

CFTC Letter No. 99-69

No-Action

November 12, 1999

Division of Trading & Markets

VIA FACSIMILE and U.S. MAIL

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25 West Monroe Street
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Chicago, IL 60661-3693

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

Dear Mr. Hahn:

This is in response to your letter dated May 14, 1999 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("CFTC" or "Commission"). By this correspondence, you request, on behalf of The International Petroleum Exchange of London Limited ("IPE" or "Exchange") and its members,^[1] that the Division grant no-action relief to permit IPE to make its electronic trading and order matching system, known as Energy Trading System II ("ETS"), available to IPE members in the United States^[2] ("No-Action Request"). Specifically, IPE wishes to make ETS available to: (i) IPE members who wish to trade for their proprietary accounts^[3] through ETS; (ii) IPE members who are registered with the CFTC as futures commission merchants ("FCMs") or are exempt from such registration pursuant to Rule 30.10 ("Rule 30.10 Firms")^[4] and who wish to submit the orders of United States customers^[5] to ETS; and (iii) IPE members who are registered with the CFTC as FCMs or who are Rule 30.10 Firms and who wish to accept orders from United States customers through automated order routing systems ("AORSs")^[6] for submission to ETS. You request that the Division confirm that it will not recommend enforcement action to the Commission against IPE or its members if IPE does not seek designation as a contract market pursuant to Sections 5 and 5a of the Commodity Exchange Act ("CEA" or "Act")^[7] or comply with those Commission regulations that specifically relate to contract markets in connection with the installation and use in the United States of ETS and/or AORSs that are used to submit orders to ETS.

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 electronic trading devices in the United States.^[8] On June 2, 1999, the Commission issued an order that withdrew those rules and directed the Commission staff to begin considering requests from foreign exchanges for

interim no-action relief to allow them to place trading systems in the United States on a temporary basis until the Commission itself promulgates rules or guidelines in this area ("June 2 Order").^[9] In accordance with this instruction, the Division has reviewed IPE's No-Action Request and the materials submitted in support thereof. Among other things, IPE forwarded the following information to the Division:

- General information regarding IPE (*e.g.*, a description of its location, organization, and activities in the United States);
- IPE's Memorandum and Articles of Association;
- The specifications of the contracts traded on IPE;
- IPE's Floor Membership Application;
- A description of ETS and a copy of the ETS User Agreement;
- A description of the trade registration, settlement, and clearing systems applicable to ETS;
- IPE's Regulations and Floor and ETS Trading Procedures;
- IPE's Registered Electronic Trader Training Manual and Workstation User Guide;
- Selected provisions of the Financial Services Act 1986, Part VII of the Companies Act 1989, and the Financial Services and Markets Bill^[10] relating to Recognized Investment Exchanges;
- A description of the regulatory regime in the United Kingdom applicable to the operation of IPE, ETS, transactions executed on IPE; transactions executed through ETS; and IPE and ETS participants;
- IPE's Regulatory Plan; and
- A description of certain applicable information-sharing arrangements.

Representations made by IPE regarding the activities conducted from IPE's representative office in the United States, IPE's membership criteria, the ETS system, the relevant regulatory regime in the United Kingdom, and the information-sharing arrangements applicable to ETS are summarized in Sections I - V below. For purposes of its response to the No-Action Request, the Division has relied upon IPE's representations and has not conducted an independent review to confirm their accuracy.^[11]

I. GENERAL INFORMATION REGARDING IPE

IPE is the largest-volume energy futures and options exchange in Europe. The Exchange offers contracts in Natural Gas (NBP) futures,^[12] Gas Oil futures and options, Fuel Oil futures, and Brent Crude Oil futures and options. Traditionally, IPE has been a floor-based market, with trading occurring through an "open outcry" auction process. IPE launched the original ETS in January 1997 to trade Natural Gas (NBP) futures contracts. IPE began using a refined version of ETS for trading the same contracts in February 1999. Currently, Natural Gas (NBP) futures contracts are traded solely through ETS. All other contracts continue to be traded through open outcry on the floor of IPE. Commencing in March 2000, IPE will offer Gas Oil futures and options contracts and Fuel Oil futures contracts for trading through ETS during specified periods before and after, but not concurrent with, the open outcry trading hours on IPE for such contracts. Brent Crude Oil futures and option contracts will be available for after-hours

trading through ETS beginning in June 2000. IPE has received approval from the relevant regulatory authorities to place ETS Workstations^[13] in several European countries.^[14]

IPE is a member-owned, not-for-profit organization that was formed in the United Kingdom in 1980. Its principal business office is located in London, but it maintains a single, representative office in the United States. IPE's United States office is located in New York, New York and employs two persons. The purposes of this office are to provide information regarding the Exchange and its contracts to current and potential U.S.-located IPE members, traders, and customers as well as customer service and support. The New York office staff generally achieves these objectives through various educational and marketing endeavors (*e.g.*, attending and participating in conferences, hosting corporate events, and preparing and distributing research and reports on the industry).^[15] IPE represents that the New York office staff does not provide investment advice nor solicit, receive, or direct orders with respect to the products traded on IPE. IPE further represents that no trade processing or clearing functions are performed by IPE in the United States.

IPE also operates an Internet web site located at www.ipe.uk.com. The purpose of IPE's web site is to provide visitors with the specifications of the contracts available for trading on the Exchange and other information regarding IPE's products.

II. MEMBERSHIP

A person may not trade directly upon ETS, unless the person becomes a member of the Exchange. IPE has established three classes of membership: (i) Floor Members; (ii) Local Floor Members; and (iii) Trade Associate Members ("TAMs"). All IPE members are required to comply with the Exchange's membership criteria through the duration of their respective memberships.^[16] IPE members also are required to sign an agreement prescribed by the Exchange's directors in which they agree to be bound by IPE Regulations insofar as they relate to the members' class of membership. IPE members may engage in trading through ETS to the extent that they are either authorized to do so pursuant to United Kingdom law, or are exempt from the authorization requirement.^[17]

Floor Members are the Exchange members that may transact business on IPE both on their own behalf and on behalf of their customers. To become a Floor Member, an entity must, among other things: (i) be a firm or company; (ii) maintain a properly established office in or sufficiently close to London for the conduct of business on IPE; (iii) have a minimum net worth of £500,000 (\$820,539);^[18] (iv) be a member of the Securities and Futures Authority ("SFA");^[19] and (v) be a Clearing Member of the London Clearing House Limited ("LCH")^[20] or satisfy IPE that it is a party to a clearing arrangement with a clearing member of LCH.^[21]

Local Floor Members are permitted to trade for their proprietary accounts or on behalf of Floor Members and other Local Floor Members, but not directly on behalf of customers. A Local Floor

Member must, among other things: (i) confirm to IPE that it is an individual or a closely-held entity; (ii) have a net worth sufficient to establish a clearing arrangement; (iii) be a member of the SFA; and (iv) be a party to a clearing arrangement with an LCH Clearing Member.

