure that traders are not disadvantaged when submitting and executing orders or when receiving information. One of the RMC's primary functions is to manage the distribution of specific contract data (*e.g.*, prices and volumes) to participants who have elected to receive such information and have thereby indicated their intention to trade in those contracts. Through

Amsterdam rules, enforcement of these rules, and the trading and clearing and settlement systems, including the computerized trading and clearing and settlement systems, must have the same material effect for all institutions and investors concerned in so far as circumstances are the same.<sup>26</sup>

#### F. Reliability and Failure Recovery

Euronext.liffe has in place four processes which provide the management control and escalation procedures to handle any service incident affecting the operation of LIFFE CONNECT®: (i) Call Management; (ii) Incident Management; (iii) Serious Incident Management (SIM); and (iv) Problem Management. Call Management is the point of entry for all incidents and deals with communications between users and experts, from initial call receipt to incident resolution. An automated call-handling switchboard captures call details and calls are allocated according to expertise and availability. Incident Management deals with the actual restoration of service and includes the actions necessary to recover or restore service to the caller. Urgent or serious incidents are escalated through the SIM Process to Expert Support via paging and telephone.

SIM is an enhanced incident management process with additional management controls and incident criteria built in to ensure appropriate escalation and management attention for potentially serious incidents. The SIM process is utilized for incidents, for example, that affect two or more customers. The SIM process also interfaces with the disaster recovery process as appropriate. Finally, Problem Management is a post-event service that performs root cause analysis to determine what caused an incident, how the service restoration was managed, what lessons can be learned from the incident, and what can be done to prevent re-occurrence of the incident. Euronext.liffe also has established business continuity and disaster recovery processes that are continually validated during both real and simulated events.

Recovery and backup for LIFFE CONNECT® are provided for by a duplex strategy of Data Centers, Trading Hosts and other related systems and equipment. Data Centers are duplicated at different geographically-separated locations and the Trading Hosts and other equipment (including networks) are similarly duplicated within those centers. Both Data Centers can run all aspects of all services necessary to operate the markets, and as a matter of regular routine the “live” Data Center alternates between the two geographically-separated Data Centers. Data is streamed on a real time basis from the “live” Trading Host to the secondary Trading Host, ensuring that the secondary Trading Host replicates the “live” Trading Host’s state and

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this management function, the RMC ensures that pertinent market data will be transmitted worldwide at exactly the same moment in time to each eligible trader simultaneously, so that any differences in trader locations are rendered immaterial. In view of this functionality and the practical experience of operating LIFFE CONNECT® in the United States since 1999, Euronext represents that US-based market participants would not be disadvantaged despite their lack of proximity to the trading host.

<sup>26</sup> As discussed below, the operator of a securities exchange in the Netherlands must obtain recognized status from the Minister of Finance, on advice of the AFM, before operating the exchange.

data content. Thus if a problem is encountered, the secondary Trading Host can become the “live” Trading Host within a few minutes.

#### G. System Security

With respect to business conducted on or submitted through LIFFE CONNECT®, a member must implement suitable security measures such that only those persons specifically authorized by the member to trade may gain access to passwords and security keys. The member must also ensure that any trading access granted to individuals, including by way of AORS, is adequately controlled and supervised, to include appropriate checks before orders are transmitted to the Trading Host. Each member has a Member's CONNECT Administrator (MCA) who is responsible for managing access to the trading system. The MCA is required to submit a form to Euronext.liffe for each Responsible Person that the member wishes to register with the Exchange and thereby be granted direct access to the trading system. The form, which must be signed by both the MCA and the prospective Responsible Person, includes details of the Responsible Person, including name, location, gateway and number of requested ITMs. Once a Responsible Person has been registered by Euronext.liffe, the ITMs and encrypted passwords are made available to the MCA via a secure website. The MCA, in turn, provides such ITMs and passwords to the Responsible Person. Finally, the Responsible Person, who may or may not be engaged in trading (*e.g.*, the Responsible Person might be head of the relevant trading desk or a risk or compliance manager) may permit other traders to have access to LIFFE CONNECT® through the ITMs. In that regard, the Responsible Person will be responsible, among other things, for being satisfied regarding the competence and suitability of such traders, and must have the authority to adjust or withdraw any orders submitted by them under the ITM(s), ensure as far as possible that all business thus conducted is in accordance with the Rules and Trading Procedures, and know and be willing to disclose to the Exchange the immediate source of all orders.

