really related to the U.S. activities of the foreign exchange.

CHAIRPERSON BORN: Thank you very much.

I think this completes our discussion of the first section, which is our Standards for Exemption.

I would propose that we take a 10-minute break and come back to take what may be a quicker look at the requirements for the contents of a petition, which is the information that the Commission will ask for in order to determine whether a petitioner meets the Standards for Exemption.

Thank you.

[Recess.]

CHAIRPERSON BORN: If everybody would take their seats, we are about to resume.

[Slide.]

We have the next slide up, which is a little harder to read. Let me tell everybody they should have the data, however, in their packets in hard copy so they can look at that.

The next issue on the agenda is the petition process that is envisioned by the proposed rules. The petition by a board of trade seeking an exemption is intended to provide the Commission with the information it needs to determine whether the Standards for Exemption that we discussed during the first 2 hours are met.

Maybe we can cover this fairly quickly. Let's run through the information that would be required, and I'll take any comments or discussion on each particular requirement.

The first requirement is that "the address of the petitioner's main business office and the name and relevant information of a contact person for additional information."

This would provide the identity of the petitioner and confirm that it is located abroad.

Are there any comments on this aspect of the petition?

MR. THORPE: It takes the fun out of it, really, doesn't it?

[Laughter.]

CHAIRPERSON BORN: The second standard is that "the petitioner's organizational documents and date and place of establishment." This information is intended to confirm the petitioner's location abroad and the fact that it is an established board of trade.

Is there any comment on this requirement of the petition information?

[No response.]

CHAIRPERSON BORN: Going on to the third point, "a description of the contracts to be traded via the automated trading system in the U.S."

Comments?

Volker Potthoff.

MR. POTTHOFF: Just a question for clarification purposes. Does that mean that if you add new contracts, each and every contract has to e approved, or is it just for information purposes?

CHAIRPERSON BORN: It is my understanding that in the terms and conditions, which we will come to next, that would be applicable. A board of trade that was exempt, that had an exemption under 30.11, would have a responsibility to

give the Commission notice of new contracts 10 days before they started trading, but there would be no approval process; it would just be information provided to the Commission. But we will get to that next, if and when we get to terms and conditions.

Is there any other discussion of this point?

[No response.]

CHAIRPERSON BORN: The next point is "the petitioner's rules and membership requirements."

This information would assist in determining the self-regulatory regime of the petitioner and the nature of its membership requirements.

Is there any discussion, comments?

[No response.]

CHAIRPERSON BORN: Going on to the next point, "the address of the office responsible for monitoring compliance with petitioner's rules and the supervisory arrangement for maintaining compliance, as well as the name and address of the petitioner's home country regulator."

This information relates to the applicable self-regulatory and regulatory responsibilities.

Is there any discussion on that point?

[No response.]

CHAIRPERSON BORN: Seeing none, the next point is "a description of the regulatory structure in the board of trade's home country governing futures and options trading, including applicable laws, regulations and requirements."

This goes to the heart of the regulatory regime to which the petitioner is subject.

Phil Thorpe.

MR. THORPE: Chairperson, just for clarification, the Commission has been through the process, as you described before, under 30.10, of looking at the number of jurisdictions. That, of course, has been in the context of FCMs or equivalent. Is it the Commission's intention to take note officially in some form, or can it take note, of that exercise that it has already undertaken, or is this going to be a recipe for repeating the exercise under the guise of this application?

CHAIRPERSON BORN: I think it can take into account its past findings; and in fact, it seems to me that there are some specifics in the proposed rule that are not

up on the chart here that say if you have gotten 30.10 approval and have already submitted the information that is required here, you do not have to resubmit it, that it will be taken as a given, unless there have been changes in law which you can then submit.

MR. THORPE: If I may have a follow-up, Chairman, that is, I suppose, the nub of it for me. The petitioner in the circumstances contemplated in this slide will be an exchange or an exchange operator. The 30.10 applicants will have been FCMs, I would guess.

CHAIRPERSON BORN: The 30.10 applicants are either boards of trade themselves or the regulatory authority in the foreign country, so that either we would have gotten application from, I think, the SIB, the SFA--all those were the applicants--but in some countries, it is the Toronto Exchange, for example, that applies, or did apply for 30.10 for its members.

MR. THORPE: But you are expecting to do a read-across, and I think that would be satisfactory.

Thank you.

CHAIRPERSON BORN: That is my understanding, and it seems to me the only logical way to go.

Volker Potthoff?

MR. POTTHOFF: Madam Chairperson, I have to repeat the comment I made earlier so that it is not forgotten. This is a regime that covers the FCMs and not the exchanges themselves, in our opinion, and this is insurmountable because this fits together with the jurisdiction question. Plus, we experienced at that time, which you may not be aware of, that DTB went through the 30.10 process, and we stopped it because we had the no-action relief then. It took us more than 2 years. If any foreign exchange wants to go through this, it is a long procedure.

The second question is who is going to monitor whether, for example, 30.10 reliefs that were given 10 years ago are still valid, because regulatory frameworks change, especially in Europe, through the implementation of the directives; and is the CFTC taking this burden to follow up on the regulatory scheme?

CHAIRPERSON BORN: The CFTC does a continual follow-up on 30.10 validity. New foreign brokers apply all

the time, I think, to Bob Wilmouth's operation, the National Futures Association, for confirmation of the availability of 30.10 treatment. All of the countries that we have given 30.10 treatment to in the past, which I listed earlier--there are eight of them, I think--continue to have 30.10 treatment.

Beyond that, let me just say that while DTB did not pursue its 30.10 application, the Commission staff did do exactly this kind of examination of German law to ascertain the comparability of the regulatory regime that DTB would be subjected to, and if this point were not applied, if this were not examined, DTB would be the only foreign exchange that was not subjected to this kind of examination.

Is there any other discussion?

[No response.]

CHAIRPERSON BORN: Let's go on to the seventh point--well, let me at this point go on to another slide, because the petition provision suggests that there are several points of foreign law that the Commission would be

interested in seeing information about in the petition to assist it in making the general comparability assessment.

[Slide.]

That is the slide that is up here. These are not requirements that establish the standard of general comparability. What this is is the information that needs to be provided in the petition about the foreign law. It would include the prohibition of fraud, abuse and market manipulation, recordkeeping and reporting by the board of trade and its members, fitness standards for intermediaries, financial standards for members of the board of trade, protection of customer funds, trade practice standards, review of operations by the regulatory authority, surveillance, compliance and enforcement mechanisms, and regulatory oversight of the clearing facilities.

Is there any comment on including these rules or laws in the petition?

Volker Potthoff?

MR. POTTHOFF: I am very sorry to repeat on that, but this is the crucial point here. When you like to gather this information, and you say just for the purpose of

gathering this information--what are you going to do with this information if, for example, you find out that the kind of enforcement policy of a foreign exchange--I am not talking of Eurex, but maybe any other exchange--is not what you would expect of an exchange. What you come down to is that it is, in my opinion, included in the comparability test, obviously, because otherwise we would not collect this information. Then you start really reviewing the rules of the foreign board of trade, and that is what I am concerned about.

CHAIRPERSON BORN: Well, just as we did with DTB, it seemed to the Commission and the staff that these might be relevant laws and rules in order to assess whether there is general comparability.

For example, if there were no fraud law in the foreign jurisdiction, that would certainly give me severe pause in terms of protection of U.S. investors who were trading on electronic systems that would be impacted by that lack of fraud laws.

On the other hand, this information would be taken as a whole in assessing general comparability.

Are there other comments?

George Crapple.

MR. CRAPPLE: Is it conceivable or likely that an exchange will make such a petition if its contracts have not already been approved for U.S. investors?

CHAIRPERSON BORN: There is no U.S. approval of any foreign contracts except two kinds. Any foreign futures or options contract may be sold by U.S. FCMs or foreign brokers who have 30.10 exemptions to U.S. customers without any approval, except, one, stock index futures, which have to go through an approval process domestically before they can be permitted, and secondly, futures contracts on foreign government debt like the LIFFE Long Gilt or the German Bund contract, which requires both SEC exemption as a preliminary matter and then confirmation by CFTC of permissibility to trade in this country.