TAMs are sub-divided into two classes of membership. One class of TAMs may trade only Natural Gas (NBP) futures contracts and may trade such contracts solely as principals for their own accounts. They have no voting rights. A smaller number of TAMs have neither voting nor trading rights. The sole purpose of their membership is to maintain close contact with IPE (*i.e.*, to ensure that they receive Exchange information circulars and publications). To qualify as a TAM, an entity must: (i) be able to demonstrate a bona fide, continuing interest in the production, processing, manufacture, distribution, trading, or use of physical energy products; (ii) generally have participated in the physical energy business for a sufficient period of time to ensure IPE that the TAM is an appropriate customer for the Exchange and have adequately satisfied the standards for business conduct in that industry; (iii) have a net worth of £100,000 (\$164,108); and (iv) establish a clearing arrangement with a clearing member of LCH.

Clearing Members of IPE are subject to higher financial resource requirements than those set forth above. The enhanced financial qualifications have been established by IPE in conjunction with LCH^[22] and vary depending upon the person(s) for whom the Clearing Member clears. Clearing Members that clear only for their proprietary accounts are required to have a minimum net worth of £500,000 (\$820,539). Clearing members that clear only for their proprietary accounts, customer accounts; and/or for Local Floor Members must have a minimum net worth of £1,000,000 (\$1,641,077). Clearing members that clear for their proprietary accounts, customer accounts; Local Floor Members, and other IPE members must have a minimum net worth of £2,000,000 (\$3,282,083). IPE Members are required to submit financial returns to the Exchange to demonstrate ongoing compliance with their financial obligations. IPE shares such information, where appropriate, with LCH, the FSA, and regulators in the United Kingdom and elsewhere.

IPE membership is open to natural persons, partnerships, and corporate entities that satisfy the membership criteria, regardless of the location of the entity or the type of business in which the entity is engaged. However, IPE membership is restricted to bona fide commodity professionals. Accordingly, IPE represents that United States retail customers could not become members of the Exchange. IPE's Directors retain the absolute discretion to approve or disapprove an applicant for membership, subject to the applicant's rights to reconsideration and appeal. The Exchange's Directors also retain the authority to expel a member from membership or to suspend any or all of a member's membership rights.

III. OVERVIEW OF ETS

A. Technical Aspects of ETS

1. Introduction

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

2. ETS Architecture

a. Components

ETS is an open system that does not require dedicated terminals to operate. IPE provides its members with certain components of the system, while requiring them to purchase other elements. Specifically, the Exchange supplies the central order processing facilities of the system, known as the "Trading Host;" the local area network ("LAN"); the front-end trading application software ("Trading Application"); and certain hardware and software through which the Trading Application communicates with the Trading Host. IPE members that wish to utilize ETS must purchase their own Windows NT workstations ("ETS Workstations")^[23] and leased lines.

b. Trading Host

The Trading Host performs the security, order processing, and connection monitoring functions of the ETS system. Among other things, the Trading Host maintains a database of currently authorized ETS Traders, validates a trader's authority to trade on ETS, processes and records all orders, validates requests for order modifications and cancellations, matches orders, maintains the central order book, sends market broadcast data messages to ETS Workstations, and monitors the performance of the system connections between the Trading Host and the ETS Workstations. IPE represents that the Trading Host underwent comprehensive business and technical testing before it was declared operational.

c. Trading Application

The Trading Application is the front-end trading application software that runs on an ETS Workstation. The Trading Application itself does not perform any services. Rather, it serves as the interface between the services provided by the Trading Host and the ETS Workstation. Currently, IPE Members must purchase and use the Trading Application offered by IPE. They may not use self-developed Trading Applications or Trading Applications that have been purchased from independent software vendors.

d. Network

ETS is based upon an Ethernet LAN maintained at one of IPE's satellite offices in London. An Ethernet LAN and attached ETS application servers that act as a back-up to the main servers at this office are maintained at a different satellite office in London. IPE represents that the ETS network is operated to achieve at least 99.98% availability.

e. ETS Workstation

Although IPE members are responsible for purchasing their own ETS Workstations, IPE requires that such workstations satisfy certain minimum specifications established by the Exchange. For example, IPE generally requires that the ETS Workstations adhere to prescribed levels of processing speed, megabyte RAM, and disc capacity.

3. Access to ETS

An IPE member who wishes to trade through ETS must do so through one or more traders that have been registered with IPE and have been granted the right to trade through ETS ("ETS Traders").^[24] Members are required to have a sufficient number of ETS Traders for the nature and the volume of business they conduct.^[25] Persons wishing to become ETS Traders must satisfy certain requirements. Among other things, an ETS Trader must:

- be either:
 - a trader employed by or representing a Floor Member or a Local Floor Member or
 - an individual Local Floor Member;
 - be a member of the SFA (unless the ETS Trader is a TAM);
 - be "fit and proper," as determined in accordance with SFA rules;
 - be authorized as an ETS Trader by the FSA;
- complete a training program and pass a competency examination;^[26]
- obtain a certification from a compliance officer of the IPE member for whom he will be trading that states that the Exchange member has authorized the ETS Trader to trade on its behalf;
- be able to obtain the use of the ETS Workstation of the member for whom he trades;
- ensure that his staff is adequately trained and properly supervised; and
- be authorized to adjust or withdraw any order submitted under his Individual Trader Mnemonics ("ITMs").^[27]

ETS Traders must use the ETS system in accordance with the ETS User Agreement and Workstation User Guide and comply with all IPE Regulations. A person's status as an ETS Trader may be suspended or revoked as a result of disciplinary action taken under IPE Regulations.

ETS includes security mechanisms designed to prevent unauthorized access to the system.^[28] An ETS Trader cannot enter an ETS Workstation and hence, the Trading Host, until he inputs the unique user name that has been assigned to him by an IPE Supervisor^[29] and his eight-character password. The user name is derived from the ITM assigned to the ETS Trader by the Trading Host. IPE requires ETS Traders to alter their passwords no less frequently than every thirty days. Passwords are encrypted at the point of entry.

4. Order Processing System

ETS accepts several types of orders for execution, including limit orders, cross trade orders,^[30] stop limit orders, fill or kill orders, and intra-commodity spread orders. ETS will match new and standing orders if. (i) one order is a buy order and the other order is a sell order; (ii) the two orders are for the same contract, the same delivery month, and, in the case of options, the same exercise price; and (iii) the price of the buy order is equal to or better than the price of the sell order. If all of the foregoing criteria are satisfied, ETS will determine the trade quantity executed in the transaction based upon the lower of the quantity of the new order or the remaining quantity of standing order(s) in the market at the time the new order is placed.

ETS utilizes the same trade matching algorithm for all contracts traded on IPE. The algorithm is a first-in, first-out ("FIFO") system that matches orders in a strict time and price sequence. Specifically, the "oldest" order in the system at a given price has a higher priority and is filled prior to any subsequently placed orders at the same price. Once a standing order is completely filled, the remaining orders will be filled based upon the time of entry of the order, in accordance with the FIFO algorithm. Thus, older orders are favored; newer orders are filled only if sufficient volume remains. The time associated with an order is the time of its arrival at the Trading Host, not the time it is submitted at the ETS Workstation.

