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October 8, 1998

Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Center, 1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

Re: Over-the-Counter Derivatives Concept Release ("Concept Release")

Dear Ms. Webb:

The Foreign Exchange Committee appreciates the opportunity to comment on the Concept Release issued by the Commodity Futures Trading Commission ("CFTC") on May 7, 1998. The Foreign Exchange Committee was formed in 1978 under the sponsorship of the Federal Reserve Bank of New York, and includes representatives of major domestic and foreign commercial and investment banks and foreign exchange brokers. The Foreign Exchange Committee represents many of the most significant participants in foreign currency trading in the United States.

The purpose of this letter is to draw the CFTC's attention to those portions of the Concept Release and related recent actions by the CFTC that our members believe have a potential negative impact on the foreign exchange market.^{1/}

Over-the-counter ("OTC") foreign exchange trading is explicitly excluded from coverage under the Commodity Exchange Act ("CEA") and regulation by the CFTC unless

^{1/} The Foreign Exchange Committee submitted testimony on the impact of the Concept Release on the foreign exchange market to the House Subcommittee on Risk Management and Specialty Crops on June 10, 1998 and to the House Committee on Banking and Financial Services on July 17, 1998. In addition, the Foreign Exchange Committee joined several trade associations in sponsoring testimony before the Senate Committee on Agriculture, Nutrition and Forestry on July 30, 1998.

conducted on a "board of trade" by virtue of the so-called "Treasury Amendment" to the CEA. Even though the Concept Release does not expressly address foreign exchange or foreign exchange clearing and settlement facilities, the CFTC's focus on organized clearing entities in the Concept Release has renewed concern in the private sector that the CFTC will seek to regulate OTC foreign exchange transactions and the clearing and settlement of OTC foreign exchange transactions through an expansive and unauthorized reading of the term "board of trade" as including OTC foreign exchange clearing and settlement facilities. The result is legal uncertainty that has caused some of our members to consider whether it would be prudent for them to move their business outside the United States^{2/} and has thwarted the development of risk-reducing facilities for U.S. financial institutions.

CFTC authority over clearing corporations

In the accompanying text to questions 33-40 of the Concept Release, the CFTC states that it believes "it is necessary to consider and formulate a program for appropriate oversight and exemption of swaps clearing." However, the CFTC does not have statutory authority over clearing corporations that do not clear for a CFTC-designated contract market. The CFTC has the authority to regulate clearing when it is performed by or for a CFTC-designated contract market, even when the clearing is performed by a separately incorporated clearing corporation.^{3/} The CFTC's statutory authority does not extend to other clearing corporations which are unconnected to an exchange or other contract market.

The CEA provides that no person shall enter into, or offer to enter into, a transaction involving the sale of a commodity for future delivery, unless it is conducted on or through a "board of trade" designated and regulated by the CFTC as a contract market.^{4/} The CEA defines "board of trade" as "any exchange or association, whether incorporated or

2/ See, e.g., Testimony of Dennis Oakley, Managing Director, Chase Manhattan Bank before the House Committee on Banking and Financial Services (July 17, 1998) ("Let me be frank. If the legal uncertainty posed by CFTC assertions of jurisdictions is not removed, Chase will be forced to move this business to another location, probably London, where we don't have the specter of legal jeopardy that as been raised by the CFTC.").

3/ This point was litigated in the 1978 case Board of Trade Clearing Corporation v. United States, 1978 U.S. Dist. LEXIS 20220, (D.C.D.C. 1978) ("BOTCC case"), and we do not dispute it here.

4/ 7 U.S.C. §6.

unincorporated, of persons who are engaged in the business of buying or selling any commodity or receiving the same for sale on consignment.”^{5/} But clearing corporations are not boards of trade.

On its face, the CEA definition of “board of trade” does not encompass the clearing function independent of a CFTC-designated contract market. The definition contains the terms “buying and selling”, which refer to the execution of a transaction on its trade date. The execution of a transaction does not occur at the clearing corporation, but rather can occur on an exchange. A “board of trade” is the equivalent of an organized exchange, where members can regularly execute orders for standardized contracts with clearance and settlement of those contracts through exchange facilities. There is nothing in the definition of “board of trade” or elsewhere in the CEA to suggest that clearing corporations that do not clear for a CFTC-designated contract market are subject to CFTC jurisdiction.