Euronext.liffe has issued several policies and guidelines in order to control risks to which it is exposed and to ensure the availability, integrity and confidentiality of data and the knowledge derived therefrom. The policies issued by Information Security are based upon the framework detailed within the British Standard for Information Security and are constantly updated. The Information Security team ensures Euronext.liffe is protected in a comprehensive and cost-effective manner by using preventative controls that include firewalls, appropriate encryption technology and authentication methods. Intrusion detection is deployed across the key network points and onto the organization's critical hosts and vulnerability scanning is used to identify high risks to be contained and to measure conformance with the policy and standards. Multi-vendor anti-virus protection has been deployed at the external email gateway, across all desktops, on critical servers, at the web proxy and across the internal email infrastructure. A security awareness program has been defined and presented to new employees and existing staff, who also are briefed with regard to changing security matters and the Information Security team.

Upon detection of a security incident, a dedicated team utilizes the SIM Process to guide their response to the incident. All alerts are classified and investigated fully and post-incident reviews ensure that lessons are learned and applied to improve the controls and processes in place. Information Security procedures are reviewed by internal and external audit entities to maintain appropriateness and effectiveness. Finally, Euronext.liffe has regular independent external tests carried out to ensure adequacy of the protections against external attack and also conducts unannounced internal checks.

#### H. Adherence to IOSCO Principles

Both the Netherlands AFM and the Financial Services Authority (FSA) of the United Kingdom have examined LIFFE CONNECT® to determine that it complies with the Principles for the Oversight of Screen-Based Trading Systems for Derivative Products developed by the Technical Committee of the International Organization of Securities Commission (IOSCO Principles).<sup>27</sup> Euronext represents that it will ensure that LIFFE CONNECT® will continue to comply with the IOSCO Principles.

#### I. Settlement and Clearing

LCH.Clearnet SA acts as a central counterparty between the clearing members of the buyer and the seller in a given transaction. From the matching of the buy and the sell orders comprising the transaction, LCH.Clearnet SA guarantees that the transaction will be registered in the clearing system (unless otherwise provided in a notice).<sup>28</sup> Registration involves the legal process of novation, whereby each contract between two clearing members is replaced by two contracts, one with LCH.Clearnet SA as buyer to one clearing member, and the other with LCH.Clearnet SA as seller to the other clearing member. Following novation, therefore, a clearing member's counterparty exposure to other clearing members disappears and is replaced by an exposure to LCH.Clearnet SA. This means that where a client has dealt through a non-clearing member, there will be a chain of linked contracts (so-called "back-to-back" contracts): (i) between the client and the non-clearing member; (ii) between the non-clearing member and a clearing member; and (iii) between the clearing member and LCH.Clearnet SA.

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<sup>27</sup> The FSA examined LIFFE CONNECT® in connection with its oversight of LIFFE as a Recognized Investment Exchange. 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).

<sup>28</sup> LCH.Clearnet SA is not liable for failure of registration or improper registration caused by a third party's default or by a force majeure event.

LCH.Clearnet SA settles contracts, and requires margin payments, in accordance with the Clearing Rules. Payment of initial and variation margin must be made by the clearing member by such time as LCH.Clearnet SA may specify by instruction issued to the clearing member. Failure to meet the margin requirements by that time would constitute an act of default under the Clearing Rules. LCH.Clearnet SA imposes margin requirements only on clearing members with whom it has a contractual relationship. However, all Euronext Amsterdam members are required to call for margin on at least a daily basis from their clients and, where relevant, their non-clearing members, in an amount no less than that LCH.Clearnet SA would call for from a clearing member for an equivalent position. In practice, with respect to smaller or private clients, members may choose to call for higher amounts of initial margin to reflect the higher risk associated with such clients compared to that of clearing members.

In order to meet losses in the event of a default of one or more clearing members, LCH.Clearnet SA maintains a clearing fund (Clearing Fund) currently valued at approximately 450 million Euros.<sup>29</sup> A clearing member is obliged to contribute to the Clearing Fund according to the terms and conditions of instructions received from LCH.Clearnet SA. The amount of the required contribution depends on the product group that the clearing member is authorized to clear, is correlated with the risk associated with the clearing member's open positions at LCH.Clearnet SA, and is recalculated and readjusted by LCH.Clearnet SA monthly. The contribution may be delivered through outright transfer of collateral to LCH.Clearnet SA or through a direct or indirect transfer to a central bank of assets accepted as collateral by such central bank under the conditions defined by the central bank for the issuance by it of a guarantee in favor of LCH.Clearnet SA.

