HM Treasury

Parliament Street
London SW1P 3AG

Tel 0171 270 5550
Fax 0171 270 4365

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(28)

Ms Jean A Webb
Secretary of the Commission
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

7 October 1998

Dear Ms Webb,

COMMENT

CONCEPT RELEASE ON THE PLACEMENT OF A FOREIGN BOARD OF TRADE'S COMPUTER TERMINALS IN THE UNITED STATES

I am writing to comment upon the CFTC's Concept Release, which we feel is an extremely welcome development.

2. You may be aware that in the UK, HM Treasury is responsible for granting overseas investment exchanges the status of being "recognised overseas investment exchanges", "ROIEs", which allows them to place their screens in the UK. HM Treasury is also responsible for monitoring ROIEs. Both responsibilities will be transferred to the Financial Services Authority when the current draft Financial Services and Markets Bill is enacted some time towards the end of 1999[1].

3. We have a number of comments on specific aspects of the CFTC proposals, based on our own years of experience. Before coming to these, I would like to explain how we regard ROIE status in the UK, to make sure that we are coming from the same direction.

Concept Release and ROIE status

4. I have seen that under the Commodity Exchange Act, the CFTC is obliged to maintain the integrity and competitiveness of US markets and to protect US customers. We are under similar obligations in the UK under the Financial Services Act, and believe that allowing the placement of foreign terminals in the UK helps meet those aims; our domestic exchanges benefit

[1] (In terms of terminology, domestic UK exchanges are also "recognised", but by the FSA not HM Treasury, and under a procedure and subsequent regulation which are much more onerous. Domestic exchanges are granted RIE status rather than ROIE status).

from greater competition, investors benefit from greater choice, and a greater concentration of financial activity promotes the development of London as a leading financial centre.

5. Underpinning this approach to competitive recognition is a requirement for all exchanges operating in the UK (both domestic and overseas) to be subject to an equivalent degree of regulation. Foreign terminals cannot be placed here unless we are satisfied that the overseas exchange in question is regulated at least as well as all domestic UK exchanges. When we are satisfied, we do not place a restriction on the volume of business conducted in the UK, nor do we require the overseas exchange to be regulated as a domestic exchange if volumes exceed a certain level. This would place a double regulatory burden on the foreign exchange. Whilst domestic exchanges may (or may not) welcome the degree of protection this offers, in our view this requirement would be anticompetitive and would undermine the benefits of competitive recognition outlined above.

6. By the same token, we do not allow overseas exchanges to operate in the UK if they are under-regulated. Apart from being anticompetitive (to the detriment of domestic exchanges this time), this would undermine our consumer protection and market integrity objectives.

Particular aspects of the Concept Release

(i) Specific tests

7. The specific tests proposed by the CFTC for the evaluation of applications by overseas exchanges seem to be reasonable, and indeed are very similar to the tests we apply when processing requests for ROIE status.

8. In addition to considering these specific criteria, I agree that it might also be sensible to evaluate the "totality of the circumstances", as you have suggested. This might be the best stage to consider whether an exchange should or should not be registered as a domestic US exchange (and subject to domestic monitoring arrangements), or whether it should be registered as an overseas exchange (and subject to different monitoring arrangements). (See also para 15 below)

(ii) Terms and Conditions

9. In the UK, we do not currently apply intrusive "terms and conditions" on an overseas exchange's operations here. Instead, we apply a light regulatory touch (whilst monitoring the effectiveness of home state regulation). ROIE status also provides an exemption from insolvency law, and provides the overseas exchange with a largely free hand to develop and market products in the UK.

10. In future, when the new Securities and Markets Bill is enacted, the FSA will have a power to "issue directions", which may allow certain terms and conditions to be applied where desirable. We have not yet considered how this would be applied, but our general policy is to apply terms and conditions on a non-discriminatory basis (ie to overseas exchanges on the same grounds as they are applied to domestic exchanges).

(iii) Conditions of placement

11. The CFTC's proposed conditions of placement broadly replicate the conditions we apply in the UK, with one or two differences. In particular, we do not specify where the screens may or may not be placed (eg with a full member or affiliate member of the exchange in the Concept Release). Instead, we allow the overseas exchange to decide where to place its screens, in accordance with its own rules and procedures, and in accordance with the requirements which apply in the exchange's home state. In practice, overseas exchanges have only placed screens in the UK with members or with affiliate members.