Other foreign contracts--the Indian green bean contract--can be sold without any kind of examination or approval by the CFTC or any other U.S. entity. Contracts on the various four exchanges in the People's Republic of China can be sold to U.S. customers. However, to date, they have

been sold via discussions with your FCM, discussions with your commodity trading advisor, as to whether these are appropriate markets to trade on and whether they are appropriate vehicles to risk-shift on.

MR. CRAPPLE: So the big contracts, the high-volume contracts, which tend to be the subject of the non-U.S. electronic exchanges, do fall into the category because their interest rates are stock indexes that tend to have been already approved.

I guess my point is to the extent that the contracts that are the subject of the petition have already been approved, this seems like a very repetitive sort of approval process.

CHAIRPERSON BORN: The interest rate contract would only be approved if it were on foreign government debt, not LIBOR or something like that.

I see Volker Potthoff and nobody else.

MR. POTTHOFF: Taking the example of fraud prohibitions, for example, or market manipulation, you know this is an issue all around the world, and there are

different standards all around the world regarding this issue.

I understand the point of investor protection, but my question is if you, for example, have a U.S. customer who, according to this rule proposal and according to the common understanding, would go via a U.S. FCM or a 30.10 exempted firm, then the investor would be protected also against fraud, because the U.S. prohibitions would apply.

Therefore, I do not quite understand why you look into the different jurisdictions and what regulatory regimes are there with regard to market manipulation when you have the customer protection via the FCMs or Part 30.10 firms.

That is my point.

CHAIRPERSON BORN: Well, of course, while we may have broad authority over the U.S. FCM, we do not have broad authority necessarily over operations that happen solely in Germany.

Gary DeWaal?

MR. DeWAAL: Actually, again, I don't ever want to roam into the world of politics and things like that--I have

enough trouble being a lawyer, and I am not going to even try being a trader.

But I just wonder as a matter of curiosity what would happen if the CFTC while receiving a petition from an electronic exchange decided that the prohibitions against fraud were horrible, there was virtually no recordkeeping, there was no regulatory oversight or clearing facility, there were no trading practice standards, and it decided as a result that it would not grant a petition for terminals, but now it is faced with a situation where it knows all these bad things about that contract, and then customers can still pick up the phone, call their U.S. FCM and trade this thing-- and it blew up. I could not imagine that situation.

CHAIRPERSON BORN: I suppose the CFTC would have the power to issue a report on its investigation of the foreign board of trade.

Phil, did you want to be recognized next?

MR. JOHNSON: As I indicated earlier, among the concerns that many of my clients have is basically the

question of process and how things will be done and how long it will take and how much of an ordeal it might become.

I would assume, and correct me if I am wrong, that in case of a nation that has more than one exchange that may wish to apply, that the first to submit this kind of information will suffice for all purposes.

CHAIRPERSON BORN: It is my recollection that there is also a provision somewhere in the rule that says if the information has already been submitted by another board of trade, the next board of trade can piggyback on that.

MR. JOHNSON: I know that to be true in connection with the examination of the electronic trading system itself that this has been a useful clarification.

CHAIRPERSON BORN: Well, if it is not clear in the proposed rule, it should be made clear, certainly.

Other discussion?

[No response.]

CHAIRPERSON BORN: All right. So we'll go back to Slide 2 and go to the seventh requirement there, which is that the petition should provide "information-sharing arrangements in effect between the board of trade and the

regulatory authority in the petitioner's home country and the Commission."

This information obviously relates to the Commission's ability to obtain information concerning the petitioner and its operations as they may affect the Commission's regulatory responsibilities.

Discussion on this point?

[No response.]

CHAIRPERSON BORN: Seeing none, we'll go on to the eighth, which is "information about the order matching/execution system and any direct execution system's software or devices operated by the board of trade along with information on any technical review by the petitioner's home country regulator."

Jerry Tellefsen?

MR. TELLEFSEN: I have heard a number of people today mention that the process for certification or approval by the Commission takes a long time. I would submit that if the exchange or board of trade applying had an electronic trading system, a direct execution system, that had been certified by their home country regulator as meeting IOSCO

standards, that the amount of information that would be necessary for the Commission to review would be relatively minor. The IOSCO standards already include two very important pieces of functionality, which are the execution algorithm and the risk management functionality of the system.

There are four other categories or areas in which I think maybe two dozen questions would provide you the information you needed. Those areas are the security of the system, the redundancy and reliability of the system, the network capacity and speed, and the ability to keep an accurate, comprehensive and timely audit trail. If you had that data combined with the certification of the home regulator that this ETS or this DES meets IOSCO standards, which are fairly strict, I would think you would be able to have all the information you need quickly.

It is also very unlikely that you would have the time to verify that what you are being told is true unless you had a very significant staff to be able to do that, and that would take a lot of time.

One of the other things in the IOSCO standards that I think is important for everyone to understand is that the standards call for "periodic objective risk assessment of the system and system interfaces." So, presuming "periodic" is at least once a year, these standards require that someone kick the tires of the DES on a regular basis.

Thank you.

CHAIRPERSON BORN: Thank you.

Any other discussion?

David Pryde?

MR. PRYDE: Thank you.

In the proposed rules, the FIA has strong concerns that the Commission is not distinguishing between order entry systems and direct exchange systems. There is a difference in our view. Unlike direct exchange systems, order routing systems do not provide direct access to an exchange but instead they insure that access is intermediated by an FCM, and such intermediation typically can include credit filters, trading limits, the ability to shut off a client immediately, the ability to download trade history, to name just a few.

So I think we want to ensure that order routing systems are treated differently from DESs, because in our view, they are.

CHAIRPERSON BORN: Any other discussion of this point?

Leo Melamed?

MR. MELAMED: If I heard correctly, the issue as it relates to the distinction between ORS and DES is a little bit specious, because today there is only ORS and DES, but I know two people right now who are working on something--I think, David, you might be part of that group that is going to have a system coming from the Moon to Earth, and it will be the third system, and I know someone who is thinking about Mars, and certainly, there are a couple of satellites that will be launched of different systems. So we will have five or six within a year, certainly. Are we going to have a different set of rules about each of those when in fact the result is the same? Is the result not the same that a trade here in the United States ends up somehow being executed on a foreign exchange? And unless the rules for our competitive structure are

lowered, we cannot compete, whether it is through an ORS system that the trade is executed or through a direct system or through a satellite or what-have-you. It makes no difference in terms of competitive abilities that we have.

So although I honestly do not want to regulate ORS, believe me--I don't think any exchange wants to get into the business of regulating ORS--but the idea that it is somehow different than anything else, when in fact it achieves the same purpose, we have trouble with that.

CHAIRPERSON BORN: Ron Hersch?

Mr. HERSCh: What is being excluded from Leo's argument, of course, is that an ORS is intermediated. We have rules right now that apply to FCMs, and those rules are significant. FCMs are regulated. An order entry system is intermediated by an FCM, and all the rules that typically apply today to a U.S. FCM and a Part 30 firm have to be applied now, and they will have to be applied with respect to orders that go through an ORS.

DES is completely different, because when you are dealing with DESs, you are talking about customers who are

allowed to go directly to an exchange where an order is matched; so it is different.

MR. MELAMED: Are you saying that--

MR. HERSCH: Well, I don't know--if this is supposed to be two-way, we can do it. Otherwise maybe you should wait until you are recognized.

MR. MELAMED: I was just going to ask a question.

MR. HERSCH: But an ORS is a distinctly different animal, and it is nothing more than a communication system. And I might add that I would suggest--or I may suggest--when we get to the section on ORS that we should reconvene the meeting at the Federal Communications Commission because that is really where that argument belongs.

CHAIRPERSON BORN: Unfortunately, they used to be just a block away, and it would have been easy to do, but they moved. They moved down to a place where they didn't want to be, in Southwest.

If there is nothing else on this issue, the next point of information that would be required in the petition is a description of the activities of the board of trade in the U.S. along with addresses of and activities of any

office or employee of the board of trade in the U.S. or warehouse--if the petitioner lists for trading a futures contract with physical delivery in connection with that warehouse--number of personnel employed or retained by the board of trade in the U.S.

Again, this information would relate to the Commission's finding as to whether the petitioner's presence in the U.S. is appropriately limited, so that it should not be subject to the contract designation requirements of the CEA.

I throw the floor open for discussion of this information point in the petition.

[No response.]

CHAIRPERSON BORN: Seeing no discussion, the next point is "an agreement to abide by the terms and conditions of the Commission's exemptive order." The next point which we will discuss in just a minute is the terms and conditions.

