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August 1, 2006

COMMENT

Eileen A. Donovan, Acting Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: Boards of Trade Located Outside of the United States
71 *Fed. Reg.* 34070 (June 13, 2006)

Dear Ms. Donovan:

Euronext.liffe is pleased to submit this letter in response to the Commodity Futures Trading Commission's ("Commission's") request for comment on various issues arising from the Commission's review of the procedures by which a board of trade located outside of the United States, *i.e.*, a foreign board of trade ("FBOT"), is permitted to provide direct access to its electronic trading system from the United States. 71 *Fed. Reg.* 34070 (June 13, 2006). Euronext.liffe is the derivatives markets division of the Euronext Group, which includes LIFFE Administration and Management in London ("LIFFE"), Euronext Paris, Euronext Amsterdam, Euronext Brussels, and Euronext Lisbon. Euronext.liffe is the fourth largest derivatives exchange, by volume of contracts traded, in the world.

We commend the Commission for undertaking this review. The international derivatives markets have evolved substantially in the ten years since the Commission issued its first no-action letter allowing an FBOT to place direct access terminals in the U.S.[1] The continuing technological advances that facilitate cross-border trading, the more diverse range of products offered for trading, the emergence of hedge funds as significant market participants and, more recently, increasing volatility caused by economic uncertainty and geopolitical unrest have all contributed to the tremendous growth of the international derivatives markets. This growth has encouraged the conversion of mutually-owned, non-profit derivatives exchanges to for-profit corporations and the subsequent consolidation of markets both within and across international boundaries. It is appropriate, therefore, that the Commission take the time to consider whether the no-action process continues to provide the Commission with the tools necessary to assure the protection of U.S. market participants and the integrity of U.S. markets. As we made clear in the Preliminary Position Paper we submitted at the time of the June 27 public hearing ("Hearing"),[2] we believe it does.

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1 CFTC Staff Letter No. 96-28, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,669 (February 29, 1996).

2 For the convenience of the Commission, a copy of our Preliminary Position Paper is enclosed with this letter.

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In that first submission, we addressed the question of whether the decision to require an FBOT to register in the U.S. should be based on specific, at least partially quantifiable, criteria such as volume of trading originating from the U.S., U.S. presence, and the nature of the contracts in question. We explained why we believe that each of the suggested criteria for determining whether an FBOT should be required to register as a Designated Contract Market ("DCM") was fundamentally flawed.

In this new submission, we will emphasize two points that were reinforced during the Hearing: one, the no-action process, grounded in the principle of comparability and bolstered by effective cooperation, works; and two, the no-action process allows for considerable Commission involvement while assuring necessary flexibility.

The Commission Should Rely on Cooperation and Comparability, not Adherence to Particular Rules

A policy under which the Commission required FBOTs to adhere to particular U.S. rules would be unworkable and unnecessary. As Benn Steil of the Council on Foreign Relations observed at the Hearing, in a globalizing world, more and more exchanges are going to offer their products outside their home jurisdictions:

> [In] an inherently globalizing industry like the electronic derivatives trading industry, you are going to see two things. One, very large exchanges in one jurisdiction inevitably trading contracts that have an intimate relation with the economy in another jurisdiction.... Second, to the extent that such exchanges are successful, they are certainly going to get increasing participation from foreign jurisdictions...[3]

Trading on such exchanges cannot be effectively regulated without cooperation among a number of international regulatory authorities.[4] By combining deference to comparable home state regulation[5] with bilateral information sharing arrangements, the no-action process

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[3] Benn Steil, Director of International Economics, Council on Foreign Relations, Hearing Transcript at pp. 65-66.

[4] As Mr. Steil noted: "... the activities of the U.S. market participants on markets can in some instances give rise to legitimate concerns at the Commission and might merit more active Commission involvement in regulation. ... [T]hat would not necessarily mean that the Commission should repeal a no-action letter, *but it would perhaps suggest that the Commission would want to initiate a higher level of cooperation with the foreign regulator.*" Hearing Transcript at pp. 50-51 (emphasis supplied).