Recent case law has interpreted the term “board of trade” to mean formally organized futures exchanges.^{6/} In Commodity Futures Trading Commission v. Frankwell Bullion Ltd.,^{7/} the Ninth Circuit held that the term “board of trade” in the Treasury Amendment meant “on-exchange” and “exempt[ed] all off-exchange transactions . . .” An entity that provides only clearing and settlement services for OTC foreign exchange transactions, and does not do so for a CFTC-designated contract market is not a board of trade.

There is support in the legislative history for this position. Among the bills introduced in 1973 to amend the CEA was one which specified that, prior to the clearing of any contracts traded on an exchange, clearing houses would be required to register with the CFTC. Congress, however, rejected this proposed legislation. Therefore, Congress did recognize the distinction between clearing corporations and contract markets.^{8/}

In sum, questions 33-40 in the Concept Release on clearing request commenters to answer questions about clearing activities over which the CFTC lacks any authority.

^{5/} 7 U.S.C. §1a(1).

^{6/} The case law has done so in the context of the Treasury Amendment. Nonetheless, this case law is instructive on the limitations of CFTC jurisdiction.

^{7/} 99 F.3d 299 (9th Cir. 1996).

^{8/} S. 2837, 93rd Cong., 1st Sess. (Dec. 20, 1973).

Clearance and settlement of foreign exchange products and other Treasury Amendment products

The foreign exchange community has been at the forefront in developing clearing and settlement mechanisms that reduce risks and improve efficiencies for all participants in the foreign exchange market. We have been strongly encouraged in these efforts by financial supervisors and regulators in the United States and around the world.^{9/} Action by the CFTC indicating that it will regulate clearing, as suggested in the Concept Release and recent CFTC staff actions, has already discouraged the private sector's fragile efforts to develop these risk-reducing initiatives in the United States.

Several recent actions by the CFTC indicate a strong desire to regulate the clearing and settlement facilities for other products protected by the Treasury Amendment as boards of trade. These actions include the enforcement action against the Delta Clearing Corporation ("DCC") in connection with its proposal to operate a clearing facility for its "RAIT" product^{10/} and the investigation of the Government Securities Clearing Corporation's clearing and settlement facilities for its GCF Repo product,^{11/} both of which involve transactions in government securities protected by the Treasury Amendment, and the discussions leading to the submission of the request for exemptive relief from the London Clearing House ("LCH") for its swaps clearing facility.

In light of the CFTC v. Dunn and Frankwell cases, there is no justification for CFTC regulation of the clearing and settlement of foreign exchange products or other Treasury Amendment products. Only action by Congress would give the CFTC these powers.

Actions along the lines of the Concept Release and related CFTC actions will increase legal uncertainty and encourage litigation over the Treasury Amendment. The

^{9/} Bank for International Settlements, Reducing Foreign Exchange Settlement Risk: A Progress Report (July 1998) and Settlement Risk in Foreign Exchange Transactions (March 1996).

^{10/} A RAIT, the acronym for Repurchase Agreement Instrument Transaction, is a transaction in which one participant agrees to make a payment based upon a specified repo rate agreed to by the participants which may vary on a daily basis, and the other participant agrees to make a payment based upon a fixed rate agreed to by the participants. DCC proposed to provide clearance and settlement services for RAITs before it was attacked by the CFTC.

^{11/} The CFTC has focused specifically on "forwarding starting" GCF repos, which are repos whose opening or start leg will occur one or more days after the transactions are entered into.

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litigation in this area has proved to be very costly, both in terms of time and financial costs. Legal uncertainty, particularly over the application of the Treasury Amendment to clearing organizations in OTC foreign exchange, will be unproductive and have serious implications for foreign exchange trading in the United States. A part of that market, and many of its participants, may move abroad as a result of the CFTC's aggressive regulatory stance, which would hurt the stature and strength of the United States economy. We urge the CFTC not to engage in damaging efforts to regulate activities beyond the scope of its authority.

Conclusion

The Foreign Exchange Committee believes that the clearing- and settlement-related issues raised by the Concept Release are too complex and important to the financial markets of the United States to be decided by the CFTC absent proper authority and to the exclusion of Congress and other Federal financial regulatory agencies, the latter of which may have clearer statutory authority to address these issues and many other issues raised in the Concept Release. The Foreign Exchange Committee strongly urges the CFTC not take any action by way of the Concept Release or similarly targeted enforcement and/or exemptive relief actions that rely on questionable or faulty assertions of jurisdiction. The CFTC's role and input in the supervision of products and activities discussed in the Concept Release is properly realized through its membership in the President's Working Group on Financial Products. The CFTC is a participant in -- but not the driver of -- the process by which the Working Group reports on new initiatives like the Concept Release to Congress.

Sincerely,



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Chairman

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