5. Trade Registration and Clearing, Processing Systems

IPE's trade registration system ("TRS") and clearing processing system ("CPS") are real-time trade administration systems that provide integrated trade registration and clearing facilities for both IPE's open outcry and ETS markets. During the initial phases of ETS, while contracts continue to be traded on the IPE floor, clearing and settlement functions will continue to be carried out by clearing members in London on behalf of IPE members located outside of the United Kingdom. IPE intends to develop a new Windows-based application program interface ("API") for TRS and CPS that will support a PC application and will provide essentially the same functions of the existing TRS and CPS. When the API becomes available, members located outside of the United Kingdom who wish to gain direct access to IPE's clearing and settlement facilities may do so via ETS.

The clearing process starts with the entry of the details of an executed trade into TRS. Trades affected upon ETS are matched automatically and entered into TRS as matched trades. By using TRS terminals, IPE members can check their trading activity and the status of individual trades and may complete registration by assigning trades to the correct account for margining and position-keeping, adding account references, and allocating or claiming trades.^[31] Although full counterparty information is passed to TRS, this information will not be displayed upon users' terminals, to ensure post-trade anonymity. IPE requires that trades be processed completely (including the allocation, claim, and assignment of the trade) within thirty minutes of trade execution, so that all trades will be fully registered thirty minutes after the market closes. IPE members are required to ensure that at least one member of their staff that possesses the authority to resolve mismatches and/or misallocation remains on duty until thirty minutes after the close of the trading of a contract on ETS.

CPS provides position maintenance and clearing functions for IPE members. It carves out end-of-day

processing and transmits the details of matched trades to LCH for registration. LCH will receive the details of the instructions IPE members have submitted to TRS and CPS, details of settlement prices, margin data, members' full margin reports, clearing member reports, and open interest reports. LCH settles and clears all trades executed on ETS by the end of the relevant trade date.

6. Audit Trail

IPE members are required to maintain proper and complete accounting and other records relating to all contracts made, whether such contracts are for the member's proprietary or customer accounts. Separate accounts must be kept with respect to each customer and all orders and accounts must be given a unique and clearly identifiable reference. Members must keep daily records of open positions.

ETS Registered Traders must ensure that an order received from a customer for execution on ETS, whether such order is received before or in the course of the ETS trading session, is recorded on an order slip.^[32] ETS Traders must time-stamp all order slips immediately upon receipt on a time-stamping machine that is unique to the IPE member for whom it trades and that is adjacent to the member's ETS Workstation.^[33] The order must be time-stamped again if it is altered, executed, or cancelled by the customer or if it is transmitted to another location before being shown to the market. In addition, orders sent through ETS are time-stamped by the system itself.

Order slips relating to business transacted on ETS must contain the following information: IPE member identification; a client identifier or reference; whether the trade is for the house or a customer account (if known); the identity of the person completing the slip; the ITM under which the order is being submitted; whether the order is to buy or to sell; the contract; contract month; quantity; price, price limit, or price range; and any other order instructions (*e.g.*, order type, price/quantity specification). If the order is an option, the order slip must note whether it is a call or put option and the exercise price. Order details must be retained by IPE members for no less than three years after the date of the transaction. All telephone conversations by ETS Traders with respect to business done on ETS must be conducted on audio-logged lines. Recordings of audio-logged lines must be retained by IPE members for a period of no less than three months after the date of the recording. IPE has full access to the audit trail information described above in order to satisfy itself that appropriate procedures and controls are in place with respect to business conducted on ETS.

7. System Response Times

IPE represents that the Trading Host and network have been designed and sized to process ETS transactions (under normal conditions) in under two seconds. The system sizing includes contingencies for substantial growth in product range and for trading volume that significantly exceeds currently-projected levels. IPE further represents that the network has been constructed to ensure that, as far as is physically possible, no one network connection is disadvantaged over another and that response times across borders will be equivalent. IPE will not accept cross-border response times that vary by more than .01 second.

8. Reliability

IPE has identified certain areas in which the ETS system may fail and has adopted specific remedial procedures. In the event of the failure of a leased kilostream line, ISDN line, central site router, customer router, or central site server, IPE's Network Monitoring Centre ("NMN") would be notified immediately and the NMN would take appropriate measures to correct the problem. IPE anticipates that all such difficulties will be resolved within four hours of occurrence. In the event that an ETS Workstation at an IPE member firm's office failed, IPE customers would be responsible for repairing or replacing all hardware and non-ETS software. However, IPE would provide additional ETS software, as necessary, after the workstation has been repaired or replaced.

ETS Traders would be alerted to a major failure of the Trading Host through a system error message shown on their ETS Workstations. In this event, all orders would be held as inactive until the Trading Host was restarted. Generally, the market would be re-opened following the procedures that are followed at the start of a normal trading day. If a Trading Application or its link to the Trading Host fails, the ETS Trader would be permitted to transfer his order to any replacement trader with whom he has an arrangement to share order books and the replacement trader would be permitted to trade in his stead. If the ETS Trader did not have such an arrangement, his orders would be deactivated.

B. IPE's Year 2000 Program

IPE is using the British Standards Institute DISC Compliance Standard for Year 2000 ("Y2K") Compliance which has been adopted by a majority of United Kingdom companies as their Y2K compliance testing benchmark. The IPE's "core" systems (*i.e.*, systems that are involved in the ability to service IPE members and their customers) have been successfully tested by IPE, LCH, and a representative sample of twelve IPE members. IPE's "non-core" systems (*i.e.*, internal systems that affect the effectiveness of IPE) have been successfully unit and integration tested. ETS was developed as a Y2K compliant system and was fully and successfully integration tested in June 1999. IPE has required its members to certify that their own electronic systems have been tested for Y2K compliance and that any problems that were discovered during those tests have been corrected. IPE members must also agree to perform additional testing on January 1, 2000 and the Exchange will not permit members to access ETS until such testing is complete. IPE submitted the results of its Y2K testing to the FSA and the FSA announced that it was satisfied with the results in September 1999.

C. Adherence to IOSCO Principles

IPE represents that it employed the expertise of industry specialists during the design, building, and implementation of ETS to ensure that the resulting system infrastructure would follow best industry practice and quality standards. It also represents that, in developing and operating ETS, IPE has adhered to, and will continue to adhere to, the Principles for the Oversight of Screen-Based Trading Systems for Derivative Products developed by the Technical Committee of the International Organization of

Securities Commissions ("IOSCO Principles").^[34] In connection with the FSA's exercise of its oversight of IPE as a Recognized Investment Exchange ("RIE"), IPE has satisfied the FSA that the arrangements for ETS and its use of the technology employed by that system are satisfactory.

D. Demarcation of Responsibility and Liability

Due to the open nature of the ETS system, it is likely that most, if not all, trading activity on ETS will occur away from IPE's direct oversight and control and that the roles assigned to particular individuals at a member's site may differ considerably both from member to member and from the traditional roles on a market floor. IPE requires that its members ensure that all persons on the member's staff sufficiently understand the manner in which ETS operates to perform their assigned roles effectively. IPE members and certain persons on their staff also are responsible for ensuring that: (1) the arrangements for conducting IPE business are consistent with IPE Regulations and (ii) all business conducted by way of such arrangements is consistent with IPE Regulations. IPE may institute disciplinary action against and impose sanctions upon both Exchange members and/or their ETS Traders should they fail to perform these duties. IPE Regulations stipulate that neither IPE nor its officers, employees, agents, or representatives may be held liable to an IPE member or customer for any loss or damage arising from or in connection with the occurrence of a suspension or closure of IPE or a disruption in ETS service, regardless of cause.