If a clearing member is declared in default by LCH.Clearnet SA, a call may be made on the Clearing Fund. In the event of a call, assets held by LCH.Clearnet SA are used in the following order: (i) any collateral deposited by the defaulting clearing member; (ii) the individual contribution of the defaulting clearing member to the Clearing Fund; (iii) if applicable, any other collateral or letter of credit; (iv) the shares of the other clearing members in the Clearing Fund, pro rata to their respective contributions for that monthly period (not to exceed the total clearing fund contributions set for that monthly period); (v) funds received from a central bank pursuant to any guarantees issued in favour of LCH.Clearnet SA; and (vi) LCH.Clearnet SA's own capital.

#### **IV. OVERVIEW OF EURONEXT AMSTERDAM'S REGULATORY STRUCTURE**

##### **A. The Netherlands Authority for the Financial Markets**

In the Netherlands, the AFM is responsible for the operation of the financial markets and is the supervisory authority for all parties involved in the securities trade.<sup>30</sup> The statutory basis for AFM's powers is the Act on the Supervision of the Securities Trade 1995 (Wte), the aim of

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<sup>29</sup> As of the date of this letter, EUR 450 million = \$553,410,000.

<sup>30</sup> Futures contracts and options on futures contracts are included in the definition of securities.

which is to ensure the efficient, fair and orderly operation of the securities markets and to protect investors against malpractice, the provision of inadequate information and incompetence on the part of securities institutions. The Wte provides that the AFM can exercise supervision of the securities exchanges and securities institutions through statutory powers to carry out investigations and inspections, to monitor compliance, and to obtain information as laid down in the Wte. The Wte also creates a licensing system for various types of securities services, including a requirement that all securities exchanges must have recognized status from the Minister of Finance before they can operate.<sup>31</sup>

In order to obtain recognized status, the operator of the securities exchange must demonstrate, among other things, that the exchange is established in the Netherlands and that the operation of the exchange, the rules that are to be applied by the exchange, the application of the rules, and the monitoring of compliance with the rules, meet the standards necessary for ensuring the proper operation of the securities markets or protecting the position of investors in the markets. At a minimum, the following aspects will be verified: the expertise of the persons who determine the day-to-day policy of the operator, the integrity of the persons who determine or help to determine the policy of the operator, the financial guarantees, the settlement system and the application of the current rules of the securities exchange, to issuers and to securities institutions that will be admitted to the securities exchange and to subsidiaries thereof. Restrictions may be imposed and conditions attached to the recognition, in the interests of the proper operation of the securities markets or the position of investors in the markets.

The AFM supervises securities exchanges and automated trading systems, clearing, settlement and custody systems, and market personnel. Supervision of securities exchanges includes the granting of securities exchange recognition, the assessment of rules and changes to rules, and supervision of compliance with those rules.<sup>32</sup> Supervision of clearing, settlement and custody systems includes initial and ongoing testing based upon the criteria laid down in the Wte. Supervision of market personnel includes safeguarding access to the market and involves the testing of such personnel as clearing members, market makers, liquidity providers and traders with respect to such factors as internal organization, risk management and expertise. The AFM carries out its supervisory role by checking and enforcing standards and acts specifically on tips from the market and on the findings of its own control organization. If the AFM ascertains that there has been a breach, it may impose penalties. It may issue a reprimand or give a public warning, appoint a secret receiver, withdraw a license, report an offense to the Public

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<sup>31</sup> The Wte also gives the AFM the option of exchanging information with foreign securities supervisory authorities and of carrying out investigations based upon agreements to exchange information.

<sup>32</sup> The rules and regulations of a recognized exchange are initially approved by the Minister of Finance, after formal advice from the AFM, by the exchange recognition. Any intended change in those rules has to be announced to the AFM. Although the AFM does not formally approve new rules or amended rules, it may issue instructions to the operator of a securities exchange recognized pursuant to the Wte regarding the rules that are to be applied to the securities exchange, their application, or the monitoring of compliance with the rules. Among other things, the AFM may issue instructions regarding the standards necessary for ensuring the proper operation of the securities markets or protecting the positions of investors in the markets and addressing the adequacy of the means to monitor trading conduct, to supervise the system, to address disorderly trading conditions, and to deal with non-compliant conduct.

Prosecutions Department, or impose a fine or other penalty. With respect to the field of financial markets, the AFM also formulates, enforces, and applies policy and regulations.

## B. Euronext

### 1. Organizational Structure

In accordance with Dutch law, Euronext has a two-tier governance structure, with a Supervisory Board and a Managing Board. The Supervisory Board consists of independent members who cannot, at the same time, also be members of the Managing Board. The Supervisory Board oversees the actions and policies of the Managing Board and the general course of Euronext's business activities, such as the achievement of corporate objectives, general business operations, and corporate strategy and risk, and assists and advises, in its supervisory capacity, the Managing Board in performing its managerial duties. The Managing Board is responsible for managing Euronext's affairs and is under the supervision of the Supervisory Board.<sup>33</sup> The Managing Board meets weekly to discuss Euronext's strategy, set policy and implement managerial decisions. The chairman of the Managing Board reports to the chairman of the Supervisory Board on a regular basis.