Is there any discussion of that part of the petition?

[No response.]

CHAIRPERSON BORN: And "any further information requested by the Commission." This provision allows the Commission staff to follow up after it receives the petition if for some reason the information is unclear, or it has the need for additional information to inform the Commission about the Standards for Exemption.

I see Arthur.

MR. HAHN: I made the point.

CHAIRPERSON BORN: Is there any other discussion other than Arthur's point, which will be considered?

[No response.]

CHAIRPERSON BORN: Let's go on, then, to the terms and conditions of an exemptive order, which are provided for in Proposed Rule 30.11(d).

[Slide.]

CHAIRPERSON BORN: Thank you, Ethiopis.

The first point is that "only members of the board of trade and their affiliates will have access to direct execution systems."

This term or condition is premised on the view that U.S. investors should not have direct, unintermediated

access to an exempted board of trade, but rather should trade through knowledgeable and regulated commodity professionals, either U.S. FCMs or 30.10-exempt foreign brokers.

Discussion of this as a term and condition of an exemption for a board of trade?

[No response.]

CHAIRPERSON BORN: I see none.

The second requirement is that customer orders must be intermediated by a member of the board of trade that is a registered FCM or a 30.10-exempt foreign broker--somewhat close to the first requirement in terms of purposes.

Discussion on that?

Gary DeWaal.

MR. DeWAAL: Again, it is a motif I have hit before: If it ain't broke, don't fix it.

Again, I wonder what is being added here. Only U.S. FCMs can carry the positions, under the current law, of U.S. clients. I'm not sure what this adds.

It is funny--listening to Ron, Leo and David, I agree with all three of them. We are talking about different types of systems; with DESs and AORs, we are talking about the same kinds of systems. But the problem is that we are talking again about a transmission system, and in fact, it is intermediation that to me is at the crux of all this matter. It is the gateway that we are talking about, and the issue is how best to deal with that gateway.

I immediately go back in time and think of the task force that the industry put together following the Berings crisis and how we came up with best practices of order transmittal, about what kind of information exchanges should make available, what kind of information customers should think about when placing orders. It was a good document, and I think firms try to follow it, I think customers try to follow it, and exchanges and clearinghouses try to follow it.

I am struck again--shouldn't the discussion really be about how best to deal with this gateway, how best to deal with the technological issues of speed, how best to protect the investing public through the gateway, and to

forget that the recipient of the gateway is something that is already authorized. We have to keep going back to that. We are talking about an authorized product, and to me, how best to mind the gateway is best practices. That is something that we should work together to figure out what really works for everybody, as opposed to more regulation in areas that have probably already been dealt with sufficiently.

CHAIRPERSON BORN: Is there other discussion?

Phillip Thorpe.

MR. THORPE: Thank you, Chairperson.

Gary is sounding a bit like a broken record, and I have to hope that I can do the same. I think this rule is the one that leaps off the page at me as this condition is the one that seems to have immediate and total validity, but it does so almost to the point that it excludes the validity of much of the rest of the details.

This does come, of course, from our desire to look at that relationship. If you have established sets of controls for that relationship between the customer and the

intermediary, beyond that, I think the attention can be de minimis.

CHAIRPERSON BORN: Thank you.

Is there any other discussion?

[No response.]

CHAIRPERSON BORN: Let's go on to the third term and condition.

The board of trade must submit to the Commission on a quarterly basis the total trade volume originating from automated trading systems located in the U.S., its worldwide trade volume, and a current list that identifies and provides U.S. members and affiliates that have DESs or allow their customers to use AORSs.

Art Hahn.

MR. HAHN: As a mechanical matter, this cannot be done by LIFFE. We have no idea whether an order that comes down the LIFFE connect system came directly from that broker or through an AORS. We just don't know. And we don't know which of our members do or don't have AORSs out there. So that as constituted, the rule cannot be met by us.

CHAIRPERSON BORN: Well, I hope you also comment on this in writing or provide more detailed information to Trading & Markets so that--obviously, we don't want to ask for information that is unascertainable.

Volker Potthoff.

MR. POTTHOFF: If you collect information about trading volume--we are happy to provide this, but what we would be a little bit concerned about, and it was discussed in the concept release, is in terms of thresholds for being a bona fide foreign exchange in terms of volume.

In the rule proposal, you left this up in the air whether this is something you would consider, but we have to be sure about that, because if you build something up, you invest a lot of money, you have members here in the United States who themselves invest a lot of money, and all of a sudden you meet a threshold, and somebody comes and says, oh, listen, you are not a foreign board of trade anymore, and now you have to apply as a designated contract. That would be something which we could not live with.

CHAIRPERSON BORN: Well, as I'm sure you know, Volker, Eurex is providing this data to us on a quarterly basis, and we find it very useful and informative.

There was a discussion in the concept release about whether the Commission should set a particular volume of trade in the U.S. that would suggest that the foreign board of trade should be designated as a contract market here rather than obtain an exemption.

I think in the proposed rules, the Commission went away from that kind of an approach and suggested that the initial determination as to exemption would look at all the activities of the foreign board of trade to determine whether it was in fact an established foreign board of trade.

The Commission obviously reserves unto itself in the long term the possibility of revisiting that issue, in case what is now a foreign board of trade becomes just a domestic board of trade and uses the original foreign nature as a facade, but I don't think it is laying down any kind of markers at this point for when that determination would be made. It is certainly not setting a particular volume level

as the determinant. Obviously, the Commission in the future, I suspect, would look at all facts and factors.

Phillip Thorpe.

MR. THORPE: Chairperson, I am concerned with this provision in that it does appear to create some uncertainty. I have taken from the rest of the proposed rulemaking that this is not something that the Commission intends as a general issue.

I am also worried that by creating that uncertainty, it may have a perverse regulatory outcome, that if, as Volker suggests, institutions are investing in setting up a system and then are worried about an unknown point at which the fundamental basis of which their operation will change, they may be tempted into action which either disguises the trade that they are doing or alters the manner in which they promote the trade to one sector or another or restricts trade from one sector or another. Any of those outcomes would appear to be rather the reverse of what the Commission or indeed any regulatory system would like to achieve. And I can understand the concern of exchanges that having a point uncertain in the future at

which their status might change is a very difficult one, and as a direct regulator of one of those exchanges, I would find that uncomfortable as well.

CHAIRPERSON BORN: Phil, just to clarify, I assume you are talking about the volume data and not the data about what U.S. members and affiliates there are with screen-based trading.

MR. THORPE: That is indeed correct, Chairperson.

CHAIRPERSON BORN: Danny Rappaport.

MR. RAPPAPORT: I'll pass.

CHAIRPERSON BORN: David Downey.

MR. DOWNEY: I am a bit confused by some wording here. I assume the goal is to identify how much U.S. volume is driving the foreign markets, and the wording that I am troubled with is "volume originating from automated trading systems located in the U.S."

I currently provide order flow to the DTB, and I do not have a DTB terminal in the United States, so all the volume that I do would not have to reported?

CHAIRPERSON BORN: I don't know how you are doing this, David, so I cannot answer that question--

MR. DOWNEY: Okay, I'll clarify it.

CHAIRPERSON BORN: --and clearly, nothing is required now. These are proposed rules, and we are taking comments.

MR. DOWNEY: I'll clarify. An order routing system does not need the portal to be on U.S. territory to work. The question is are you trying to get the number of U.S. contracts that originate in the U.S., or are you trying to get the number of contracts that originate from a foreign terminal that is actually located in the U.S.?

CHAIRPERSON BORN: That's an interesting question that our staff should think about.

Danny Rappaport.

MR. RAPPAPORT: I am sorry. I have reconsidered. I will make my comment, and I'll keep it short.

Having heard from the representative of LIFFE, the representative of Eurex and the FSA as to how it makes them uncomfortable that once they get the foot in the door, they really do not think it is appropriate that at some point they be designated a U.S. contract market, I would like to express the uncomfortableness that the U.S. exchanges have

that once the foreign exchanges get their toe in the water in terms of getting into the U.S. market, there is no point at which they could be required to be a U.S. contract market if their business grows.

CHAIRPERSON BORN: Other discussion of this term and condition?

[No response.]

