

**TESTIMONY OF PETER REITZ,
MEMBER OF THE EXECUTIVE BOARD,
ON BEHALF OF EUREX**

**BEFORE
THE UNITED STATES COMMODITY FUTURES
TRADING COMMISSION
AND THE
UNITED STATES SECURITIES AND EXCHANGE
COMMISSION**

SEPTEMBER 2, 2009

I am Peter Reitz, a member of the Executive Board of Eurex. Chairman Gensler, Chairman Schapiro, and Commissioners of the Commodity Futures Trading Commission ("CFTC") and of the Securities and Exchange Commission ("SEC"), I appreciate this opportunity to appear before you today and thank the Commissions for calling this unprecedented joint meeting on the important subject of regulatory harmonization. As a member of the Executive Board of Eurex, I have overall responsibility for the management of Business Development for Eurex.

1. *Eurex and Affiliates*

Eurex Deutschland is a futures and options exchange operated by Eurex Frankfurt AG (hereinafter "Eurex Deutschland" and "Eurex Frankfurt AG" together are referred to as "Eurex"). Eurex's wholly-owned subsidiaries include Eurex Clearing AG, its clearinghouse, and the International Securities Exchange ("ISE"), a national securities exchange.

Eurex operates through an all-electronic trading platform and is the world's largest futures and options exchange. Eurex lists futures contracts and/or futures options on interest rates, volatility indexes, inflation rates, commodities, weather and property values. Notably, Eurex also lists on the same exchange options and futures on individual stocks, stock indexes and exchange traded funds.

Underlying Eurex's futures and options contracts are, with a few exceptions, European government and equity securities and European traded commodities. Eurex is the home of derivatives on the Dow Jones EURO STOXX 50, DAX, and SMI indexes which are the benchmark indexes for the euro zone, German and Swiss stock markets. Eurex's bund, bobl and schatz contracts provide the benchmarks for not just German interest rates but also all highly rated, euro-denominated sovereign debt. Eurex offers the largest, most liquid stock options market in Europe.

The Eurex market operates independently of a member's location, permitting international participation. Members are connected to Eurex via a dedicated communications network from over 700 locations around the world. As of July 15, 2009 Eurex had 407 members and more than 8,500 registered traders in 26 countries. 74 of Eurex's members are U.S. resident entities. In addition, many Eurex members in Europe and Asia are wholly-owned

subsidiaries of U.S. financial institutions. To facilitate access to the Eurex trading platform, access points have so far been installed in a number of financial centers including Amsterdam, Chicago, New York, Frankfurt, Gibraltar, Helsinki, London, Madrid, Paris, Zurich and Singapore.

More than 2.1 billion contracts were traded on Eurex during 2008. Like many other derivatives exchanges, Eurex attracted unprecedented levels of trading last year as the world financial system fell into disarray. During last year's market turbulence, bankruptcies and investment bank restructurings, Eurex Clearing safeguarded its members' funds and assured liquidity remained available to the marketplace. At no time during the crisis were clearing funds at significant risk of dissipation. The organization and operations of Eurex Clearing are familiar to both Commissions due to your recent approval of it as a Multilateral Clearing Organization and the order permitting Eurex Clearing to operate a central counterparty ("CCP") for credit default swap ("CDS") contracts.

The ISE is an electronic options exchange registered with the SEC. In December 2007, Eurex acquired the ISE in a transaction that was supervised by the SEC. The ISE lists options on U.S. equities and equity indexes, complementing Eurex's European product line. The SEC Commissioners and staff worked closely with both our and the ISE's staff to assure that the transaction furthered the public interest and that the closing was timely.

2. *Regulation of Eurex and Affiliates*

Eurex Deutschland, a German public-law institution, is the derivatives exchange. Eurex Frankfurt AG operates Eurex and is registered as a German stock corporation. It is headquartered in Frankfurt, Germany, where the most of its employees and management are located. All transactions on Eurex are governed by Eurex rules and the laws of Germany. Operation of Eurex Deutschland is supervised by the "Exchange Supervisory Authority," the highest competent state authority of the State of Hesse. Intermediaries trading on Eurex Deutschland are supervised by the German Federal Financial Supervisory Authority, Bundesanstalt für Finanzdienstleistungsaufsicht ("BaFin").