Below the Managing Board, and with the approval of the Euronext Regulators, Euronext has been organized to recognize the distinct lines of business operated by the company. These business lines, which represent Strategic Business Units (SBU), are as follows: Securities, Derivatives, Information Services, and Clearing. Each SBU is run as a distinct business. However, both to ensure coherence across the group and to reflect the fact that some activities are better conducted centrally, a number of group functions have been established, to provide services to all the SBUs. These functions include regulation and compliance/market supervision, although real-time monitoring remains at SBU level. Thus, with respect to Euronext Amsterdam, real-time monitoring of activity on the derivatives market will be conducted by operational staff attached to the derivatives SBU (based in either Amsterdam or London) and post-trade scrutiny will be conducted by the group-wide Compliance and Market Supervision departments, based in Amsterdam, but responsible for activity on all Euronext's continental derivatives markets.<sup>34</sup>

### 2. Euronext Regulators

Euronext is subject to oversight by regulatory bodies in each jurisdiction in which it has established markets, and each market is subject to national law and oversight by the relevant

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<sup>33</sup> The Managing Board serves as the managing board for each of the continental Euronext Markets, as well as for Euronext as a whole.

<sup>34</sup> The SBUs are internal managerial tools and not legal entities, except for LCH.Clearnet SA and LCH.Clearnet Ltd., each of which has its own legal identity. Decisions by Euronext remain the responsibility of the Managing Board and the Supervisory Board of Euronext, as well as the Boards of Directors of the various Euronext Markets.

regulatory authority in that jurisdiction.<sup>35</sup> Notwithstanding the arrangements for cooperation described below, each regulatory authority maintains jurisdiction over its national market, and it is the responsibility of each national regulatory authority to ensure that the market within its jurisdiction discharges fully the obligations imposed upon it by national law and the rules of the regulatory authority. However, in order to facilitate the unification of the Euronext markets, the continental regulators agreed to implement a formal arrangement of cooperation and consultation. These arrangements were set out in a detailed Memorandum of Understanding (MOU). A subsequent MOU was adopted following Euronext's acquisition of LIFFE in order to bring the UK's FSA within the arrangements with respect to derivatives business.<sup>36</sup>

As a result of these cooperation arrangements, the practice for regulatory approvals (for changes to the Rules, for example), is that Euronext will discuss proposals with the college of Euronext Regulators as a whole, and that approval will come from the college on behalf of each regulator. Nonetheless, although Euronext would not anticipate that a national regulatory authority would reject rules approved by the college, each national regulatory authority has the formal responsibility to approve or otherwise sanction rules of its national market, and there are administrative procedures that need to be followed to meet national requirements.<sup>37</sup> Additionally, changes to purely local provisions would be dealt with at the national level rather than through the college.

## B. Regulatory Regime Applicable to All Euronext Markets

Each Euronext market is regulated at national level,<sup>38</sup> but within the framework established by the ISD and other initiatives undertaken by the European Union to create a "single market" in financial services in Europe.<sup>39</sup> The Council Directive of May 10, 1993, on investment services in the securities field<sup>40</sup> had, as its key purpose, the extension to "investment firms" (non-banks) of the "passport" concept introduced in an earlier Directive<sup>41</sup> for banking entities that

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<sup>35</sup> The national regulators are as follows: Commission Bancaire et Financière and the Belgian Minister of Finance (Belgium), Autorité des marchés financiers (France), Netherlands AFM (Netherlands), Comissão do Mercado de Valores Mobiliários (Portugal) and the FSA (UK).

<sup>36</sup> "Memorandum of Understanding on the co-ordinated regulation, supervision and oversight of the Euronext Group" dated March 26, 2002, and "Memorandum of Understanding regarding the co-ordinated regulation and supervision of the derivatives markets operated by the Euronext Group and of Euronext N.V." dated March 6, 2003. The parties to the earlier MOU are the regulatory bodies of Belgium, France, Netherlands and Portugal. The latter MOU includes the UK as well.

<sup>37</sup> For example, the board of the AFM would have to consider formally and approve changes to the rules of the markets operated by Euronext Amsterdam.

<sup>38</sup> As previously noted, the relevant national legislation with respect to Euronext Amsterdam is the Wte.

<sup>39</sup> The obligations and arrangements set out in Directives are binding on Member States, but need to be implemented under national law before they become effective.