CHAIRPERSON BORN: If not, let's go on to one of the information requirements or term and condition, that is, that the board of trade needs to give the Commission 30 days' written notice after any material change to information in the petition, change of laws or rules relevant to futures and options that may have a material impact on the order, any known violation of obligations under the order committed by a member or affiliate operating in the United States, any disciplinary action taken against a member or affiliate that involves market manipulation, fraud, deceit or conversion or that results in a suspension or expulsion and involves the use of an automated trading system in the U.S.

Discussion of this term and condition?

[No response.]

CHAIRPERSON BORN: Seeing none, we need to go to the next slide, because there are five more terms and conditions.

[Slide.]

CHAIRPERSON BORN: The next one is the term that I referred to earlier in answering Volker's question. A term of the order would be that the exempted board of trade provide the Commission with 10 days' prior written notice of its plans to offer any new products.

Discussion of that point?

[No response.]

CHAIRPERSON BORN: The next point is another information-providing condition that the exempted board of trade provide the Commission with written notice within 24 hours of any significant system failure or interruption, or a member's default, insolvency or bankruptcy.

Volker Potthoff.

MR. POTTHOFF: Well, when you require--first of all, the term "significant failure"--there is the question if you have a 10-minute interruption, is that a "significant

system failure." But again, it is one of these things where, really, it appears to me that the CFTC is taking jurisdiction over the foreign exchange. It is not itself that we have a problem with providing certain information, but it is a little bit arbitrary what is significant. We would discuss it with the CFTC, we would discuss it with our regulators. You see, that is the burden that we are talking about, and it is no so much clear what you mean by that, and if you talk about a member's default, of course, it should be a member that is located in the U.S. Whatever other information is required, we may have restrictions to providing you with such information due to local law, and I don't know whether that is--if you talk about the clearing system entirely, yes, but then it should be expressed differently.

CHAIRPERSON BORN: Other discussion of this point?

[No response.]

CHAIRPERSON BORN: The next term and condition is that "satisfactory information-sharing arrangements remain in effect between the board of trade, the board of trade's foreign regulatory authority and the Commission."

Art Hahn is making the same point.

MR. HAHN: For the record, yes, the same point. I am very uncomfortable with the foreign exchange reporting directly to the CFTC. It should be to our own regulator.

CHAIRPERSON BORN: Phil Johnson?

MR. JOHNSON: And I also assume that implicit in this is an understanding that a breakdown in communication between the two agencies will not necessarily imperil the status of the exchange.

CHAIRPERSON BORN: I believe that a violation of one of the terms and conditions does not automatically invalidate the order, but instead, there would have to be Commission action taken to revoke, and that would be done only, I assume, after careful consideration.

MR. JOHNSON: I guess I wasn't clear. Suppose we have a situation where there is a perfectly good information-sharing arrangement between the Commission and the foreign regulator, but by reason of some development in the country or a falling out in personalities--any cause whatsoever--that arrangement is interrupted for some reason

having nothing to do with the exchange's performance whatsoever.

I am sure you have thought about it, and I am sure you are making provision for not imperiling an exchange's status under the circumstance where the problem is an interagency problem.

CHAIRPERSON BORN: I think the way the proposed rules are currently written--and obviously, we can take into consideration any written comments on this--the Commission reserves to itself the ability to revoke an order prospectively only if it finds it cannot carry out the necessary regulatory responsibilities that it has.

Now, I think that that would rarely, if ever, be so. I think that that is the situation with our 30.10 orders as well, that we reserve the right to revoke, and we never have done so in the 10 or so years that those have been in effect.

Leo Melamed.

MR. MELAMED: Well, although this is an issue that affects the foreign exchange, in the spirit of the same philosophy of reducing the burdens of such regulation, we

certainly would agree with Art Hahn's point of view that this seems to be an unnecessary burden on them. Once they have submitted to the jurisdiction, why not go through the regulator of theirs? Why do you have to bother them and put them through all kinds of requirements that are really unnecessary? We certainly agree with that point of view.

CHAIRPERSON BORN: Phil Thorpe?

MR. THORPE: I cannot imagine a situation where relationships would break down to that point, of course, but I had assumed--and perhaps your clarification would be helpful on this--that in the terminology that is being here, you are talking about bilateral, perhaps pairs of bilateral, arrangements, so that you were looking for a satisfactory information sharing agreement, for instance, between the CFTC and the FSA and confirmation that we in turn had an ability to obtain information according to these terms from the operator of the DES.

CHAIRPERSON BORN: That's the way I have always read that, Phil. It may need to be clarified if it could be read in other ways. But I think also the point that Art and Leo are making is one that the Commission has tried to be

sensitive to. Frequently, foreign regulators and foreign exchanges prefer that the regulator be the gateway for information exchange. I think we have been amenable to that. That is not necessarily uniformly true in all countries. Sometimes, foreign exchange may prefer to be the direct provider of information, in which case that would be a satisfactory arrangement.

I think the real concern here is that the Commission have access to the information it needs to do its job.

Is there any other discussion of this point, which I think is the seventh of the exemption requirements?

[No response.]

CHAIRPERSON BORN: Then, the eighth is one we have already talked about at some length, which is the requirement that two things are provided to the Commission. One is an appointment of an agent for service of process, and the other is an irrevocable agreement to submit to the jurisdiction of the Commission and State and Federal courts with respect to the board of trade's activities under the exemptive order in the U.S.

We shall incorporate at this point the earlier points made on Subpart (2) of this about agreement to submit to the jurisdiction.

Is there any additional discussion of that point?

[No response.]

CHAIRPERSON BORN: Then, let's go on to the last condition, which is requiring other information to evaluate the board of trade's continued eligibility for the exemption or for other reasons, including information regarding the stocks held at any warehouse maintained in the U.S. for products that require physical delivery.

Is there discussion of this last point?

We incorporate here Art Hahn's earlier comments about the route of information provision.

Volker Potthoff.

MR. POTTHOFF: It there is no comment on this point, I would add a point that is not in the rule proposal, and that is the lack of transition rules. For example, in the case of Eurex, we have 10 members out there trading on Eurex via U.S. screens, and what happens if tomorrow this rule is enacted? Do we have to cut them of until we go

through the application procedure? I don't find anything in the rule proposal.

CHAIRPERSON BORN: I think somewhere there--and I cannot point to the specific language, but I'll ask Trading & Markets to find it for you--there is a statement that as to boards of trade that have gotten a no-action letter, a category of which you are the sole member, they will be given an appropriate period of time during which to make the transition to apply for approval and exemption under the proposed rules.

Am I correct on that, T&M?

STAFF: I think that's right. The Eurex letter expired about 2 months ago, though, just so everyone knows that.

[Laughter.]

CHAIRPERSON BORN: That was a joke. For the record, that was a joke. That's stricken from the record.

But certainly, the plan is that while Eurex is not permanently grandfathered in, because it got the no-action treatment, it will be given a reasonable opportunity to

apply and be able to continue to operate under the no-action during the application process.

George Crapple.

MR. CRAPPLE: This may not be an appropriate moment, but I think I am one of the few representatives at the roundtable who is speaking for customers, the users of the exchange, as opposed to exchanges and FCMs, and I think that one of the thrusts of regulation is supposed to be protecting us customers. We use the U.S. and international exchanges currently, and the thing that bothers me about the proposed rule is that it creates about 20 hoops that have to be jumped through before we customers can utilize the most effective access to these exchanges, and I think it is something that really has to be taken into account. I mean, who is being protected from what here? And I personally don't feel that as a customer, the proposed rule is helping me.

CHAIRPERSON BORN: Is there any other discussion before we go on to AORSs--a hot topic if there ever was one?

[No response.]

CHAIRPERSON BORN: Let's put up the next slide, which deals with the standards for qualified AORSs.

[Slide.]

CHAIRPERSON BORN: Let me just say a couple of words about this before we start. This involves Proposed Rule 1.71(b), specifically.

Under the proposed rules, all trading in the U.S. via automated trading systems would require an otherwise foreign board of trade to become a designated contract market or to enter into a Commission-approved linkage arrangement with a designated contract market or to obtain an exemption pursuant to the proposed rules.

Only members of an exempted board of trade or their affiliates could have direct execution systems, or DESs, that permit direct access to that board of trade's electronic markets. This proposition is based on the premise that customers should not trade directly on these exchanges, but instead, their trading should be intermediated through a knowledgeable commodity professional who is registered with the Commission or has been exempted

because he or she is the subject of comparable foreign regulatory regimes.