IV. OVERVIEW OF THE REGULATORY STRUCTURE IN THE UNITED KINGDOM

A. Introduction

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

The principal legal provisions for investor protection in the United Kingdom's financial services sector are contained in, or derived from, the Financial Services Act 1986 ("FS Act") and the FSA fulfills its regulatory responsibilities within the framework established by that Act and related legislation.^[35] The FSA also has established Statements of Principle ("FSA Principles") that set forth universal standards of practice, including standards relating to internal organization; the financial resources, integrity, skill, care, and diligence of market participants; customer assets; conflicts of interest; market practice;

information about customers; information for customers; and relationships with regulators.^[36]

The Division notes that the Commission previously reviewed the regulatory regime administered and enforced by the FSA applicable to transactions on United Kingdom exchanges in connection with the relief it granted to the FSA's predecessors in 1989. On May 19, 1989, the Commission issued orders pursuant to Rule 30.10 that granted exemptive relief to the members of the Association of Futures Brokers and Dealers ("AFBD"), The Securities Association ("TSA"),^[37] the Investment Management Regulatory Organization ("IMRO"), and the SIB to permit such members to solicit and accept orders from United States customers for otherwise permitted transactions on non-United States exchanges that are "Designated Investment Exchanges."^[38] In each of these orders, the Commission noted that the standards for relief set forth in Rule 30.10^[39] generally had been satisfied by each of the petitioning regulatory authorities, and compliance by the Rule 30.10 Firms with applicable United Kingdom law and the rules of the respective petitioning authority could be substituted for compliance with certain provisions of the CEA and the Commission's rules set forth in the Commission's orders.^[40]

B. Regulation of the IPE as an RIE

IPE is an RIE^[41] under the FS Act and, as such, is exempt from the requirement that it be "authorized" to conduct "investment business"^[42] in the United Kingdom in relation to the operation of its markets.^[43] However, to acquire recognition status, IPE was required to satisfy several statutorily-prescribed recognition requirements. IPE must continue to fulfill these obligations in order to maintain its recognition status. Among other things, IPE is required to: retain specified financial resources; operate its markets with due heed to the protection of investors and to ensure that trading is conducted in an orderly and fair manner; maintain suitable arrangements for trade reporting; maintain suitable arrangements for the clearing and settlement of contracts;^[44] monitor compliance with its rules; enforce its rules; investigate complaints with respect to its business; maintain rules to deal with the default of its members; cooperate with other regulatory bodies through the sharing of information or otherwise;^[45] maintain high standards of integrity and fair dealing; and prevent abuse. The FSA has produced a formal interpretation of the statutory recognition requirements that sets forth the meaning of those obligations in practical terms.

The FSA is the authority charged with ensuring that RIEs, such as IPE, continue to comply with the recognition criteria and is authorized to de-recognize any RIE that fails to meet the statutory recognition requirements. Accordingly, IPE is subject to the oversight of the FSA. The FSA exercises its supervisory responsibility by conducting an ongoing assessment of whether IPE's rules, procedures, and practices are adequate for the protection of investors and for the maintenance of an orderly market. For this purpose, the FS Act requires IPE to report changes in its rules and procedures to the FSA within seven days of such amendments becoming effective. In practice, IPE notifies the FSA of significant changes to its rules or procedures before such changes become effective. IPE is also required to produce an annual regulatory plan detailing its intended regulatory activities over the succeeding twelve months. IPE has

never been declared to be in breach of its regulatory responsibilities.

C. Regulation of IPE Members

Because trading through ETS constitutes the carrying on of investment business in the United Kingdom, most United Kingdom-based members of the IPE that trade through ETS are required to be authorized under the FS Act.^[46] To obtain authorization, an applicant must satisfy the FSA that it is "a fit and proper person" to carry on investment business and to provide the financial services in which it intends to engage. In addition, most IPE members that trade through the ETS are subject to the rules of an SRO.^[47] Because IPE requires its Floor Members and Local Floor Members to be members of the SFA, a majority of IPE members are subject to rules imposed by the SFA.

SFA members are required to be "fit and proper persons" to carry out investment business. In evaluating a membership applicant's fitness, the SFA may consider a variety of factors, including the applicant's integrity, honesty, competence, and financial soundness. The directors, employees, or representatives of firms whose activities include managing investments, procuring persons to enter investment agreements, or giving advice on investment agreements must be registered with the SFA as registered representatives and, with limited exception, have passed an SFA-required examination.^[48] The SFA also imposes, among other things, fitness standards; financial resource requirements (that are designed to reflect, among other things, the firm's position risk and its exposure to counterparties); sales practice rules (*e.g.*, rules governing the responsibility of a firm for its employees and agents; the suitability of investment products for private customers; solicitation, advertising, and publishing; the contents of customer agreements; the disclosure of risks, material interests, and charges and other remuneration; and the handling and recording of customer complaints); rules designed to ensure the integrity of the market (*e.g.*, rules regarding best execution, customer order priority, and customer order allocation; restricting the offer of illiquid or off-market investments; prohibiting members from trading ahead of customers; and prohibiting the churning of accounts and switching of contracts); and reporting and recordkeeping requirements.^[49] The SFA further requires the maintenance of compliance procedures. The FSA may impose disciplinary actions and levy fines for violations of these requirements.

D. IPE's Regulations and Trading Procedures

All trading on IPE through ETS must be conducted in accordance with IPE Regulations and the rules of LCH. IPE Regulations are applicable to IPE members without regard to jurisdictional boundaries because the obligations thereunder arise by virtue of the contractual relationship between the Exchange and its members. IPE Regulations are designed to enable the Exchange to fulfill its recognition obligations, including the requirement that it ensure that its market is fair and orderly and is operated with due regard to the protection of investors. IPE Regulations are also intended to impose the FSA Principles and other regulatory guidance issued by the FSA that is relevant to IPE's business. Members and each of their respective ETS Traders are subject to disciplinary action for failure to comply with IPE Regulations. Disciplinary action may result in fines, suspension, expulsion, or unlimited fines. Members

are responsible for the actions of their ETS Traders. Firms that cease to be members of IPE and ETS traders who are de-registered remain subject to IPE's disciplinary jurisdiction for one year afterwards or for as long as disciplinary proceedings continue.

IPE Regulations contain both substantive provisions relating to membership requirements and trading and procedural provisions relating to discipline, arbitration, and the default of members. Among other things, IPE regulations prohibit fraud and market manipulation and require IPE members to: (i) satisfy minimum financial resource requirements;^[50] (ii) observe high standards of integrity, fair dealing, and market conduct; (iii) act with due skill, care, and diligence; (iv) avoid or manage conflicts of interest; (v) record all details of customer orders, execute customer orders promptly (except where otherwise permitted by IPE Regulations), and submit details of customer trades to IPE for registration and clearing; (vi) maintain accounting and other records sufficient to create an audit trail with respect to IPE business; (vii) submit financial statements on a regular basis; (viii) address customer complaints; (ix) take such steps when a customer defaults as are open to the member to reduce the customer's liability; and (x) ensure that the appropriate procedures and controls are in place with respect to the business the member conducts. IPE Regulations also generally prohibit any member from committing any act or engaging in any conduct likely to bring the IPE into disrepute or otherwise be substantially detrimental to the interests of the exchange.