Eurex Clearing AG ("Eurex Clearing") was formed in 1997 to function as the clearinghouse for the Eurex exchanges. Eurex Clearing AG is a stock corporation formed and incorporated under the laws of Germany. Eurex Clearing received permission to act as a CCP from BaFin on December 12, 2006, and is supervised by BaFin cooperatively with the Deutsche Bundesbank (the German Federal Bank).

The ISE is a U.S. national securities exchange, registered with the SEC under the Securities Exchange Act of 1934. ISE conducts regulation of its market both through its own employees and through a contractual relationship with the Financial Industry Regulatory Authority ("FINRA"). As such, ISE operates a highly automated surveillance system and employs in-house surveillance analysts to monitor trading and trading alerts and to conduct investigations into potential violations of ISE rules and the federal securities laws. The ISE may take appropriate action or have employees of FINRA perform certain functions for ISE, but subject to ISE oversight.¹

3. *Interest in these hearings*

Among exchanges testifying here today, Eurex may be unique in that it lists both futures and equity options on a single trading platform, with a common rule book and common regulatory requirements. Accordingly, we believe that we may have a number of insights relating to harmonization of regulatory and legal requirements of like instruments in the United States.

¹ ISE has also entered into a joint agreement with the other options exchanges to form the Options Regulatory Surveillance Authority, or ORSA. The purpose of ORSA is to consolidate insider trading surveillance, which traditionally had been done separately by each of the options exchanges.

Moreover, as discussed in greater detail below, as an exchange with an international membership, Eurex is affected by many issues relating to derivatives regulation in the United States. First, because U.S. entities are able to become members of Eurex, but are only permitted to trade futures, options on futures, and commodity options directly from their terminals in the U.S., we experience directly the effects of lack of harmonization of certain U.S. trading requirements. Secondly, the lack of harmonization is also acute in the area of product approval. Finally, there are important differences in the way that U.S. intermediaries access the Eurex market for economically similar derivatives. These issues are significant and cause U.S. entities to bear higher costs compared to their international counterparts. Where these differences in regulatory treatment exist side by side on a common trading platform, the effect of these differences in driving business activity are quite pronounced and can effect the investment and trading decisions of market participants without offering enhanced regulatory protections.

4. *Areas in need of harmonization*

a. *Access by U.S. members*

Beginning in 1996, Eurex's predecessor, the DTB, was the first foreign board of trade ("FBOT") to request that its members be able to access the exchange's trading platform through computer terminals in the United States.² That request was granted, and accordingly its U.S. members have been able to access the Eurex trading platform from trading terminals in the U.S. for over thirteen years with respect to a wide array of broad-based equity index and fixed income futures and options on futures contracts under the provisions and conditions set forth by the CFTC relief.

Although U.S. members are able to access the Eurex market directly for trading futures, Eurex is not permitted to provide any terminal access to U.S. resident members for its equity or equity index options, including options on the Dow Jones EURO STOXX® 50 Index, which are the second most actively traded options contracts in the world.

Eurex members registered in and operating from locations in the U.S. contribute about 17% of the volume in the EURO STOXX® 50 Index futures contract, which has had an average daily trading volume of somewhat more than 1.7 million contracts per day in 2008. Neither the Dow Jones EURO STOXX® 50 Index equity options contracts tradable by Eurex members from Eurex terminals in the U.S., nor is Eurex even permitted to provide information about them to the U.S. public except for eligible qualified institutional buyers ("QIBs") and broker-dealers.³

One result of this disharmony is that it encourages Eurex's member firms to trade option products through non-U.S. affiliates. In Eurex's experience, a number of U.S. firms have even gone so far as to set up operations outside of the U.S. simply to trade Eurex stock index products not available to them in the U.S. The prohibition on electronically trading these instruments in the U.S. also acts to encourage market participants to trade in the less-transparent over-the-counter markets. None of these outcomes is in the public interest.