<sup>40</sup> As previously noted, a revised version of the ISD, the MiFID, will be implemented in May 2006. As noted, the broad characteristics of the current ISD described in this section will not change materially when MiFID is implemented.

<sup>41</sup> The Second Banking Co-Ordination Directive (2BCD).

enables firms authorized in one Member State to do business in another Member State either through branches or by direct provision of services. Under these arrangements, a firm's home Member State's authorization for it to undertake specified investment business would enable it to undertake that business in other Member States (host Member States) without further authorization in those States.

To enable these arrangements to be put into place, the ISD established certain minimum standards which firms must fulfill before they can be granted a passport.<sup>42</sup> The ISD also made provisions with respect to organized markets established in Member States. It introduced the concept of a "regulated market,"<sup>43</sup> which is defined as an organized market for financial instruments within the scope of the ISD, established in a Member State of the European Union which: (i) is characterized by the fact that regulations issued or approved by the competent authorities define the conditions for the operation of the market and the conditions for access to the market; and (ii) complies with all the reporting and transparency requirements laid down pursuant to the ISD. As previously stated, Euronext Amsterdam is a regulated market under the ISD.

In order to facilitate investment firms' rights under the ISD to engage in investment activity throughout the European Union on the basis of a single authorization, and their right to have access to regulated markets in any Member State, the ISD requires Member States to permit regulated markets established in other Member States to provide "appropriate facilities" (*e.g.*, trading screens) to investment firms in that jurisdiction. Thus any regulated market can provide trading and clearing facilities to firms operating anywhere within the European Union without the need for additional approval by the host Member States. Although the obligations for regulated markets contained in the ISD are high level in nature, they were supplemented by work undertaken by the Forum of European Securities Commissions (FESCO), a body formed by the securities regulators within the European Union, which considered that more complete and more explicit regulatory standards were needed in some areas.<sup>44</sup> Accordingly, they developed and published "Standards for Regulated Markets under the ISD," which adds detail to and supplements the ISD requirements for regulated markets. FESCO members, which include the Euronext Regulators, agreed that they would introduce these standards in their regulatory objectives and, where possible, in their respective rules.

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<sup>42</sup> Most of these standards are set out in the ISD itself; the most important exception is the minimum level of regulatory capital firms must have available, which is set out in the Council Directive on the capital adequacy of investment firms and credit institutions (93/6/EEC).

<sup>43</sup> Derivatives based on physical commodities are outside the scope of the present ISD (though they will be covered in the text of the MiFID), so they would not be included within the concept of regulated markets. In other words, Euronext Amsterdam, Euronext Paris and LIFFE operate both regulated markets (derivatives based on financial instruments and company securities) and other organized markets (physical commodities and other products). In practice, there is no distinction made in the rules or the operational arrangements between the regulated market and other segments of the Euronext markets in terms of regulatory obligations. The major consequence of commodities being outside the scope of the ISD is that activity relating to those contracts will not benefit from the ISD passport and will require authorization at a national level rather than at a European level.

<sup>44</sup> FESCO has now been superseded by the Committee of European Securities Regulators (CESR), a body with a more formal role within the legislative process of the European Union.

## 1. Market Surveillance

The general structure for the monitoring of the Euronext Derivatives Markets and supervision and enforcement of the Euronext Rulebook consists of three layers, Market Operations, Market Supervision, and Compliance. Market operations includes intra-day or real-time monitoring of the markets and is performed by Derivatives Markets Operations, a part of the derivatives SBU, and involves initiating preventive and immediate corrective actions when the functioning of the orderly market is threatened and market rules are breached. Market Operations has the responsibility for monitoring compliance with rules relating to trading activity, including the provisions addressing fraudulent and misleading conduct, on a real-time basis. Potential infringements of the Euronext rules are reported to Compliance for further investigation and, if required, enforcement action by Euronext. Potential cases of market abuse are reported (via Compliance) to the competent regulatory authority (the AFM for Euronext Amsterdam).

Market Supervision is a group-level department that is responsible for the monitoring of trading on all continental markets on a next-day basis. The objectives of this post-trade monitoring include the detection of possible cases of market abuse, such as insider trading and market manipulation, and of possible infringements of the Euronext rules. Again, potential infringements of the Euronext rules are reported to Compliance for further investigation and, if required, enforcement action by Euronext. Potential cases of market abuse are reported (via Compliance) to the competent regulatory authority. Also a group-level department, Compliance is responsible for conducting inspections of members, initiated either as part of a regular audit or by referrals from Market Supervision or Market Operations, claims and complaints, or as a result of other investigations. Identified infringements of the rulebook are handled through the procedures set out in the Euronext Rulebook for the continental markets, discussed below.