This ensures that the customer has access to knowledgeable advice about complex issues relating to trading futures and options and that a commodity professional is available to be financially responsible to the market for that customer's activities.

The proposed rules would permit screen-based trading by U.S. customers on an exempted board of trade under certain circumstances designed to assure some limited intermediation by a commodity professional.

This aspect of the proposed rules may involve some of the most important public policy issues posed by the rules. We all know that the availability and immediacy of screen-based trading has posed some new dangers to the investing public and to the market. Media reports of naive investors losing everything through internet securities trading abound, and congressional committees are currently inquiring into the adequacy of regulation in light of these new risks.

Parenthetically, I appeared at the end of March before a subcommittee of the House Banking Committee and was questioned about the degree to which we allow screen-based trading for customers, as was the SEC Commissioner who was there as well, Laura Unger.

We have also heard stories about members and professional traders on electronic futures exchanges losing millions because the wrong button on the computer was pushed. Screen-based trading by customers on futures markets in the U.S. is in its infancy. The T&M no-action letter to Eurex does not permit access to Eurex terminals by customers. With respect to domestic contract markets, some firms, I believe, are now offering online trading access to the E-mini version of the S & P 500 futures contract on Globex 2, and authorized customers will be able to access products on the Cantor Financial Futures Exchange.

Such access is subject to position limit and credit checks and other protections. Indeed, these initial experiments with customer screen-based trading are being approached by our domestic exchanges with great care.

The proposed rules provide standards for screen-based trading systems which are available to U.S. customers as follows--and they are up on the screen. The proposed standards are intended to guarantee a certain minimum degree of intermediation with respect to a customer's screen-based trading. They are intended to protect customers against illegal trading, insecure and unsound automated trading systems, and responsibility for unauthorized trading in their name.

They are also designed to protect the market and other customers from irresponsible trading by the customer that endangers their financial stability or security.

They require an FCM or an exempt firm under Rule 30.10 to comply with certain safety and soundness standards to protect their customers, their own operations and their markets.

The first of these standards is that access is limited to trading conducted on a designated contract market through an FCM, to trading conducted on a board of trade exempt pursuant to Section 4(c) through an FCM or a Rule 30.10 firm, or to trading conducted on a board of trade

otherwise operating primarily outside the United States which has gotten a 4(c) exemption--I am sorry--this is a foreign board of trade with a linkage arrangement with a U.S.-designated contract market. Trading there may be through an FCM or a Rule 30.10 firm.

This requirement is designed to ensure that the customer is trading on a market that is legally permitted to operate in the U.S. through screen-based trading. To date, as I have said, customer screen-based trading has been done on designated contract markets subject to U.S. law and regulation.

Issue has been raised about whether customers should be allowed to trade through automated systems, their PCs or other terminals, on foreign markets which have not been analyzed by the Commission under the proposed rules.

There are new electronic exchanges being created in countries around the world, including places like India, Malaysia, Korea, South Korea, the People's Republic of China. This standard is designed to ensure the customer is trading on a sound exchange subject to the generally comparable regulatory standard.

I think we should begin with discussion on this standard.

Kyra Bergin.

MS. BERGIN: We have spent a long time talking about competitive issues, and I would like to start by saying that like exchanges, the FCM community is subject to the whims of competition.

The FCM community in its drive to provide better customer service has been focusing on using technology to increase the speed and efficiency of access to markets and to provide better market information and analytics--everything that is on a screen. This is what the U.S. customer wants, coming back to what does the U.S. customer really want. And maybe I should be a bit more forceful--it is what our U.S. institutional customer base is demanding from us.

And FCMs, spurred on by customer demand, have developed order routing systems that are simply a means to improve the way an order gets executed. FCMs are regulated already. They are simply using technology to provide a better service to their customers. By imposing additional

standards, I believe that the CFTC wants to impose additional burdensome rules on order routing systems developed by FCMs who are merely trying to provide efficient access to customers to non-U.S. electronic exchanges.

This is flawed because I don't believe there is a true distinction between open outcry and electronic exchanges that warrants additional rules for order routing systems solely based on electronic exchanges. Indeed an argument can be made that order routing systems protect against human error in the execution of orders.

Second, I still think that the FCM is the intermediary; it is simply providing a more efficient means of order entry. And I think that the CFTC already has sufficient existing regulatory authority and power over its supervision of FCMs. I don't believe more rules or more standards are required.

And I'll finish, since there was some statement made about incorrect buttons being pushed, which is a button that I am concerned about--this actually goes to the point that Phillip Thorpe made earlier. As technology advances, the market learns as the technology advances. There is no

way that one can predict what technology will be able to provide 6 months or a year from now.

The issues that come up with electronic trading often have to deal with the system interface into the exchange, and if you look at the exchanges both in the United States and elsewhere, you will often find limitations of liability that individuals and companies that trade on the exchanges are becoming more aware of. We are becoming more aware of the role of the interface provider to the exchange. But this is a developing process, and it is one that the intermediaries learn about in tandem, often through unfortunate situations that arise, but I don't think you can regulate for those changes. The market will adjust and deal with them.

Thank you.

CHAIRPERSON BORN: Other discussion?

Ron Hersch.

MR. HERSCH: As I indicated in my earlier comments, certainly on behalf of many in the FCM community and the FIA, we really do not believe that any additional rules need to be imposed on FCMs, and really, what this does

in effect is impose new and more onerous rules on FCMs, and as I said before, FCMs are already regulated, and the way in which we handle customer orders both on domestic and on foreign futures exchanges is already regulated.

I don't want to be redundant and repeat Kyra's comments, but I agree with all of them, so I'd like the record to so state that.

I will go back to what George Crapple said a few minutes ago. Let's think about this functionally. Who really will get hurt by additional regulation being imposed upon FCMs with respect to technology, automated order routing systems? The customer ends up getting hurt, I would suggest, because you are not saying that customers will not be able to trade on certain foreign futures exchanges; you are only saying that those customers, should they choose to utilize exchanges that have not agreed to submit to CFTC jurisdiction, will have to have their orders handled the good old-fashioned way, by telephone or by a nonautomated means, which obviously is a much less effective way. It is not as effective in terms of audit trail, and it is not as

effective as all the other technological protections that can be built into an automated order routing system.

CHAIRPERSON BORN: Leo Melamed.

MR. MELAMED: I think the exchanges would agree that the FCMs do not need any additional regulatory requirements, and we certainly don't want further burdens on the FCM community. In this respect, they are regulated more than enough--too much, probably.

But again, we have to come back to the same issue. We cannot make a distinction as it relates to regulatory requirements on the exchanges and in competition with foreign exchanges between the delivery mechanism of that order, whether it is an order entry system like through ORS, or whether it is a DES system, direct or any other way, because for us it is a competitive issue again. And if by doing it this way and not requiring the same regulatory framework for electronic systems, whatever they be, and American exchanges, then the standard is too difficult for us to meet in a competitive environment.

So again, we urge the Commission to consider that. We are not looking for additional regulation. On the

contrary--we would like to lower our regulatory requirements, and I know I am harping on the same theme, but that's the theme that is of greatest concern to the exchanges--the ability to be able to compete.

I might also make one more mention of this, though it isn't of great import, but perhaps it is, to remember that a lot of FCMs do not have an order system. They are smaller FCMs. They are the bulwark of how the industry grew up, and they offer innovations and competition, but sometimes they cannot afford an ORS system of their own. And if we bifurcate the regulatory requirements so that the smaller FCMs that cannot afford the ORS system must live in a much more difficult environment in terms of sending their orders than does someone who sends it through an FCM with an ORS system, we are creating a bit of a monopoly for the larger FCMs or those that can afford it.

It is perhaps not the most critical issue, but it is one to remember.

CHAIRPERSON BORN: Other discussion?

David Downey.

MR. DOWNEY: This is a very interesting topic. I am on Leo's side on this one--I am not on his side to the extent that I want him to lower his regulatory requirements in terms of customer protection, but I do believe that a device that connects to an electronic matching engine should have certain regulatory requirements, very much like an electronic matching engine.

The lure of these systems, if I could--this is matching engine, and inside of that circle is an audit trail that cannot be broken. And exchanges provide front ends that are connected to the audit trail and maintained on that audit trail from birth to death of an order.