Eurex believes that the Commissions should recommend that the U.S. Congress should address the foreign index options anomaly in legislation. Among other things, such

² The CFTC's Division of Trading and Markets issued a letter on February 29, 1996, determining that it "would not recommend any enforcement action against DTB in connection with the placement of its trading terminals in the U.S. in order to permit DTB members to execute transactions involving DTB futures and option products which are otherwise approved for trading by U.S. persons, subject to compliance with [a number of] conditions." This relief was expanded in a letter issued in 1999. Accordingly, its U.S. members have been able to access the Eurex trading platform from trading terminals in the U.S. for over thirteen years with respect to a wide array of broad-based equity index and fixed income futures and options on futures contracts under the provisions and conditions set forth by the No-Action Letter

³ See Letter to J. Eugene Marans, from Elizabeth K. King, dated July 27, 2005; Letter to J. Eugene Marans from Elizabeth King, dated May 3, 2006.

legislation should explicitly direct the SEC to extend the same exemptions from the Securities Act of 1933 which it provides domestic options markets to options traded on non- U.S. exchanges; require the Commissions to implement policies of substituted compliance for foreign exchanges seeking to do business in the U.S.; and direct each Commission to recognize the other's determinations of substituted compliance albeit with the ability to modify or limit access a foreign exchange's products if deemed necessary to protect the public interest.

In the meantime, Eurex has requested exemptive relief from the SEC's requirement to register as a national securities exchange under Section 6 of the Securities and Exchange Act of 1934 in order to provide direct market access to the Eurex electronic market to registered broker-dealers in the U.S. for the purpose of trading equity and equity index options. The petition is pending.⁴ In requesting this exemptive relief, Eurex noted that:

Today, U.S. broker-dealers and qualified investors seeking to trade Eurex Products must access Eurex through a Eurex member located outside the United States. This arrangement can be established through affiliates of U.S. broker-dealers or through arrangements U.S. broker-dealers have with Eurex members off-shore. Execution of orders on Eurex for broker-dealers and U.S. investors thus requires at least one layer of intermediation by a foreign broker or dealer in the trading process or requires investors to incorporate subsidiaries overseas that become Eurex members to gain direct access to Eurex. Such business strategies result in higher costs with lower execution efficiency for the investor and result in transactions that occur outside of the direct oversight of the Commission.⁵

This exemptive relief would be premised on the basis of substituted compliance by Eurex with its home-country regulatory regime.

The policies established by the CFTC on direct market access to foreign markets have been widely accepted because international comity and deference to home country regulation are critical to the ability of both U.S. and foreign markets to operate global electronic trading systems. These policies implement a workable and transparent system for all major markets which is adherence to minimum international standards, such as the IOSCO standards relating to screen-based trading, and deference to home country regulation. This model has increased exchange and intermediary efficiencies and lowered costs for U.S. and foreign market participants. It has also benefited U.S. investors and consumers by easing access to foreign markets and foreign risk management tools, while at the same time encouraging transactions in the safer exchange-traded environment rather than the over-the-counter environment. Accordingly, we believe that these policies should be incorporated in statute for both futures and for equity options. We also believe, however, that even without Congressional action, the SEC should treat foreign stock options and foreign index options in a manner similar to the direct market access policies applicable to foreign boards of trade.

b. Product approval procedures

About ten years ago, the SEC amended its rules to streamline the process whereby new products can be listed on derivatives exchanges. Under these amended procedures, a derivatives exchange may list a new derivatives securities product that falls within previously approved listing standards without obtaining SEC approval with respect to that individual

⁴ See Letter to Elizabeth Murphy from Andreas Preuss and Michael Peters, dated August 5, 2009, amending letter dated September 8, 2008.

⁵ *Id.* at pp. 5-6. Under the requested exemption, any marketing efforts by either Eurex or Eurex members to U.S. persons would be limited to qualified investors. The exemptive relief would cover options on (i) equity indices and (ii) the most liquid ordinary equity shares whose primary listing is on the FSE (together, "Eurex Products"). All such underlying equity shares are issues whose public float is at least \$700 million and which have been public for at least six months. In addition, the financial statements of all such issues would be in compliance with International Financial Reporting Standards ("IFRS").

product.⁶ Specifically, pursuant to Rule 19b-4(e), if the SEC has previously approved the self-regulatory organization's ("SRO's") "trading rules, procedures, and listing standards for the product class that would include the new derivative securities product and the [SRO] has a surveillance program for the product class[.]"⁷ then the derivatives exchange may list new derivatives securities products within that product class without having to submit a proposed rule change.