## 2. Enforcement of Rules

All the Euronext.liffe markets are required to enforce their rules and do so on the basis of their contractual relationship with their members. If a rule has been violated, Euronext may, among other things, terminate the Member's Euronext membership, suspend the Member's Euronext membership for a period of not more than six months, or suspend some of the Member's trading or membership rights for a period of not more than six months. Euronext may also levy financial penalties for rule infractions. However, because of the constraints posed by the French and the Belgian civil codes, and the insistence of the Euronext Regulators that a common approach should be adopted for all continental markets, the approach agreed to between Euronext and the Euronext Regulators with respect to the continental markets (including Euronext Amsterdam) is that violations of the rules are subject to fixed penalties, and Euronext is not able to take into account factors such as intent or negligence when imposing a financial penalty.<sup>45</sup> Thus, the Euronext Rules specify a fixed financial penalty to be imposed for violations of specific Rules.

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<sup>45</sup> In summary, the legal position of both Euronext Paris and Euronext Brussels is that any arrangements to punish non-compliance must not be capable of being described as disciplinary in nature, for disciplinary action is the sole

## **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 LIFFE CONNECT® directly from Euronext Amsterdam. Additional information relevant to LIFFE CONNECT® and Euronext Amsterdam members will be available to the Commission and its staff under the terms of certain information-sharing arrangements to which both the CFTC and the AFM or the Government of the Kingdom of the Netherlands are parties. These agreements include, without limitation, the *Agreement between the Government of the Kingdom of the Netherlands and the Government of the United States of America on mutual administrative assistance in the exchange of information in futures matters*, dated April 29, 1993, and the *Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations*, as amended March 20, 1998 (commonly known as the Boca Declaration). By email dated May 24, 2005, the legal department of the AFM confirms that the Boca Declaration information-sharing arrangements would extend to information required by the CFTC or the AFM in connection with the placement in the United States of electronic facilities providing access to an AFM-regulated market or products traded through an AFM-regulated market.

## **VI. CONCLUSION**

Consistent with the Commission's June 2 Order, the Division has reviewed and considered Euronext Amsterdam's No-action request and the information and documentation forwarded to the Division in support thereof. Among other things, the materials furnished by Euronext Amsterdam indicate that Euronext Amsterdam does not maintain any office or staff in the United States, other than marketing personnel employed by LIFFE USA Ltd. in New York City and Chicago, and does not 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 Euronext Amsterdam and its members are subject to oversight in the Netherlands by a legitimate regulatory authority that is responsible for ensuring their compliance with an extensive regulatory regime, Euronext Amsterdam adheres to the IOSCO Principles, and the CFTC and the AFM are parties to the Boca Declaration information-sharing arrangements applicable to the activities of Euronext Amsterdam.<sup>46</sup>

Based specifically upon these and other representations made by Euronext and Euronext

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prerogative of public bodies under the respective civil codes. “Disciplinary” measures applied pursuant to contractual arrangements would be unenforceable and invalid under those civil codes.

<sup>46</sup> 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 Euronext Amsterdam 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.

Amsterdam in support of its No-action request, the Division has determined that granting no-action relief to Euronext Amsterdam and its members would not be contrary to the public interest. Accordingly, subject to compliance with the terms and conditions stated herein, the Division will not recommend that the Commission institute enforcement action against Euronext Amsterdam or its members solely based upon Euronext Amsterdam's failure to obtain contract market designation or DTEF registration pursuant to Section 5 or 5a, respectively, of the CEA if: (i) Euronext Amsterdam members trade for their own accounts through LIFFE CONNECT® in the United States; (ii) Euronext Amsterdam members who are registered with the CFTC as FCMs or who are Rule 30.10 Firms submit orders from or on behalf of United States customers for transmission to LIFFE CONNECT®; (iii) Euronext Amsterdam members who are registered with the CFTC as CPOs or CTAs, or who are exempt from such CPO or CTA registration pursuant to Commission Regulation 4.13 or 4.14, submit orders on behalf of United States pools they operate or United States customer accounts for which they have discretionary authority, respectively, for transmission to LIFFE CONNECT®, provided that an FCM or Rule 30.10 Firm acts as clearing firm with respect to all activity conducted by such CPOs and CTAs through the submission of orders on LIFFE CONNECT®; and/or (iv) Euronext Amsterdam members who are registered with the CFTC as FCMs or who are Rule 30.10 Firms accept orders for United States customers transmitted via AORS for submission to LIFFE CONNECT®.

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

- AEX Index® Futures,
- Light AEX Index® Futures,
- U.S. Dollar/Euro Futures,
- Euro/U.S. Dollar Futures, and
- Potato Futures.