United Kingdom law requires that RIEs, such as IPE, and RCHs, such as LCH, maintain rules that allow the RIE or RCH to declare a member to be a defaulter and to close out all open positions on the market. Market authorities are not required to wait for the commencement of formal insolvency proceedings to declare a default if they possess a good faith belief that the member will be unable to meet its future obligations under market contracts.^[51] Accordingly, IPE has promulgated rules that delineate the procedures to be followed by IPE in the event of default. However, LCH's default rules take precedence over IPE's default rules with respect to contracts to which LCH is party. If, therefore, a clearing member were to default, LCH would apply its default rules to the registered contracts, while IPE would deal with the back-to-back contracts between the defaulting clearing member and its customer and the non-clearing members for which it clears. Were a non-clearing member to default, only IPE's default rules would apply. The default rules of both LCH and IPE set forth, among other things, the circumstances under which the respective authority may declare a member to be in default, the actions that the authority may take in the event of default, the type of resources that may be used to satisfy the defaulting member's obligations, and the sequence in which such resources may be used.

IPE has appointed two principal officers (collectively, "IPE Supervisors") to monitor compliance by IPE members with Exchange Regulations as they relate to trading on ETS from the United States or on behalf of United States customers. They are supported by a team of compliance assistants and a market supervision team that monitors both open outcry and electronic trading in real time. At least one IPE Supervisor or his qualified designee is available at all times IPE is open for trading to offer clarification or advice with respect to IPE Regulations.

IPE has granted IPE Supervisors real-time access to information regarding its member firms (*e.g.*, order

books) to help ensure that trading is conducted in accordance with IPE Regulations. IPE Supervisors continually monitor all user activity on a real-time basis. IPE Supervisors are authorized by the Exchange to take the necessary measures to confirm that IPE members are in compliance with Exchange Regulations,^[52] including logging off and disabling ETS users' access at the network and trader/supervisor level. If a user is logged off, all open orders for that user are cancelled and purged from the system. If a user's name and password are disabled, the user will be prohibited from logging on to the system absent Exchange approval.

IPE's compliance and regulatory functions are overseen by its Business Conduct Committee ("BCC"). The BCC is required to appoint at least one Compliance Officer responsible for monitoring compliance with and investigating alleged breaches of IPE Regulations. The Compliance Officer and his department both investigate suspected misconduct that has been reported to them^[53] and identify suspicious trades or patterns. In order to facilitate its investigations, the Compliance Department will analyze, among other things, data held on IPE's computer systems; members' trade paperwork; and relevant audio, video, and telephone logs. If the Compliance Officer forms the provisional conclusion that a breach of IPE Regulations has occurred, he reports the alleged breach to the BCC which may authorize an investigation into alleged infringement. The BCC also is empowered to investigate any disorders on IPE and other events or practices that may impair the orderly conduct of the Exchange or the performance of the contracts that are traded on the Exchange. All IPE members are required to cooperate with such investigations. The panel investigating such incidents is required to submit a written report, including its recommendations to IPE's directors or the BCC. The directors or BCC may commence disciplinary proceedings, refer the matter back to the original or a new investigation panel for further inquiry, issue a warning, or decide that no further action should be taken. If allegations of non-compliance with IPE Regulations are upheld, the Disciplinary Panel may impose anyone or a combination of the following sanctions: a private warning or reprimand; a notice of censure; disqualification of the member or any of its partners, directors, employees, or associates from being a director or member of a committee or panel of the Exchange for a definite or indefinite period; suspension or curtailment of market access for a definite or indefinite period; a recommendation to the directors that any or all of the member's rights of membership be suspended; a recommendation that the member be expelled from membership; and an unlimited fine.

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 ETS directly from IPE. Additional information relevant to IPE and IPE and ETS participants will be available to the Commission and its staff through certain information-sharing arrangements to which both the CFTC and the FSA or the SIB are parties. These include, without limitation, the Memorandum of Understanding ("MoU") on Mutual Assistance and the Exchange of Information between the United States Securities and Exchange Commission and the CFTC, and the United Kingdom Department of Trade and Industry and the SIB dated September 25, 1991 and the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations, as amended, March 1998 (commonly

known as the "Boca Declaration").^[54]

VI. CONCLUSION

Consistent with the Commission's June 2 Order,^[55] the Division has reviewed and considered IPE's No-Action Request and the information and documentation forwarded to the Division in support thereof. Among other things, the materials furnished by IPE indicate that IPE has a single, representative office in the United States, but that the staff of that office does not provide investment advice nor solicit, receive, or direct trading orders from that office; IPE does not maintain order matching or clearing facilities in the United States; IPE is an RIE under the laws of the United Kingdom; IPE, ETS, and IPE and ETS participants are subject to oversight in the United Kingdom by a legitimate regulatory authority that is responsible for ensuring their compliance with an extensive regulatory regime; ETS adheres to the IOSCO Principles; and the CFTC and the FSA are parties to various information-sharing arrangements applicable to ETS participants and activities involving ETS.^[56]

Based specifically upon these and other representations made by IPE in support of its NoAction Request, the Division has determined that granting no-action relief to IPE and its members, pending the adoption by the Commission of rules or guidelines regarding access to foreign boards of trade from electronic trading devices in the United States, would not be contrary to the public interest. Accordingly, subject to compliance with the terms and conditions stated herein, the Division will not recommend that the Commission institute enforcement action against IPE omits members solely based upon IPE's failure to obtain contract market designation pursuant to Sections 5 and 5a of the CEA, if: (i) IPE members trade for their proprietary accounts through ETS in the United States; (ii) IPE members who are registered with the Commission as FCMs or who are Rule 30.10 Firms submit orders from United States customers for transmission to ETS; and/or (iii) IPE members who are registered with the Commission as FCMs or who are Rule 30.10 Firms accept orders through United States AORSs from United States customers for submission to ETS.

The Division's no-action position is only applicable to the contracts described below, and shall become effective with respect to such contracts as follows:

(i) The relief is effective immediately with respect to the:

- Natural Gas (NBP) Daily futures;
- Natural Gas (NBP) Monthly futures; and
- Natural Gas (NBP) Balance-of-the-Month futures contracts.

(ii) The relief will become effective with respect to the following contracts immediately upon such contracts becoming eligible for trading on ETS:

- Gas Oil futures and options;

- Fuel oil futures; and
- Brent Crude futures and option contracts.

If additional contracts or products become available for trading through ETS and IPE wishes to make such contracts or products available in the United States through ETS, IPE must request in writing and receive supplementary no-action relief prior to offering such contracts or products. In the event that a supplemental request for relief is made by IPE, IPE will not be required to submit materials already received by the Division in connection with the No-Action Request addressed herein, unless there has been a material change in the structure, operation, or regulation of IPE or ETS such that the information that already has been provided to the Division no longer remains accurate. Any supplemental request for expanded no-action relief to cover different IPE products need only be accompanied by a certification to the effect that the material information previously submitted to the Division remains accurate and by a description of the contracts or products available for trading on ETS to which IPE wishes to extend the Division's no-action relief.