Prior to the adoption of Rule 19b-4(e), many derivatives products remained subject to the standard statutory procedures for proposed rule changes by SROs, which required an SRO to file a proposed rule change with the SEC for each new product, which was published and made available for public comment, and ultimately approved or disapproved by the SEC.⁸

The SEC's rationale for amending its review and approval procedures to approve listing standards by product class rather than by individual product was twofold. First, it further streamlined the listing of new derivatives products. In its adopting release, the SEC reasoned that,

SROs are facing increasing competition from overseas and over-the-counter derivatives markets... SROs need to bring new derivatives securities products to market quickly to provide investors with tailored products that directly meet their evolving needs. Although the existing generic rules have helped to speed the process of reviewing new derivative securities product proposals, the Commission now believes that further changes are warranted.⁹

Second, the SEC believed that less oversight was needed for new products within an already-approved product class, stating that

[t]he Commission believes that when the Commission has approved... an SRO's trading rules, procedures and listing standards for the product class that would include the new derivative securities product, the listing and trading of the new derivative securities product is reasonably and fairly implied by the SRO's existing trading rules, procedures and listing standards."¹⁰

In contrast to this streamlined approach for equity-derivatives, the offer or sale by a foreign board of trade of a futures contract on a broad-based stock index remains subject to significant procedural hurdles. With the exception of stock index contracts, no prior qualifying action by the CFTC or its staff is required in order for persons located within the United States to enter into futures contracts traded on a foreign board of trade.

However, the offer or sale of stock index futures contracts traded on a foreign board of trade to U.S. persons requires special procedures. Specifically, the CFTC's Office of the General Counsel ("OGC") has established a process wherein it issues a no-action letter with respect to requests from foreign boards of trade to confirm that a foreign security index may be offered or sold to persons located within the United States.¹¹ OGC has previously issued to Eurex No-Action Letters with respect to a number of non-narrow based stock index futures contracts, and a number of Eurex's requests for OGC No-Action Letters are pending.¹²

A growing gap has developed between the efficiency of the streamlined procedures applicable to the listing of options on equity indexes under the SEC's product-wide approval

⁶ See e.g., Amendment To Rule Filing Requirements For Self-Regulatory Organizations Regarding New Derivative Securities Products, Exchange Act Release No. 34-40761 (December 8, 1998).

⁷ 17 CFR 240.19b-4(e).

⁸ 17 CFR 240.19b-7.

⁹ Exchange Act Release No. 34-40761, *supra* note 8.

¹⁰ *Id.*

¹¹ This No-action policy and the information that OGC considers in issuing these No-action letters is found at Appendix D to Part 30 of the Commission's rules.

¹² See

<http://services.cftc.gov/SIRT/SIRT.aspx?Topic=ForeignOrganizationProducts&implicit=true&type=DCM&status=No-Action+Letter+Issued&CustomColumnDisplay=TTTTTTTT>

procedures (and the streamlined procedures applicable to the listing of all other futures contracts), and the procedures that remain in place with respect to approval of foreign broad-based stock index contracts. Under these existing procedures, it is not out of the ordinary for CFTC consideration for approval of a new foreign stock index contract to take up to a year, or longer.

To address this regulatory inconsistency, Eurex petitioned the CFTC for rulemaking, requesting that the CFTC propose a new procedure for consideration of requests to trade such foreign stock index contracts.¹³ As Eurex petitioned, the new review procedure would be established under CFTC rules and would provide that where the CFTC previously has had an opportunity to conduct a full-scale review of a foreign board of trade under either a request for a prior OGC No-Action Letter or a foreign terminals No-Action Letter, the foreign board of trade could avail itself of the new, streamlined review procedure.

The foreign board of trade applying for streamlined review of a stock index futures contract would be required to provide all of the same information and justification as required under current procedures under Appendix D to Part 30 of the CFTC's rules. The chief enhancement of the petition for streamlined procedure is that the foreign stock index would be deemed to conform to the requirements of the Commodity Exchange Act and CFTC rules 45 days after submission absent a contrary action by the staff or Commission.¹⁴

Eurex's Petition for a streamlined procedure for consideration of foreign stock index futures contract serves the public interest in a number of ways. The petitioned for rule streamlines current procedures, but maintains the same substantive review standards and the same information that is required to be filed with the CFTC with respect to qualification of foreign stock indexes. Accordingly, despite the significant procedural savings and greater efficiency that the rule would bring about, there would be no diminution of protections to the public or to market users. Moreover, the petitioned for rule would bring the treatment of foreign stock index contracts into greater harmony with the standards established by the SEC that apply to equity options.

d. Security futures products

We also note with respect to product approval, that the SEC recently issued an Order exempting QIBs, among others, from certain requirements, thereby permitting them to legally enter into futures on individual stocks and narrow-based stock indexes traded on a foreign board of trade.¹⁵ Single stock futures and futures on narrow-based security indexes are listed on Eurex and have gained a large degree of market acceptance. Accordingly, we believe that the SEC should be commended for taking steps to make it legal for U.S. QIBs and others to purchase and sell such exchange-traded products offered on a foreign board of trade.