If additional futures and option contracts become available for trading through LIFFE CONNECT®, Euronext Amsterdam may make such futures and option contracts available for trading through LIFFE CONNECT® 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.<sup>47</sup>

The scope of the Division's no-action position is restricted to providing relief from the requirement that Euronext Amsterdam obtain DCM designation or DTEF registration pursuant to Sections 5 and 5a of the CEA and regulatory requirements that flow specifically from the DCM designation and DTEF registration requirements if the above-referenced contracts are made available in the United States for trading through LIFFE CONNECT®, in the manner set forth

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<sup>47</sup> 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).

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 Euronext Amsterdam 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.

The Division specifically notes that its no-action position does not alter the general requirement that a firm operating pursuant to the no-action relief provided herein must be appropriately registered or exempt from such registration to engage in the offer or sale of a foreign futures contract or a foreign option transaction for or on behalf of a United States customer. For example, nothing in this letter is intended to alter current Commission rules that require 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 own account) be a registered FCM or a Rule 30.10 Firm. However, if a foreign firm solely carries accounts on behalf of United States customers that are the foreign firm's or any registered FCM's proprietary accounts (as defined in Rule 1.3(y)) or the foreign firm is either a member of the relevant foreign board of trade or is a foreign affiliate of a registered FCM 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 nor confirm relief under Rule 30.10.

Moreover, the Division's no-action position does not amend, revise, or negate the obligations of CPOs, CTAs, 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 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). FCMs or Rule 30.10 Firms who solicit or accept orders from United States customers for trading on LIFFE CONNECT® 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 LIFFE CONNECT® shall be subject to all existing Commission rules and regulations and to any future rules or guidance issued 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, or any other applicable federal securities law or rule promulgated thereunder.

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

- Euronext Amsterdam will continue to satisfy the criteria for recognition as a regulated market under the applicable laws of the Netherlands with respect to transactions effected through LIFFE CONNECT®.

- The laws, systems, rules, and compliance mechanisms of the Netherlands applicable to Euronext Amsterdam will continue to require Euronext Amsterdam to maintain fair and orderly markets; prohibit fraud, abuse, and market manipulation; and provide that such requirements are subject to the oversight of the AFM.
- Euronext Amsterdam will continue to adhere to the IOSCO Principles, as updated, revised, or otherwise amended.
- Only members of Euronext Amsterdam will have direct access (*i.e.*, not through an AORS) to LIFFE CONNECT® from the United States and Euronext Amsterdam will not provide, and will take reasonable steps to prevent, third parties from providing such access to Euronext Amsterdam to persons other than Euronext Amsterdam members.<sup>48</sup>
- All orders that are transmitted through LIFFE CONNECT® by a member of Euronext Amsterdam that is operating pursuant to the no-action relief provided herein will be solely for the member's own account unless (i) such member is registered with the CFTC as an FCM or is a Rule 30.10 Firm, or (ii) such member is registered with the CFTC as a CPO or CTA, or is exempt from such registration pursuant to Commission Regulation 4.13 or 4.14, provided that an FCM or Rule 30.10 Firm acts as clearing firm with respect to all activity conducted by such CPO or CTA through the submission of orders on LIFFE CONNECT®.
- All orders for United States customers accepted through an AORS and transmitted by Euronext Amsterdam members through LIFFE CONNECT® will be intermediated by a Euronext Amsterdam member that is either an FCM or a Rule 30.10 Firm.
- Prior to operating pursuant to the no-action relief requested herein, Euronext Amsterdam will require each current and prospective member that is not registered with the Commission as an FCM to execute and file with Euronext Amsterdam a written representation, executed by a person with the authority to bind the member, stating that as long as the Euronext Amsterdam member operates pursuant to the no-action relief provided herein, the member agrees to and submits to the jurisdiction of the CFTC with respect to activities conducted pursuant to the no-action relief. Euronext Amsterdam will maintain the foregoing representations as long as the relevant member is operating pursuant to the no-action relief and shall make such representation available to the Commission upon the request of a CFTC representative.
- Prior to their operating pursuant to the no-action relief provided herein, Euronext Amsterdam will require each current and prospective member that is not registered with the CFTC as an FCM to execute and file with Euronext Amsterdam 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" issued by or on behalf of the

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<sup>48</sup> 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.

CFTC.<sup>49</sup> Euronext Amsterdam will maintain the foregoing appointments as long as the relevant member is operating pursuant to the no-action relief and shall make such appointments available to the CFTC upon the request of a Commission representative.