The scope of the Division's no-action position is restricted to providing relief from the requirement that IPE obtain contract market designation pursuant to Sections 5 and 5a of the CEA and regulatory requirements that flow specifically from the contract market designation requirement in the event that the above-referenced contracts are made available in the United States through ETS, in the manner set forth herein. The Division's no-action position does not extend to any other provision of the CEA, any other Commission regulations, nor to any NFA rules, and does not excuse IPE 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 requirement that a firm operating pursuant to the no-action relief provided herein must be a registered FCM or be operating pursuant to Rule 30.10 relief to engage in the offer or sale of a foreign futures contract or foreign options transaction for or on behalf of a United States foreign futures or foreign options customer. For example, nothing in this letter is intended to alter current Commission rules and staff interpretations that require generally that any foreign firm that clears trades on a fully-disclosed basis on behalf of United States persons (including where the United States person is a non-clearing member of a foreign board of trade trading solely for its proprietary account) be a registered FCM or a Rule 30.10 Firm, unless the foreign firm solely carries accounts on behalf of United States customers that are its proprietary accounts (as defined in Rule 1.3(y)) of the foreign firm.^[57] If the foreign firm is either a member of the relevant foreign board of trade or is a foreign affiliate of a registered FCM in the United States and its sole contact with a United States customer is that it carries the FCM's omnibus account, it need not register under Rule 30.4.^[58]

Moreover, the Division's no-action position does not amend, revise, or negate the obligations of FCMs and Rule 30.10 Firms under the Act, 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 maintain electronic terminals providing direct access to ETS 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 ETS remain responsible for, among other things, complying with the regulatory requirements governing risk disclosure, the handling and allocation 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 an AORS to transmit orders to ETS would be subject to all existing Commission rules and regulations and to any future rules or guidance propounded by the Commission or the Division. Finally, this letter does not address issues that might arise under the Securities Act of 1933, the Securities Exchange Act of 1934, and other applicable federal securities laws or rules promulgated thereunder.

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

- IPE will continue to satisfy the criteria for designation as an RIE under the applicable laws of the United Kingdom with respect to transactions effected through ETS.
- The laws, systems, rules, and compliance mechanisms of the United Kingdom applicable to IPE will continue to require IPE to maintain fair and orderly markets; prohibit fraud, abuse, and market manipulation; and provide that such requirements are subject to the oversight of the FSA.
- IPE and ETS will continue to adhere to the IOSCO Principles as updated, revised, or otherwise amended.
- Only members of IPE will have direct access (*i.e.*, not through an AORS) to ETS and IPE will not provide, and will take reasonable steps to prevent, third parties from providing such access to ETS to persons other than IPE members.^[59]
- All orders that are transmitted through ETS by a member of IPE that is operating pursuant to the no-action relief provided herein and that is not registered with the Commission as an FCM or that is not a Rule 30.10 Firm will be solely for the "proprietary accounts," as defined herein, of such IPE member.
- All orders for United States customers accepted through an AORS and/or transmitted by IPE members through ETS will be intermediated by an IPE member that is either registered with the Commission as an FCM or is a Rule 30.10 Firm.
- IPE will require each current and future Exchange member that is not registered with the Commission as an FCM to file with IPE a written representation, executed by a person with the authority to bind the member, stating that as long as the IPE member operates pursuant to the no-action relief provided herein, the member agrees to and submits to the jurisdiction of the Commission with respect to activities conducted pursuant to the no-action relief IPE will obtain the foregoing representation before it permits the relevant member to operate pursuant to the no-action relief and will maintain the representation as long as the member is operating pursuant to that relief. IPE will make such representations available to the Commission upon the request of a Commission representative.
- IPE will require each current and future Exchange member that is not registered with the

Commission as an FCM to file with IPE 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"^[60] that are issued by or on behalf of the Commission. IPE will obtain the foregoing appointment before it permits the relevant member to operate pursuant to the no-action relief and will maintain the appointment as long as the relevant member is operating pursuant to that relief. IPE will make such appointments available to the Commission upon the request of a Commission representative.

- IPE will require each current and future Exchange member who is not registered with the Commission as an FCM to file with IPE a written representation, executed by a person with the authority to bind the member, stating that, as long as the IPE member operates pursuant to the no-action relief provided herein, the IPE member will provide, upon the request of the Commission, the United States Department of Justice, and, if appropriate, the NFA, prompt access to original books and records maintained at its United States offices as well as to the premises where ETS is installed or used in the United States. IPE will obtain the foregoing representation before it permits the relevant member to operate pursuant to the no-action relief and will maintain the representation as long as the relevant member is operating pursuant to that relief. IPE will make such representations available to the Commission upon the request of a Commission representative.
- IPE will file with the Division valid and binding appointment of a United States agent for service of process in the United States, pursuant to which the agent is authorized to accept delivery and service of "communications," as defined above, that are issued by or on behalf of the Commission. IPE will file the foregoing representation before it operates pursuant to the no-action relief and will maintain the representation as long as IPE or ETS operate pursuant to that relief.
- IPE will maintain the following updated information and submit such information to the Division on at least a quarterly basis, and at any time promptly upon the request of a Commission representative:
 - For each contract available to be traded through ETS, the total trade volume originating from ETS terminals assigned to each of IPE's members in the United States (including volume originating from AORSs that route orders to ETS) compared with total trade worldwide volume for such products traded through ETS and the total worldwide trade volume for such products traded on IPE generally.
 - A listing of the names, NFA ID numbers (if applicable) and main business addresses in the United States of all IPE members that have access to ETS in the United States.
 - IPE will promptly provide the Division with written notice of the following:
 - Any material change in the information provided in its No-Action Request, including any information contained in the documents submitted in support thereof.^[61]
 - Any material change in IPE Regulations or the laws, rules, and regulations in the United Kingdom relevant to futures and options.
 - Any matter known to IPE or its representatives that, in IPE's judgment, may affect the financial or operational viability of IPE; including, but not limited to, any significant system failure or interruption.
 - Any default, insolvency, or bankruptcy of any IPE member known to IPE or its representatives

that may have a material, adverse impact upon the condition of IPE, the IPE clearing system, or upon any United States customer or firm.

- Any known violation by IPE or any IPE member of the terms or conditions of the no-action relief provided herein.
- Any disciplinary action taken by IPE against any member of IPE operating pursuant to the no-action relief provided herein that: (i) involves any market manipulation, fraud, deceit, or conversion or that results in suspension or expulsion; (ii) involves the use of ETS or an AORS to submit orders to ETS; and (iii) either: (a) the IPE member against whom the disciplinary action is taken is located or based in the United States or (b) the disciplinary action results, in whole or in part, from conduct that: (1) involves the use of a terminal or an AORS that is located in the United States to accept or submit an order for trading through ETS; (2) involves a United States customer or firm or a registered FCM; or (3) might have a material, adverse impact upon any United States customer or firm.^[62]
- Satisfactory information-sharing arrangements between the Commission and the FSA will remain in effect.
- The Commission will be able to obtain sufficient information regarding IPE and the members of IPE operating pursuant to the no-action relief provided herein necessary to evaluate the continued eligibility of IPE or its members for the relief, to enforce compliance with the terms and conditions of that relief, or to enable the Commission to carry out its duties under the CEA and Commission regulations.^[63]
- IPE will provide directly to the Commission information necessary to evaluate the continued eligibility of IPE or its members for the relief, to enforce compliance with the terms and conditions of that relief, or to enable the Commission to carry out its duties under the CEA and Commission regulations.^[64]
- IPE employs reasonable procedures, to be determined by IPE, 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 IPE'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 trade volume information submitted as a condition to the no-action relief provided herein as well as any changes in the nature or extent of IPE's activities in the United States to ascertain whether IPE'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 IPE 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 IPE will be subject to those rules or guidelines in that event.