[5] We have used the term "comparable" home state regulation because this is the term that the Commission itself has generally used. In the U.K., the Financial Services Authority ("FSA") uses the term "equivalent." Neither term, of course, implies an "identical" regulatory regime. As the Commission explains in Appendix A to its Part 30 rules, in determining whether a person is subject to a comparable regulatory regime, "the Commission would have broad discretion to determine that the policies of any program element generally are met, notwithstanding the fact that the offshore program does not contain an element identical to that of the Commission's regulatory program." An FBOT seeking no-action relief, therefore, is not required to demonstrate that its regulatory scheme meets each of the core principles set out in section 5 of the Commodity Exchange Act. It is sufficient if its rules and the regulatory regime of its home state regulator are designed to assure the integrity of the markets, the financial integrity of transactions executed on those markets and the protection of customers trading there.

fosters cooperation among regulators. This allows the Commission to address discrete regulatory concerns as they arise in a way that "neither inhibits cross-border trading nor imposes unnecessary regulatory burdens."[6]

The principle of comparability takes as its starting point the understanding that "[i]n terms of regulatory regimes, there are clearly differences as to how regimes have grown up across the world, and they are not completely identical."[7] The principle of comparability acknowledges these differences and guides a host state regulator to respect them if, upon analysis, the host state regulator concludes that its regulatory objectives are nonetheless met. Departing from this principle would seriously interfere with the machinery of global derivatives markets. First, if an FBOT were required to follow a particular Commission rule, such as large trader reporting, it would find itself subject to the jurisdiction of two regulators, with potentially conflicting requirements, and would face the added cost and confusion of complying with such requirements. Second, if each host regulator were to impose specific elements of its regime on each exchange that offered products in that host country, the result would be regulatory gridlock.[8]

By respecting the regulatory regime of the home state regulator, the principle of comparability not only avoids such gridlock, it encourages competition by reducing unnecessary regulatory barriers to cross-border transactions. As Benn Steil noted during the Hearing:

> ... I think it is exceptionally important to acknowledge just how successful the Commission's no-action regime has been since DTB, now Eurex, started trading 10-year Bund futures out of Chicago in 1997. This particular development stimulated enormously positive reforms in both market structure and exchange governance around the world.[9]

Moreover, there is simply no need to apply individual U.S. rules to FBOTs. The no-action regime allows the Commission to take whatever steps might be necessary in a particular situation—such as requiring increased information-sharing with another regulator or, in the extreme, withdrawing a no-action letter altogether.

The Commission's recent experience with surveillance of trading in contracts for West Texas Intermediate ("WTI") crude oil is a case in point. At the Hearing, both Chairman Ruben Jeffery III and Richard Shilts, Director of the Division of Market Oversight, confirmed that the Commission has received from the UK's FSA the information it requested in order to

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6 71 *Fed. Reg.* 34070, 34072 (June 13, 2006).

7 Verena Ross, Head of Market Infrastructure Supervision at FSA, Hearing Transcript at p. 70.

8 Elements of other jurisdictions' programs, which appear central to their regulatory regimes, are not applicable to U.S. markets. For example, in Germany, customer funds cannot be forwarded to the clearing house; only clearing member funds may be deposited with the clearing house. The application of this requirement to U.S. exchanges doing business with customers located in Germany would impose a significant burden on U.S. futures commission merchants as well as U.S. exchanges.

9 Hearing Transcript at pp. 49-50.

oversee effectively the WTI market. As Mr. Shilts explained, when ICE Futures launched its WTI contract in February 2006:

> [We] started a dialogue with the FSA to arrange for information-sharing arrangements ... where we could compare information on the two markets. As you know, the Commission relies on its large trader reporting system which generates position data on traders that meet a certain reporting level in that contract. We found that the ICE Futures also has similar position information that is reported to the FSA. So, beginning in April, we have been sharing that information between the two regulators. Our large trader data is supplemented with the information we get from the FSA that is generated from ICE Futures. In doing surveillance of the NYMEX markets, we are able to accumulate and look at the positions that are on NYMEX, and look also at the positions that are on ICE Futures. That has been working very well. To date, we have not identified any particular problems. In addition to that, we have initiated a regular dialogue between our surveillance staff and the FSA surveillance staff where we compare notes on a routine basis and discuss any surveillance issues as well as any other matters that might come up of concern between the two regulators.[10]

In short, the no-action process, has worked. In cooperation with the FSA, the Commission designed an approach to surveillance of the WTI contract that gave it the information needed to assure the integrity of the WTI market on NYMEX without interfering with either the FSA's responsibilities as the home country regulator or trading on ICE Futures.