For the FCMs to connect--and this is my FCM connection--I am adding something to that system that breaks the audit trail, and that is where my problem with the FCMs is here in this discussion about some people cannot afford it. What we cannot afford as an industry is for this audit trail to be broken.

Current regulations make the FCMs time-stamp their orders to within a minute. The electronic matching engines are two fractions of a second. Without clarifying this,

this allows for a window of opportunity for bad people, if you will, to grab a customer order, trade ahead of it and then put the customer order afterwards. That is called "front-running."

My problem is that if they do that through an order routing system that does not meet the regulatory time-stamping requirements, they will never be caught.

As you know, I am in favor of order routing systems. I believe the order routing systems are an adjunct to the trade-matching engine and are a very important part of the audit trail. I differ with the FCMs, but I believe they should meet this requirement to time-stamp orders to a fraction of a second. I believe that all of their clocks should be synchronized with the matching engine so there are no conflicting time-stamps, and I also believe that a customer identifier should be placed on that order prior to it being transmitted through the order routing system to the exchange for execution.

We are either going to do this now or we are going to do it 2 years from now when somebody does come up and show that a customer was front-runned, and there was

manipulation, and then I am faced with--and I really fear this--that 2 years from now, the Commission is going to raise the bar to a level where nobody can meet it for fear that this cannot be controlled.

This definitely can be controlled. It is not as expensive as the FCMs make it out to be. This is good business practice, and it is going to save us from coming together to meet like this 2 years down the road.

CHAIRPERSON BORN: Thank you, David.

Ron Hersch.

MR. HERSCH: I accept your comments, David, but I believe that does not bode for more regulation. You are taking for granted the intelligence of most of the customers who trade in our markets nowadays.

Yes, as Leo said, FCMs will have different automated order routing systems. Some will have great ones, some will have good ones, some may have mediocre ones, and it is certainly our desire within the FCM community to see that all of those order entry systems meet some basic standard. But even after that standard is met, it is competition that will root out whatever, not necessarily

evils are there, but if my firm is not able to provide the quickest and best fills to my customers by using my automated order routing system because it is slower then yours, then I am going to lose that customer today in the same way as if I have a lousy clerk on the telephone giving me fills, I have to change the clerk. So competition will solve that problem.

And I do not mean to suggest that the FIA believes that it should be a free-for-all here. What we have in fact proposed within our response to these rules is that there should be standards, there should be best practices. But there does not need to be any more regulation.

CHAIRPERSON BORN: David Downey.

MR. DOWNEY: I understand that competition is going to drive the customer to the person who treats him the best, but that will only happen after he has been raped, and I don't think that with these systems, the way we are discussing these now, we should overlook that this possibility exists for a customer to be front-runned.

And for you to say, trust me, we are going to do our damndest so it doesn't happen, I have got to tell you

that that does not sit well with me, because the window--we are talking seconds here that this can occur. These systems can have this audit trail down to a fraction of a second that absolutely tells you who knew what when, and to say, "Trust me, we'll get that fixed," I am not buying it.

CHAIRPERSON BORN: David Pryde.

MR. PRYDE: David, I couldn't agree more with Ron on this point. We have practical experience to back this up. Right now in Europe, we use three different order routing systems, and we have had several clients bidder-test all three, and I can tell you we get a call--if a fill is a second slower on one machine versus another, they are on the phone in an instant saying, "Get this piece of junk out of here." Competitive pressures will solve the problem that you are talking about. And is electronic training the perfect medium? I'm sure it is not. We are all learning as we go. But we can't go back to open outcry, because I know for a fact that people front-orders in open outcry as well.

CHAIRPERSON BORN: David Downey.

MR. DOWNEY: Sorry, David. I agree, that's exactly what these electronic systems will wipe out if they

are properly put together. If you go in and deliberately take away the audit trail, and you argue that, well, I need this, this is what I'm having trouble with. This is a perfect audit trail. Your adjunct to it deteriorates the audit trail, and it allows for front-running. There is no front-running here.

CHAIRPERSON BORN: Is there any other discussion of this particular requirement for customer access to screen-based trading?

Phillip Thorpe?

MR. THORPE: Thank you, Chairperson.

I am conscious that I am going to have to depart this exciting discussion, so I might get one last turn at the broken record in here.

I was delighted by David Downey's comments that there is no front-running existing now, and that is a great relief to me as a regulator. I am afraid I am cynical enough as a regulatory--

CHAIRPERSON BORN: I'm afraid I didn't hear that, so I didn't get that reassurance from David.

MR. THORPE: Perhaps I was overinterpreting. But I believe the likelihood of producing a system that bulletproof in regulatory terms is low. The analysis that we have undertaken indicates that order routing systems can provide an improvement and enhancement if used sensibly by FCMs and the like. And we wish to put the onus on the FCM community and anyone else who is likely to use them to ensure they meet the best standards.

As I said earlier, the approach that we would like to see taken in the United Kingdom, and I contain it to that, is that the market come up with a better practice, that anyone executing orders does so through some intermediary who is appropriately licensed, and we hold onto our hats.

That is not a sense of risk-taking; it is just the natural state for the development of the market.

CHAIRPERSON BORN: Is there any other discussion?

George Crapple.

MR. CRAPPLE: As a customer, I am prepared to trust the FCMs that we deal with to take proper action to prevent them being bankrupted by customers madly pushing

buttons. I don't think you need a new set of rules for every possible thing that can go wrong in futures trading. I mean, there are many things that can go wrong that the rules do not necessarily cover, such as the Griffin trading system where somebody with a give-up agreement made a gigantic and ruinous order. I don't think we have to necessarily try to legislate every conceivable thing that will come up, and I don't think that we'll be successful anyone in trying to anticipate every problem with the order routing systems. I leave it to the FCMs.

CHAIRPERSON BORN: Is there any other discussion?

Ron Hersch.

Mr. HERSCH: Thank you. I don't even have to turn the microphone on again.

There are two other points I want to make for the record. One is something that hasn't been discussed as much as I would have liked to have seen it discussed with this issue. And make no mistake about it. Those on this roundtable and the Commissioners need to know that applying more regulation to FCMs, particularly with respect to AORSs, will drive business offshore. I will tell you how. The

business is 85 percent institutional. I would guess that at least 50 percent of that 85 percent of those institutional customers have foreign affiliates. It is simple for them to move their business offshore. They have offices in London. They have offices in Paris. They have offices in Tokyo.

If certain exchanges refuse to submit to CFTC jurisdiction, which in effect will disallow us from using the order entry systems that we are making huge investments in, our answer to those customers is very simple: Open your future accounts in your foreign affiliate, move it offshore where we can use our AORS. This is not good for the U.S. futures business.

Now, unfortunately, in my comments, I have not focused as much as some of my colleagues on the exchanges have with respect to a level playing field. That is a different issue, but it is something we support. And for every time I have brought up an issue relative to making it easier for us to compete as an FCM for futures business, I do not mean to imply that those same standards should not apply to U.S. futures exchanges.

That's the first point. Remember--this rule will drive business offshore.

Number two, just to say it in plain English, you are going to muck up the system. I am going to have to have two systems for my U.S. FCM. I am going to have to have one guy sitting on one side of every desk who is going to be taking orders from customers and putting them over a voice line to whatever exchanges decide not to submit to CFTC jurisdiction, and I am going to have another system which can be automated, more effective, with an audit trail and all those good things.

And I will tell you, talking about errors and pushing the wrong button, if you think you have errors now with pushing the wrong button, I can tell you that if you have clerks, salespeople, or even customers who are forced to use two different systems, one system for exchanges that decide to submit, one system for exchanges that decide not to submit, you are worse off than you would be if you didn't allow this to happen at all. And we all know we have got to go with technology.

CHAIRPERSON BORN: David Downey.

MR. DOWNEY: I finally agree with Ronny. I think that you should allow the use of order routing systems even to exchanges that are not currently exempted for the very reason that these systems will provide better customers protection than they now get by the use of telephone systems.

By the way, Ron, the FCMs are biased that they think they are going to take their current operation, and they are going to take technology, and they are going to meld it in, and we are going to have a bunch of order-takers sitting on desks, taking phone calls from customers, which they happily type into a trading system or an order routing system. I would like to put forth a different version--that the customer, the end-user customer, will be given the capability to interact with these markets in real time, obviating the need for these trade desks, in fact, obviating the need for these institutional users which now dominate. And much like the securities market on the New York Stock Exchange with the introduction of DOT, you see the rise of the individual user as a percentage of volume, and it is not something that--I have heard the big FCMs say, hey, this is

an institutional market, let us play. This is not. This is a retial market that is about to explode, and that's what we need to protect.