If you have any questions regarding this correspondence, please contact me or Jocelyn Barone at (202) 418-5450.

Very truly yours,

John C. Lawton
Acting Director
JBB/jb

cc: Daniel A. Driscoll, Vice-President-Compliance
National Futures Association
Henry J. Matecki, T&M, Chicago

^[1] For purposes of the No-Action Request and the relief provided herein, references to the members of IPE shall include "affiliates" of such members to the extent that such affiliates are granted access by the member to ETS. An "affiliate" of an IPE 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. IPE represents that, to the extent an IPE member permits an affiliate to use ETS, such affiliate will be required to comply with all IPE Regulations and the IPE member will remain responsible to IPE for ensuring its affiliate's compliance with such regulations. For purposes of the No-Action Request and the relief provided herein, the term "IPE Regulations" shall include IPE's Memorandum and Articles of Association, Regulations, Floor and ETS Trading Procedures, and any circulars, notices, or similar instructions issued by IPE.

^[2] For purposes of the relief provided herein, the term "United States" shall include the United States, its territories and possessions.

^[3] For purposes of the No-Action Request and the relief provided herein, the term "proprietary account" shall have the meaning set forth in Rule 13(y). 17 C.F.R. § 1.3(y) (1999).

^[4] Rule 30.10 permits a person affected by any of the requirements contained in Part 30 of the Commission's rules to petition the Commission for an exemption from such requirements. 17 C.F.R. § 30.10 (1999). 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 34.10 for an order to permit firms that are members of the SRO and subject to regulation by the foreign

regulator to conduct business from locations outside of the United States for United States persons on non-United States boards of trade without registering under the Commodity Exchange Act, based upon the person's substituted compliance with a foreign regulatory structure found comparable to that administered by the Commission under the Act. *Interpretative Statement with Respect to the Commission's Exemptive Authority Under § 30.10 of its Rules*, 17 C.F.R. pt. 30, Appendix A (1999).

[5] For purposes of the No-Action Request 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). 17 C.F.R. § 30.1(c) (1999).

[6] In its No-Action Request, IPE defines the term "AORS" to mean "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 human intervention, trade matching or execution takes place."

[7] 7 U.S.C. §§ 1 et seq. (1994).

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

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

[10] References to the Financial Services and Markets Bill in this letter refer to the draft Financial Services and Markets Bill that was published by Her Majesty's Treasury ("HMT") for public comment on July 30, 1998 and submitted to an all-party committee of Parliament on June 17, 1999. The committee has returned the draft to HMT for further revision and later submission to the full Parliament. The Financial Services and Markets Bill will give effect to the proposals to reform the financial services regulatory structure in the United Kingdom that were announced in May 1997.

[11] As stated below, the no-action relief provided herein is contingent upon the accuracy of the representations made by IPE in support of the 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.

[12] Specifically, IPE offers Natural Gas (NBP) Daily futures contracts, Natural Gas (NBP) Monthly futures contracts, and Natural Gas (NBP) Balance-of-the-Month futures contracts.

[13] ETS Workstations and other aspects of the ETS architecture are discussed in Section III.

[14] IPE has received other regulatory approval for or a statement of no-objection to the placement of ETS Workstations in Austria, Belgium, Finland, Germany, Greece, the Netherlands, Norway, Portugal, Spain, Sweden, and Switzerland.. IPE anticipates imminent approval from Denmark and France. No jurisdiction has denied a request by IPE for an approval or a statement of no objection of this kind.

[15] IPE represents that its marketing efforts are directed towards institutions. IPE does not intend to solicit individual Exchange users.

[16] IPE Regulations permit Floor Members and Local Floor Members to lease their trading seats. However, IPE represents that a lessee is required to comply with all of the membership requirements applicable to the lessor member.

[17] As discussed in Section IV, all IPE members that intend to conduct investment business in the United Kingdom must be authorized to conduct investment business in the United Kingdom or be eligible for an exemption from the authorization requirement. IPE members that intend to conduct investment business from an overseas location similarly must be authorized or otherwise licensed or permitted by the appropriate regulatory body in their home country to conduct investment business on the Exchange from that location.

[18] For information purposes only, the Division has indicated the United States dollar equivalent of any sum of United Kingdom pounds referenced herein, based upon the exchange rate of November 1, 1999 (£1 = \$1.64). The Division notes, however, that the financial resource requirements for IPE membership are not limited in any way to the United States dollar equivalents that have been provided in this letter.

[19] As discussed in Section IV, the SFA is an SRO charged with the oversight of futures and options market intermediaries. The SFA has delegated its monitoring responsibilities to the Financial Services Authority ("FSA"), the regulatory body that is responsible for regulating the conduct of investment business in the United Kingdom.

[20] United Kingdom law requires IPE to have adequate arrangements for the clearing and settlement of contracts executed on the Exchange. IPE achieves this through its contractual arrangement with LCH.

[21] IPE requires that all trades made by IPE members through its trading facilities be cleared. Accordingly, all members must have a guaranteed route to clearing. A Non-Clearing Member may be a party to only one clearing arrangement.

[22] IPE has agreed to fix the financial obligations of its Clearing Members at the same level as the financial resources requirements that LCH imposes upon such members.

[23] Before an IPE member can trade contracts on ETS, the address at which its ETS Workstation will be installed must be approved, in writing, by the Exchange's Membership and Rules Committees and the member must be a party to an agreement in a form prescribed by the Directors for the supply or license by the Exchange of the ETS Workstation to the member at the approved address. Members are prohibited from moving or installing an ETS Workstation to a new address, absent the prior written consent of the Membership and Rules Committees.

[24] ETS Traders must submit all orders in the name of the IPE member for whom they trade and must trade, at all times, in the name of and on behalf of that member. The IPE member is responsible for all orders and other instructions entered and all trades made by its ETS Traders or on ETS from an ETS Workstation located at the member's premises or any other premises agreed upon by the Exchange. All trades made on IPE by a member's ETS Traders or through an ETS Workstation to which the member has access are binding upon the member, regardless of whether the trade was authorized by the member or is permitted by IPE Regulations. The IPE member may also be held accountable for the behavior of its ETS Traders in executing such trades.

[25] IPE restricts the number of ETS Traders that may have access to ETS at any one point in time.

[26] The training program and competency examination are administered by IPE.

[27] The Trading Host assigns each ETS Trader at least one ITM. An ETS Trader may not trade contracts on a particular market and acquire data about such contracts (except publicly available information) unless the IPE member for whom he is trading is privileged to trade in that market. For example, an ETS Trader may not trade any contract in a jurisdiction in which the contract has not been approved for trading in that jurisdiction. When an ETS Trader obtains access to the Trading Host, the Trading Host uses the ITM to identify the trader and block him from accessing contracts that he may not trade. Accordingly, ETS Traders located in the United States would not be able to access products from ETS terminals located in the United States that are not authorized pursuant to the no-action relief provided herein.