12. Secondly, the CFTC's monitoring arrangements are slightly more demanding than our own, where we rely on annual reports rather than quarterly reports. The FSA has not yet decided how recognised overseas exchanges should be monitored in future, although the current draft Securities and Markets Bill envisages the production of annual reports.

(iv) Definitional issues

13. Your proposed definition of a computer terminal appears to be sensible. As mentioned above, we do not impose any explicit restrictions on where screens may be based, and have not defined or policed any definition of "affiliate member". We feel that unless a similar restriction is placed on domestic US exchanges, this would be an anticompetitive practice which would discriminate against overseas exchanges.

(v) Bona Fide Foreign Board of Trade

14. For the reasons outlined at the beginning of this letter, we do not believe it would be constructive to consider whether an overseas exchange operating in the US should at some stage be required to apply to be registered as a domestic US exchange. If the exchange in question is well regulated both internally and by its home-state regulator, if there is effective regulatory cooperation, and if the exchange's activities are monitored effectively (and terms and conditions are applied to any of its activities as necessary), then requiring the exchange to apply for domestic US recognition would add nothing from a regulatory point of view, but would restrict the scope of competition and limit the benefits which increased competition provides.

15. However, if an overseas exchange has applied to place screens in the US, and if the exchange is basically a US exchange which has incorporated elsewhere (eg for tax or other evasive reasons), we believe it would be legitimate to take this into consideration when processing their application. Indeed, this is a preliminary (albeit informal) test we apply to all potential applications for ROIE status. In this sense, in addition to the specific tests deployed, it would be sensible to consider the "totality of the application". (See also para 8).

16. Furthermore, if an overseas exchange which placed screens in the US began to cause concern, in terms of the way it was being regulated by its home state regulator, or problems with regulatory cooperation, then we believe it would be legitimate to reconsider the original permission granted to that exchange to operate in the US. At one extreme, this could involve repealing the original permission granted and informing that exchange that if it wishes to conduct future business in the US, the option of applying to be registered as a domestic US exchange remains open.

17. In these two instances, the CFTC's powers would not be employed mechanistically, for example once volumes had exceeded a certain level, but on a more discretionary basis according the changing quality of home-state regulation. Our main concern with the current CFTC proposals is that registration (and subsequent regulation) as a domestic US exchange would be required in a mechanistic way whenever trading volumes exceeded a certain volume, rather than because the quality of regulation per se was any worse.

(vi) Order Routing

18. This issue appears to be linked with the definition of computer terminals. Depending on how the order routing was organised, and what other information systems were in place, this might either create a loophole in the new scheme, or might simply be a quicker way of trading abroad than using the telephone or fax. We believe that Order Routing is something which should probably be considered on a case by case basis, depending on the exchange concerned and the nature of the routing.

(vii) Linkages between exchanges

19. We would agree that each overseas exchange should be approved, no matter how they are linked. The same applies to our ROIE scheme.

(viii) Timing

20. We would hope that the new rule can be implemented as soon as possible. The current uncertainties, which make it difficult for some overseas exchanges to put screens in the US

whilst other overseas exchanges continue trading, are clearly unsatisfactory. We look forward to a speedy resolution of this problem.

(ix) Grandfathering

21. We would envisage the new rule being applied on an equivalent basis to all exchanges, whether or not they have received 'no action' letters in the past.

(x) LIFFE and other UK exchanges

22. I should perhaps mention that if the new rule were in place today (subject to the above comments) we would anticipate LIFFE and other UK exchanges being granted permission to place screens in the US without having to apply for registration as a domestic US exchange in the future. We would also envisage LIFFE and other UK exchanges being treated on an equivalent basis to other overseas exchanges (such as DTB). We would envisage LIFFE, other UK exchanges, and other overseas exchanges (including DTB) all making use of the same application procedure.

(xi) Reciprocity

23. In the UK, the Financial Services Act allows reciprocity to be taken into consideration (indeed the CFTC Concept Release paper refers to this). This is not something which we have used in the past, as we believe that there are many benefits to the UK from allowing overseas exchanges to operate in the UK (as mentioned in paragraph 4). Nevertheless, the exact nature of the UK's ROIE scheme remains to be determined, and is not currently set out in the draft Securities and Markets Bill. It is likely that our future policy will take into consideration both the CFTC Concept Release and also progress on the SEC Concept Release. We have six ROIEs in the UK, and five of these are based in the US.

24. Finally, I would, of course, be only to happy to discuss any of these points with you in more detail.

Yours sincerely,

Marcello Casale

Marcello Casale
International Financial Services