CHAIRPERSON BORN: Ron Hersch.

MR. HERSCH: David, I wish you were totally right. You are fast-forwarding. We have talked to many of our customers. Not every customer is going to want to be connected by an automated order entry system to every exchange in the world. Not every customer is going to want a terminal. I predict that a significant amount of business will still be conducted for certain customers within the FCM community by people who provide value-added service to their customers and a variety of other things.

So that yes, indeed, you may be correct, but it does not alleviate the problem I just stated, that even if that automated order entry system is located at the domicile of a customer--directly with a customer--then that would preclude under these rules that customer from using that order entry system to execute business on exchanges that don't submit to CFTC jurisdiction, and that's the problem.

MR. DOWNEY: Again--I'm sorry.

CHAIRPERSON BORN: I recognize David Downey.

Mr. DOWNEY: Again, I agree with you on that point, Ronny. I believe that those order routing systems should be allowed to be given to customers even if the end, a logical destination, is an exchange that has not received exemptive relief because the use of these order routing systems provide greater protection than the current mode of collection.

CHAIRPERSON BORN: Back to Ron Hersch.

MR. HERSCH: Then, you have just agreed with me that there is a major flaw in this rule, a major flaw in this rule. The whole basis of this rule is that foreign futures exchanges have to submit to CFTC jurisdiction in order to allow the use of order entry systems.

MR. DOWNEY: I would agree with you. I am against that, too.

CHAIRPERSON BORN: Leo Melamed.

MR. MELAMED: Just so long as it is not forgotten that the American exchanges have an interest in this whole issue, and I think the CFTC has some duty with respect to American exchanges, their viability, and their competitive

capability. As long as that is remembered, and our standards are no different from foreign standards in meeting that competition, we have no argument with this entire subject.

But I am afraid that in this fast shuffle, the American exchanges might be forgotten and that that regulatory parity might never occur, and instead, we will go in some other direction. Well, if you are worried about what will happen to the United States financial sector if you put rules on ours, start worrying about what will happen to the American financial sector when there are no American futures exchanges on which to do the business. Those were the exchanges from which most of this financial sector drew and from which an enormous amount of innovation came and continues to come, and it was the backbone of what has brought this enormous greatness to the financial service sector of the United States.

I hate to think that we are sitting in a position in which we will see or do something to cause the demise of that financial sector.

I want to--and I won't belabor this point any further--but it just occurs to me that in his speech to the FIA, Chairman Greenspan had the following to say about this very subject that I am talking about: "The largest banks in particular seemed to regard the regulation of exchange-traded derivatives, especially in the United States, as creating more burdens than benefits. As I have noted previously, the fact that the OTC markets function quite effectively without the benefit of the Commodity Exchange Act provides a strong argument for the development of a less burdensome regime for exchange-traded financial derivatives."

I couldn't have said it better.

MR. HERSCH: Leo, you almost surprised me. I thought you were going to say Chairman Hersch at the FIA and that you were going to refer to my speech, where I spoke, I thought very eloquently, about the need for a lower level of regulation, a lower standard for U.S. futures markets. I hope you didn't miss my speech.

Thank you.

MR. MELAMED: I didn't miss your speech, and I am grateful for your assistance in this regard.

CHAIRPERSON BORN: Any additional discussion of the first standard for a qualified automated order routing system?

[No response.]

CHAIRPERSON BORN: Then maybe we should go on to the second standard, which is that "access is limited to products that can lawfully be offered and sold in the U.S."

As I mentioned before, there are certain futures products that are illegal within the United States at the present time, such as futures on equity securities, futures on stock indices that have not gone through an approval process, futures on foreign government securities or other debt securities that have not been exempted by the SEC and approved by the U.S.

This requirement would ensure that U.S. customers were not trading on their screens contracts that are illegal under U.S. law. For example, the Sydney Futures Exchange does, I think, have some futures on equity securities that are currently illegal to be traded here.

I see Phil Johnson, interestingly enough, asking to be recognized.

MR. JOHNSON: Just a question for clarification. Would it be permissible on these systems for, let us say, David's company to accept an order from a Japanese customer for execution in stock futures on the Sydney Futures Exchange? Is this intended to block the product or the user, I guess is my question.

CHAIRPERSON BORN: I haven't even considered that issue. It is an interesting one for our staff to look at.

George Crapple and then Kyra Bergin.

MR. CRAPPLE: Just briefly, I don't see the need for this particular rule. It seems to me that it violates other rules that are already in existence. What does this add?

CHAIRPERSON BORN: Kyra Bergin and then Leo Melamed.

MS. BERGIN: I was going to say the same thing. It seems to me that this section is redundant, because if we are dealing with FCMs accepting orders through their AORS system, the FCM is already subject to rules about what it

may legitimately solicit from U.S. persons. This is unnecessary.

CHAIRPERSON BORN: Leo Melamed and then Phil Johnson.

MR. MELAMED: I just want to rush to the fore here and suggest that rather than banning the FCM's use of such products--I agree with Kyra and George--I think what has to happen is, again, change that requirement and let the futures markets also launch some of those products. We would be very happy to compete with Australia.

CHAIRPERSON BORN: Well, as you know, that is an issue that is not within the Commission's powers at the moment because of the provisions of the statute as they now stand.

MR. MELAMED: I realize that. I just thought I'd put it out.

CHAIRPERSON BORN: Well, I think it is a very interesting idea.

Phil Johnson.

MR. JOHNSON: George and Kyra are of the view that what is being attempted to be articulated here is simply a

restatement of the prohibition. The purpose of my question was we know the prohibition says no U.S. person may trade these. The question in my mind is whether a non-U.S. person would be blocked from using an order routing system that belongs to you folks as well as the U.S. person. This language is a little vague on the point.

CHAIRPERSON BORN: Is there any other discussion of the second standard for qualified AORSs?

[No response.]

CHAIRPERSON BORN: The third standard is that "the FCM or Rule 30.10 firm takes reasonable steps to ensure that the system is and remains sound and secure and fit for the purpose for which it is intended."

Discussion on this point?

David Pryde.

Mr. PRYDE: I assume that the Commission will take steps to actually try to define what "reasonable steps" are. Obviously, in my firm, we try to ensure that all of our systems are maintained in reasonable order, but certainly when we are dealing with order routing systems that are--and most of them are supplied by outside vendors--there are

things that are just out of our control. And if a server goes down, that's also out of our control, so we really would like to see some clarification on that point.

CHAIRPERSON BORN: That interests me, because I think this was intentionally framed by the staff in such a way as to give the FCM a great deal of breadth and discretion, and this was an attempt not to micro-manage FCMs' decisionmaking.

David Downey.

MR. DOWNEY: I just want to mention that a big part of the system is an internet component that nobody has control over, and creating a requirement that we make sure the internet is secure is a bit burdensome.

CHAIRPERSON BORN: Perhaps impossible. That's a very useful comment.

Jerry Tellefsen and then Kyra Bergin.

MR. TELLEFSEN: I'd like to agree with both David Pryde and David Downey. I think it is very difficult for anyone using third party order routing systems to ensure the reliability and security of that particular system all the time.

However, I think the onus is on the FCM to be prepared to change if they think something is not operating--if they are not going to be competitive with what they have, they are going to change, but it is very difficult to monitor on a day-to-day basis how well those systems are going to perform.

CHAIRPERSON BORN: Kyra Bergin, and then David Downey, and then Leo Melamed.

MS. BERGIN: I agree with the comments that have just been made. I do not think that this additional rule is necessary. It is an attempt to provide some sort of warranty for a system of execution that I do not think is appropriate given the developing nature of the systems.

Again, remember that U.S. customers have the ability to choose which FCM they want to use to execute their orders, and there is a choice to use well-capitalized, well-managed FCMs, and I think that it is up to the Commission to appreciate that the FCMs can take different but equivalent steps to manage their own business and provide an order execution system, whether it is manually or electronically.

CHAIRPERSON BORN: Thank you very much, Kyra.

David Downey.

MR. DOWNEY: Jerry said he would be happy if a member firm could get a third party to provide him with a system, and then the FCM cleanses itself of responsibility for that system, and I think that that is an enormous way out for the FCMs and responsibility, and if it is your responsibility to route the order correctly, whether you buy or build, you are responsible for it.