[28] Although IPE currently does not permit customers to access ETS via an AORS, it intends to do so in the future. IPE represents that, in that event, Exchange members that provide, use, or accept orders from an AORS for the purpose of submitting orders to ETS would be required to comply with certain order validation and recording requirements as well as IPE Regulations. For example, IPE members would be required to maintain control over order-routed business to ensure that all orders are properly vetted and to ensure that adequate checks are performed before orders are submitted to the Trading Host.

[29] The role of IPE Supervisors is discussed in greater detail in Section IV.

[30] ETS represents that cross trade orders will be executed in a manner similar to the way in which they

are executed on Globex, although the designated time during which the market must be shown both the buy and sell side of the order and during which either side may be traded is shorter on ETS than it is on Globex.

[31] Although contracts executed on ETS are matched automatically, IPE members must assign specific trades to a house or customer account for position-keeping purposes or allocate the trade to another member. Trades that have not been assigned or allocated are allocated automatically to the member's default accounts during the overnight clearing process and may be resolved on the next trading day. When such trades are resolved, the CPS position-keeping accounts are updated to reflect the corrections.

[32] IPE permits ETS Traders to record order details in written or electronic form, but requires them to maintain a physical original of the details.

[33] IPE members are required to have a time-stamping machine or an approved electronic order recorder capable of performing a similar time-stamping function at all locations where orders are received.

[34] 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). The Securities and Investments Board ("SIB"), the predecessor to the FSA, endorsed the IOSCO Principles in April 1991. *SIB Endorsement of IOSCO's Principles for the Oversight of Screen-Based Trading Systems for Derivative Products*, Guidance Release 2/91 (April 1991).

[35] Violations of the FS Act are criminal offenses.

[36] The failure to comply with the FSA Principles could give rise to disciplinary action.

[37] On April 5, 1991, the Commission issued a supplemental order confirming the continued validity of

such previous orders following the merger of the AFBD and the TSA into the SFA. On March 7, 1997, the Commission issued an additional order to the SFA clarifying the procedures set forth in its prior orders regarding United Kingdom exchanges and their members.

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

[39] Among the issues considered by the Commission in determining whether to grant Rule 30.10 relief to a foreign regulatory authority or SRO 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. pt. 30, Appendix A (1999).

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

[41] Under the FS Act, the status of an RIE is similar in some respects to that of an SRO. That is, it is recognized by the FSA, is subject to statutory requirements, and is responsible for regulating the activities of its members. However, the function of RIEs and SROs differ in that RIEs are responsible for ensuring that their markets function fairly and efficiently, while SROs are responsible for authorizing firms to conduct investment business.

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

[43] The FS Act prohibits individuals and entities from carrying on "investment business" in the United Kingdom unless they are either "authorized" to do so or are eligible for an exemption from the authorization requirement. Authorization may be obtained from the FSA directly or by, membership in an SRO or, in certain instances, a professional body recognized by the FSA under the FS Act. The FS Act imposes criminal sanctions upon persons who violate this requirement. While agreements made by or through persons who have not been authorized to conduct investment business as required may be enforced by customers, they are not enforceable on the part of the unauthorized person.

[44] The FS Act permits an RIE to delegate these functions to a Recognized Clearing House ("RCH"). IPE has delegated them to LCH.

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

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

IPE represents that there are no Remote IPE Members that trade on IPE at the present time, although a small number of such firms belong to a sub-category of TAMS that have no trading or clearing rights. IPE represents that it will not allow foreign entities to transact business directly on IPE unless, among other things, it is satisfied that: (i) IPE Regulations are being enforced; (ii) IPE and the FSA have good working relationships with the regulator that is responsible for authorizing and supervising the member; (iii) the relevant foreign regulator is willing and able to cooperate with IPE and the FSA through the exchange of regulatory information; (iv) the member can perform its desired roles with respect to IPE business without the necessity of a United Kingdom presence; and (v) the member's ETS Traders will be available during and after the trading session in London to assist in, among other things, resolving disputes about trades. In any event, as noted, IPE members transacting business with United States customers are required to be registered as FCMs or operating pursuant to Rule 30.10 orders or other applicable exemptive relief whether such members are based within the United Kingdom or outside of the United Kingdom.

[47] Pursuant to the Financial Services and Markets Bill, as currently drafted, the FSA will acquire the powers of the SROs once the relevant portions of the bill become effective. This is expected to occur sometime in the year 2000. Pending implementation of the bill, the Board of each SRO continues to be legally responsible for the regulation of its members (*e.g.*, the SFA will continue to be responsible for the regulation of futures and options intermediaries). However, the SRO Boards have delegated some of their functions to the FSA, including the function of monitoring regulated firms. Accordingly, the FSA is now operationally responsible for monitoring compliance with SFA rules.

[48] Only those persons who have worked extensively in the industry or who have passed an examination

of an equivalent standard may be exempt from the examination requirement.

[49] As noted above, the FSA now monitors compliance with these rules.

[50] IPE's minimum financial resource requirements are in addition to those that may be imposed by the member's SRO.

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

[52] For example, IPE Supervisors are authorized to conduct spot checks to verify the authenticity of orders and trades, to scrutinize each order submitted for execution on the Exchange (from its initial placement by a member through its assignment to a counterparty), and to request written evidence of details relating to a transaction or order from an IPE member.

[53] IPE notes that its members are obligated to immediately notify IPE of any actual infringement of IPE Regulations or of any actual financial or commercial difficulty on their part or any member or person subject to IPE Regulations.

[54] The Division notes that the FSA has confirmed that these information-sharing arrangements would extend to information requested by the CFTC in connection with the no-action relief provided herein. Letter from Matthew Elderfield, Head of Department, Exchanges and Clearing Houses, The Financial Services Authority, to I. Michael Greenberger, Director, Division of Trading and Markets, Commodity Futures Trading Commission (July 23, 1999). The Division also notes that the IPE is a signatory to a companion MoU to the Boca Declaration that provides for the sharing of information between market authorities upon the occurrence of certain triggering events.

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

[56] 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 IPE 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.

[57] *See* CFTC Interpretative Letter No. 88-15, Comm. Fut. L. Rep. (CCH) ¶24,296 (Aug. 10, 1988).

[58] *See* CFTC Interpretative Letter No. 87-7, Comm. Fut. L. Rep. (CCH) 123,972 (Nov. 17, 1987).

[59] As stated above, "members" includes those persons identified in footnote I for purpose of this no-action letter and the conditions imposed upon the relief provided herein.

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

[61] 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 IPE's membership criteria; the location of IPE's management, personnel, or operations (particularly changes that may suggest an increased nexus between IPE's activities and the United States); the basic structure, nature, or operation of ETS; or the regulatory or self-regulatory structure applicable to IPE, ETS, or IPE or ETS participants (*e.g.*, the passage of the Financial Services and Markets Bill into law and the implementation of relevant regulations, advisories, or directives promulgated thereunder).

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

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

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