- Prior to operating pursuant to the no-action relief provided herein, Euronext Amsterdam will file with the Division of Market Oversight, and maintain thereafter as long as Euronext Amsterdam operates pursuant to the no-action relief, 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 or service of “communications”, as defined above, that are issued by or on behalf of the CFTC.

- Prior to their operating pursuant to the no-action relief provided herein, Euronext Amsterdam will require each current and prospective member of the Exchange that is not registered with the CFTC as an FCM to file with Euronext Amsterdam a written representation, executed by a person with the authority to bind the member, stating that as long as the 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 LIFFE CONNECT® is installed or used in the United States. Euronext Amsterdam will maintain the foregoing representations as long as the relevant member is operating pursuant to the no-action relief. Euronext Amsterdam will make such representations available to the CFTC upon the request of a Commission representative.

- Euronext Amsterdam 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 on LIFFE CONNECT®, the total trade volume originating from LIFFE CONNECT® APIs assigned to each of Euronext Amsterdam’s members in the United States compared with the total worldwide trade volume for such products traded through LIFFE CONNECT® and the total worldwide trade volume for such products traded on Euronext Amsterdam generally; and
- A listing of the names, NFA ID numbers (if applicable), and main business addresses in the United States of all Euronext Amsterdam members that have access to LIFFE CONNECT® in the United States.

- Euronext Amsterdam will promptly provide the Division with written notice of the following:

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<sup>49</sup> 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 by or on behalf of the Commission.

- Any material change in the information provided in its No-action request, including any information contained in the documents submitted in support thereof;<sup>50</sup>
  - Any material change in Euronext or Euronext Amsterdam's Rules or the laws, rules, and regulations in the Netherlands relevant to futures and options;
  - Any matter known to Euronext Amsterdam or its representatives that, in Euronext Amsterdam's judgment, may affect the financial or operational viability of Euronext Amsterdam, including, but not limited to, any significant system failure or interruption;
  - Any default, insolvency, or bankruptcy of any Euronext Amsterdam member known to Euronext Amsterdam or its representatives that may have a material, adverse impact upon the condition of Euronext Amsterdam, LCH.Clearnet SA, or upon any United States customer or firm;
  - Any known violation by Euronext Amsterdam or any Euronext Amsterdam member of the terms or conditions of the no-action relief provided herein; and
  - Any administrative action taken by Euronext or Euronext Amsterdam against any member of Euronext Amsterdam 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 that involves the use of LIFFE CONNECT® or an AORS to submit orders to Euronext Amsterdam and either (i) the Euronext Amsterdam member against whom the administrative action is taken is located or based in the United States or (ii) the administrative action results, in whole or in part, from conduct that: (1) involves the use of a terminal or an AORS that is located in the United States to accept or submit an order for trading through LIFFE CONNECT®; (2) involves a United States customer or firm or registered FCM; or (3) might have a material, adverse impact upon any United States customer or firm.
- Satisfactory information-sharing arrangements between the Commission and the AFM will remain in effect.
- The Commission will be able to obtain sufficient information regarding Euronext Amsterdam and its members operating pursuant to the no-action relief provided herein, and Euronext Amsterdam will provide directly to the Commission information necessary to evaluate the continued eligibility of Euronext Amsterdam or its members for the relief, to enforce compliance with the terms and conditions of the relief, or to enable the Commission to carry out

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<sup>50</sup> 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: Euronext Amsterdam's membership criteria; the location of Euronext Amsterdam's management, personnel, or operations (particularly changes that may suggest an increased nexus between Euronext Amsterdam's activities and the United States); the basic structure, nature, or operation of LIFFE CONNECT®; or the regulatory or self-regulatory structure applicable to Euronext Amsterdam members.

its duties under the CEA and Commission regulations and to provide adequate protection to the public or United States contract markets.

- Euronext Amsterdam will employ reasonable procedures, to be determined by Euronext Amsterdam, 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 Euronext Amsterdam'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 Euronext Amsterdam's activities in the United States to ascertain whether Euronext Amsterdam'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 Euronext Amsterdam 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 Euronext Amsterdam will be subject to those rules or guidelines in that event.

If you have any questions regarding this correspondence, please contact Duane C. Andresen, an attorney on my staff, at [dandresen@cftc.gov](mailto:dandresen@cftc.gov) or by phone at (202) 418-5492.

Very truly yours,

Richard A. Shilts  
Director

cc: Robbert Booij, the Netherlands Authority for the Financial Markets  
Arthur W. Hahn, Esq., KMZ Rosenman  
Gregory C. Prusik, Vice-President Compliance and Registration, NFA  
Branch Chief, Audit and Financial Review Unit, Division of Clearing and Intermediary Oversight, Chicago Regional Office