However, we further note that the exemptive relief, while significant, did not offer as robust a solution to the prohibition on U.S. participation as might be hoped. Although the June 30th Order states that QIBs (among certain other persons) can effect transactions in foreign single-stock futures and futures on narrow-based indices on foreign exchanges or boards of trade, it does not include an exemption from the "offering" requirements of the U.S.

¹³ See Letter to David Stawick from Paul M. Architzel, dated March 28, 2008.

¹⁴ These actions would include an extension of time if the stock index contract raises novel or complex issues or removing the request from the streamlined procedure if the request does not comply with the form or content requirement for streamlined consideration and approval.

As petitioned by Eurex, the Commission may also notify a foreign board of trade that the Commission is unable to deem that the stock index futures contract conforms to the requirements of the Act, with a brief statement of the reasons therefore. Such a notification does not preclude the foreign board of trade from submitting a subsequent request if it amends the contract or if the facts and circumstances change in a manner which addresses the issues cited in the Commission's notification.

¹⁵ See "Order under Section 36 of the Securities Exchange Act of 1934 Granting an Exemption from Exchange Act Section 6(h)(1) for Certain Persons Effecting Transactions in Foreign Security Futures and under Exchange Act Section 15(a)(2) and Section 36 Granting Exemptions from Exchange Act Section 15(a)(1) and Certain Other Requirements," Release No. 34-60194 (June 30, 2009)(June 30th Order").

securities laws. Moreover, the June 30th Order on pages 16-17 specifically states that it is not granting an exemption from the exchange registration requirements of Section 5 of the Securities and Exchange Act of 1934. The SEC states that by refraining from granting such relief, it “believes that an exchange or contract market would be required to register under Section 5 of the Exchange Act if it provides direct electronic access to persons located in the U.S.”

These limitations on the scope of the exemption restrict the ability of U.S. persons to trade the security futures products that are listed on Eurex. The continuing limitation on U.S. persons’ ability to trade such contracts on-exchange encourages transactions in these contracts to occur in the bi-lateral over-the-counter markets. We recommend that as a matter of promoting the public interest, the SEC should revisit the June 30th Order and provide more robust relief in order to enable QIBs and others to access security futures products traded on Eurex directly from the U.S. We believe that the ability to access security futures should be the same as for options on individual equities on a foreign exchange traded on the same venue, and recommend that the Commissions request that Congress include such a provision in legislation harmonizing these policies with the current CFTC policy permitting direct market access to foreign boards of trade.

e. *Product approvals that raise inter-agency issues*

Eurex has requested that the CFTC permit Eurex to make a stock dividend index futures and a stock volatility index futures available to U.S. residents, requiring the two Commissions to agree on the characterization of the instrument. On March 11, 2008, the Commissions entered into a Memorandum of Understanding to Enhance Coordination, Facilitate Review of New Derivative Products (“MOU”).¹⁶ We endorse the Commissions objective to coordinate and facilitate review of new derivatives products although we note that Eurex’s requests are still pending. We believe that the Commissions need to design more effective mechanisms to assure timely execution of the policies set forth in the MOU.

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Eurex commends the Commissions for holding these unprecedented joint meetings. We believe that the issue of harmonization of regulatory requirements for economically fungible instruments is vitally important to the markets. As we discussed above, Eurex is a unitary derivatives platform on which both equity options and futures and futures options are listed. We believe that it is in the public interest that market participants be able to access exchange-traded instruments to the greatest degree possible. We believe that the public is ill-served when regulatory quirks have the effect of discouraging market participants from trading on-exchange.

We have identified several steps that the respective Commissions can take to address instances where we believe regulatory anomalies may discourage market participants from trading in a safer exchange environment. The Commissions should take these steps which will encourage market participants to trade on-exchange rather than in the over-the-counter markets based upon the identified regulatory anomalies.

Again, we thank Chairman Gensler and Chairman Schapiro and Commissioners for your attention. We look forward to working with you to address these issues and others which may arise in the future.

¹⁶ See <http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5468-08.html>