CHAIRPERSON BORN: Jerry has asked for an opportunity to respond, and then we'll go to Leo.

MR. TELLEFSEN: I think maybe you misinterpreted, or I didn't say exactly what I wanted to say properly, David. What I am saying is that the FCM wants their third party order routing system to work and to work well, have audit trails and be fast. However, they cannot monitor how well it is performing technologically on a minute-by-minute basis.

However, when they do determine that it is not providing them the type of service they contracted for, it

is their obligation to find something better or perhaps lose some of their customers.

CHAIRPERSON BORN: Leo Melamed.

MR. MELAMED: Except for the fact that we agree the audit trail ought to be sufficient to protect the customers, as David Downey has suggested.

I would certainly embrace what David Pryde and others, Kyra and so forth, have said, that much of this is micro management, that it really does not belong--you just do not want to get into ever nook and cranny of this business that is really run by supreme professionals such as we have in the FCM community. I just find these kinds of things a little bit overdone, and I think they should be relieved of these burdens.

CHAIRPERSON BORN: Thank you.

Art Hahn.

MR. HAHN: I would echo what Leo is saying, and one of the problems with this section and, candidly, some of the sections on the way they were written on credit control and some of the other things, is that they are ambiguous enough to leave room for all kinds of private rights of

action, and that would put a huge burden on the expense of doing business in this industry, and I do not think it is intended or necessary. So I would be very careful with seemingly easy sentences like this that can cost huge amounts of money and a lot of problems.

CHAIRPERSON BORN: Are there any other comments on this particular standard, or we will go on to the next one, which is that "for FCMs, information already required by the rules is recorded as required in the rules, except that order-related times must be captured to the nearest second."

That adds a new requirement in effect to 1.35(a-1)(1) for purposes of AORS orders.

Discussion on this?

David Downey.

MR. DOWNEY: I think this is something that needs to be put in place, and I believe there is a precedent for this. While there is no rule, when Timber Hill attempted to connect to Globex, we had our connection for our proprietary trading, but we wanted to allow customers access, and that was prohibited. I believe it was Carl who told me that I had to go to the CFTC. It made sense to me

that Carl didn't want to take the ball, and he blamed it on the CFTC. It was a bit of a delay, but it was worth it.

In the end, what I came up with was that in order to connect my system to the Globex system, I had to meet three hurdles. One of them was that I had to maintain an audit trail from birth to death, in keeping with the audit trail of the system.

The second one, which is related to the first, is that of course, I had to keep my clock synchronized to a standard, it works out--you do not have to synchronize it to the machine as long as everybody is on the same standard.

And the third and the one that was really driven down my throat was that every order, prior to being transmitted through the system for execution, had to have an order identifier on it.

Now, in a concept release--not a concept release--it was an alternative means for meeting 1.35, a release advisory of February 1997, the Commission said, "We believe that the inclusion of the account identifier is critical."

Now, I'd like to see that also in here. This is a critical statement, that this allows for making sure that

the customer is not mistreated and that his order is executed and allotted to him in the order that he got there. I very much think that--again, I know the FCMs are not going to want this to happen because they have got to build this--but this is a customer protection issue, and I want to deal with it now instead of 2 years from now.

CHAIRPERSON BORN: Other discussion on this point?

[No response.]

CHAIRPERSON BORN: Seeing none, we will go on to the next standard, which is that "The AORS is designed and operated consistent with the duty of the FCM or Rule 30.10 firm to maintain proper internal controls and supervision over the handling of customer accounts, which must include, but it not limited to, credit and trading or position limit checks performed prior to an order's execution."

Discussion of this requirement, the fifth standard for a qualified AORS?

Yes.

MR. MUNRO: I don't think we would have any particular objection to this and the next two rules after it in the sense that if you look at most order routing systems

out there, they already have these sorts of features. But I think it is probably overstepping the bounds a bit in terms of trying to micro-manage what an order routing system looks like. These things are going to evolve, as other people here have pointed out, quickly over the next many months and many years into things that we don't even recognize nowadays, and specifying specifically here what these order routing systems should have is probably overstepping the bounds a bit.

I think that if you went back to the third point about FCMs taking responsibility to make sure their systems are sound and secure and fit for the purpose, that sort of preempts this one and the next two. Let the FCMs be the judge of what works and what does not. I think the Commission should really be trying to set objectives here, not specifically identifying particular features that systems should have.

CHAIRPERSON BORN: I might add just for informational purposes that there was a considerable amount of concern by the Commissioners about the experience with Griffin Trading, and in fact the Commissioners asked for

some special briefings by Trading & Markets of the Commissioners about the experience with Griffin Trading and how it might impact on these rules prior to their looking at these rules.

There, as you know, there was a customer who managed to evade his trading limits and caused the FCMs bankruptcy and serious losses to other customers. I suspect that some of the Commissioners' concerns were being reflected here.

Is there further discussion on this requirement?

[No response.]

CHAIRPERSON BORN: Seeing none, we will go on to the sixth issue or the sixth standard for customer screen-based trading in these proposed rules, which is the capability on behalf of either the FCM or the Rule 30.10 firm on a unilateral and immediate basis to block the customer's use of an AORS where necessary or appropriate to safeguard the FCM, other customers' accounts or the stability or security of the board of trade.

Discussion on this point?

David Downey.

MR. DOWNEy: I think this is going to be self-policing. Anybody who builds a system that allows unauthorized access and allows a customer to send order flow down that the FCM will eventually pay for--it's a free market.

CHAIRPERSON BORN: Is there any other discussion of the sixth standard here?

[No response.]

CHAIRPERSON BORN: Then we'll go to the seventh standard, which is that "there are reasonable safeguards to ensure against unauthorized access, unauthorized trading and unauthorized disclosure of customer orders and to provide overall integrity and security of the AORS."

Discussion?

David Pryde.

MR. PRYDE: It seems to me that this is really onerous. When we give an order routing system to a client, obviously, there are safeguards built in, there are passwords that are required for the authorized trader to access the system, and other safeguards as well. But what do we do in a case, for example, where an authorized trader

goes to the bathroom, doesn't shut down his screen, and a disgruntled employee walks in and trades a couple of thousand lots? Who is liable? I don't think the FCM should be held liable in that situation. So our ability to monitor what a client does with the screen once it is on their premises is extremely limited.

CHAIRPERSON BORN: Let me ask you, since we are talking about both retail and institutional customers, we are talking about putting this onto an individual's PC where they might leave to go to the bathroom, and their 6-year-old would come in and start trading. Since we are permitting this for retail customers as well as institutional customers, is it your feeling that there is no need for any kind of protections?

MR. PRYDE: I think there should be protection, but I can't see how the FCM can possibly police a 6-year-old.

CHAIRPERSON BORN: That may be an issue.

Ron Hersch.

MR. HERSCH: I think in this case, as with several other issues like this throughout the proposal, I have a

great deal of trouble with words like "reasonable," and "reasonable safeguards." Theses are so interpretive, and I believe this is going to be a very difficult issue to resolve. I do not as we sit here today have an answer to that, but that is an issue of mine.

CHAIRPERSON BORN: Leo Melamed?

MR. MELAMED: I would agree with both David's and Ron's comments here, because again, the CFTC is getting into an area where competitive considerations take care of this, and what is reasonable to JP Morgan will be determined in the competitive marketplace. They are going to protect themselves. They are not going to want a lawsuit to evolve from a 6-year-old or a maid or anybody else, and they are going to build in whatever protections they think they need.

I just wonder if they want the CFTC investigator going to the premises of the 6-year-old and checking out his playpen to see if he was able to get into the computer.

I mean, really, I would rather have the FCMs decide what they need here.

CHAIRPERSON BORN: Other discussion of this point?

[No response.]

CHAIRPERSON BORN: The last proposed standard is that "an FCM has the capability to download trade history on each order entered through an AORS on a daily basis and otherwise to maintain records related to such orders in accordance with Rule 1.31."

Discussion of this?

[No response.]

CHAIRPERSON BORN: Seeing none, I would like to thank you all for your participation--

COMMISSIONER HOLUM: Excuse me.

CHAIRPERSON BORN: --and I hereby adjourn the meeting.

[Whereupon, at 5:10 p.m., the meeting was adjourned.]

- - -