The Existing No-Action Process Should Be Retained

While replacing the no-action regime with a more formal procedure might have superficial appeal, we do not think it would be a good idea.

To begin with, the notion that the no-action process is somehow loose, lacking in rigor, or implemented outside the purview of Commissioners is just not true. No-action relief is granted only after a thorough review—one that addresses many of the same issues that concern the Commission in considering an application for registration as a DCM under the core principles set forth in Section 5 of the Commodity Exchange Act. As Chairman Jeffery said at the hearing:

> I think there is some thought or suggestion out there that we have a tsunami of no-action letter requests that are coming in and they kind of go through the mail and nobody takes a look at them. If that is the impression anywhere out there, I just want to disabuse people of any such notion. ... I should point out that each no-action letter ... gets pretty carefully considered. Also ... every

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[10] Hearing Transcript at pp. 86-87. Before asking Mr. Shilts to comment, Chairman Jeffery noted: "We have reasonably full access to the information [FSA receives]. ... I do not want people in this room, or participants on this panel, to think that things are happening and nobody on either side of the pond, if you will, knows what those things are." Hearing Transcript at p. 85.

> single Commissioner sees them and has an opportunity to comment or object.[11]

Indeed, the Commission has been heavily involved in the no-action process from the outset, having established the procedures by which petitions for no-action are reviewed and having twice modified the terms under which no-action letters are granted.[12] We fully expect the Commission to continue to play an active role in monitoring the effectiveness of the no-action process.

In addition, the no-action regime preserves for the Commission and other home state regulators the kind of flexibility required to address issues in a rapidly evolving marketplace. Verena Ross of the UK's FSA underscored the importance of flexibility:

> We believe that the most appropriate action lies with greater flexibility and cooperation within the regulatory community rather than increasing oversight of the markets by the host regulator. ... We do not know what those future issues might be. Any new concerns will most likely require equally flexible responses, therefore, and we would therefore advise against any moves which could negatively impact on the adaptability of our collective regulatory response and strategy.[13]

Even if a more formal procedure were limited to codifying the no-action regime (a limitation that would likely come under substantial pressure once a formal process was initiated), we suggest that, on balance, this would not be a good idea. The current regime allows for maximum flexibility to account for marketplace changes driven both by technology and globalization. We see little benefit in giving up any of that flexibility.

Conclusion

In our Preliminary Position Paper, we stressed our strong belief, one that was shared by most of the Hearing panelists, that the foundation of the no-action process—deference to comparable home state regulation, consent to jurisdiction, and bilateral information sharing arrangements—is sound and should be retained. The no-action process is consistent with the Commission's historic policy of encouraging international cooperation and of granting relief to persons subject to comparable home state regulation. It is also a course of action that Congress has consistently endorsed, most recently in the Commodity Futures Modernization Act. Most important, as discussed above, the no-action process works. We urge the Commission to continue to endorse the no-action process as the most appropriate means of examining requests for no-action relief from an FBOT seeking to provide direct access to its electronic trading platform from the U.S.

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[11] Hearing Transcript at pp. 147-148.

[12] *See* 64 *Fed. Reg* 32829, 32830 (June 18, 1999); 65 *Fed. Reg.* 41641 (July 6, 2000); 71 *Fed. Reg.* 19877 (April 18, 2006).

[13] Hearing Transcript at pp. 33-34.

Once again, we appreciate the opportunity to submit these comments. We would be happy to meet with the Commission or its staff at their convenience to discuss the views expressed in this letter in greater detail.

Sincerely,

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Euronext.liffe

Nick Weinreb
Group Head of Regulation
Euronext

cc: Honorable Reuben Jeffery III, Chairman
Honorable Walter Lukken, Commissioner
Honorable Fred Hatfield, Commissioner
Honorable Michael Dunn, Commissioner

Nanette Everson, General Counsel
Richard Shilts, Director, Division of Market Oversight
David Van Wagner, Chief Counsel, Division of Market Oversight
Duane Andresen, Special Counsel, Division of Market Oversight
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