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COMMENT

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

October 7, 1998

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COMMODITY FUTURES TRADING COMMISSION RECEIVED FOR PUBLIC RECORD

Re: Foreign Board of Trade Terminals

Dear Ms. Webb:

SBF-Paris Bourse, the French equity market, and its derivatives subsidiaries, MATIF SA (MATIF) and MONEP SA (MONEP) (collectively referred to herein as "SBF Group"), are pleased to respond to the Request for Comment on the Commodity Futures Trading Commission's (CFTC or Commission) concept release on the *Placement of a Foreign Board of Trade's Computer Terminals in the United States (Concept Release).* 63 Fed. Reg. 39779 (July 24, 1998).

We would like to emphasize three points before addressing the CFTC's Concept Release in detail.

First, SBF Group is a party to the comment response prepared by the European Committee of Options and Futures Exchanges (ECOFEX) dated September 18, 1998. In general, we endorse the views and comments set forth therein, but wish to highlight herein certain issues of particular importance to SBF.

Second, the SBF Group commends the Commission for its efforts to formalize the regulatory treatment of the placement of a foreign board of trade's computer terminals in the United States. However, for the reasons discussed herein, we would urge the Commission to exempt from the scope of the Concept Release foreign futures exchanges whose products are accessed from computers terminals that are located in the U.S. pursuant to a CFTC-approved link arrangement with a U.S. futures exchange.

Third, in this regard, we seek clarification from the CFTC regarding the scope of its comment concerning the effectiveness of past no-action letters issued by CFTC staff.[1] We understand that such letters as a legal matter "do not constitute Commission action and do not establish any

[1] 63 Fed. Reg. at 39780.

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precedent" and that the "Commission is free to act contrary to, and to review, the views expressed by its staff."[2] However, in the case of the "no-action" letters issued with respect to MATIF,[3] SBF Group wishes to note that these letters formed the basis for the approval by the Commission of CME rules implementing a formal cross-exchange access program with MATIF on GLOBEX.[4] In addition, the position of CFTC staff in the 1989 and 1990 Letters regarding the U.S. regulatory status of MATIF was critical in the Commission des Operations de Bourse's (COB) decision to grant reciprocal treatment to the CME under applicable French law. We further note that the positions in the 1989 and 1990 letters formed a material basis for the execution on June 6, 1990 of the Mutual Recognition Memorandum of Understanding between the CFTC and COB.

At a minimum, SBF Group believes that any decision by the Commission to alter an existing arrangement with a foreign governmental authority should only be done after consultation with that foreign regulatory authority. More fundamentally, as discussed below, SBF Group believes the interests of global markets, customer protection and regulatory efficiency would best be served if the Commission distinguished between foreign futures exchanges whose products trade on computer terminals in the U.S. pursuant to a link arrangement with a U.S. contract market and those whose products are not so linked.

We nevertheless welcome the CFTC initiative and would like to contribute the following comments.

I. DEFINITIONS

The procedure envisaged by the Commission employs a number of key terms. In our view, it is vital that they be defined.

1. Foreign board of trade

The Commission raises the question of the threshold beyond which a foreign exchange would be deemed a U.S. exchange and would be required to meet the applicable legal and regulatory obligations once such foreign exchange began recording significant activity in the United States.

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[2] Id.

[3] See letters dated May 26, 1989 from Andrea Corcoran, CFTC Division of Trading and Markets, to Carl Royal, Chicago Mercantile Exchange (CME), and May 7, 1990 from Andrea Corcoran to Gerard Pfauwadel, MATIF (referred to herein as 1989 and 1990 Letters).

[4] See letter dated September 25, 1992 from Jean A. Webb, CFTC, to Eileen Flaherty, CME.

The Commission proposes that a board of trade is deemed foreign when it is located outside the U.S. and is a *bona fide* foreign board of trade. The criteria for *bona fide* status would be measured by U.S. presence and trade volume originating from the U.S.

We support the Commission's proposal to extend recognition only to *bona fide* foreign exchanges. However, we believe that the criteria for determining who is a *bona fide* foreign exchange and who is not should be analyzed in a different manner. In our view, the proper test should consist of three key tests: (i) is the exchange organized under the laws of a foreign jurisdiction; (ii) does that foreign jurisdiction have requirements addressing investor security and market integrity that are deemed comparable to those in effect in the United States and does it monitor for compliance with such requirements; and (iii) does the foreign jurisdiction have cooperative arrangements with the CFTC to share information.

We further believe that it is not appropriate to adopt specific tests to evaluate each required item or an objective set of criteria for a "*bona fide*" foreign futures exchange that will apply to all exchanges in all circumstances. In general, the Commission's approach should be qualitative, not quantitative. We recommend that the Commission's decision to issue an order of exemption be based upon a "totality of the circumstances" rather than specific tests to evaluate each item of information.

Once these assessments are made, issues such as the amount of volume on the foreign exchange originating from the U.S. and the number of terminals accessible from U.S. locations should have no bearing on whether a foreign futures exchange is *bona fide* or not. In our view, a foreign exchange does not become a U.S. exchange solely by virtue of its activities from locations in the U.S.

We would like to mention that in the case of European markets, a list published at the E.E.C. Official Journal delineates the regulated markets covered by the European Union's Investment Services Directive. A petitioner's inclusion on the list should be considered by the Commission as a guarantee that the petitioner is a bona fide foreign exchange.

2. Computer terminal

The Commission raises the issue of how "computer terminal" and related terms should be defined, in view of the increasingly sophisticated capabilities of information transmission systems. In the Concept Release, the Commission raises issues related to order routing terminals, human intervention, and the placement of terminals. We address these four main points individually.

2.1 The Commission proposes that the term "computer terminal" be defined as broadly as possible to anticipate changes in technology. In our view, such a definition is acceptable if a clear distinction is made between the computer terminal at the member's site (which could be referred to as the "trading terminal") and the computer terminal at the client's site (referred to herein as the "order routing terminal"). We understand that the computer terminals mentioned in the Concept Release are limited to the trading terminals installed in the offices of exchange members or their affiliates.

A "trading terminal" could be characterized as a terminal owned and operated by the foreign exchange that allows direct access to the exchange without human or automated verification. The distinguishing criterion of a trading terminal would be whether it enables an order, irrespective of its origin, to be executed on the exchange without manual or automated verification by a third party.

The trading terminal would be the point of entry through which orders arrive on the exchange under the code of the member who guarantees the orders for execution. Such an approach would satisfy the concerns of technological advances as well as the intermediation principle, whereby the member has the double duty of executing "client" orders and verifying their conformity. Orders entered on a trading terminal, therefore, create a liability for the member who enters the order for execution.

An order routing terminal could have certain functions aimed at protecting the client (who may lack the market member's experience), and other functions aimed at safeguarding the integrity of the exchange. An order routing terminal would not give the client more information than he could obtain by other means and would not enable the order to reach the exchange without verification (see our discussion of human intervention below). Conversely, a trading terminal generally provides more comprehensive market information and would enable direct market access without constraints on criteria such as volume, bid/ask spread, etc. In terms of the client's behavior, the use of an order routing terminal is identical to other methods of transmitting orders to the exchange.

2.2 The Commission seeks to ascertain whether U.S. futures commission merchants (FCMs) and their U.S. customers should be able to use automated systems to transmit orders to the foreign exchange and whether such routing should be limited to *bona fide* foreign futures exchanges and intermediaries recognized by the Commission.

We would encourage the Commission to permit the use of such order transmission mechanisms. Moreover, it appears reasonable to limit access by an order routing terminal located in the U.S. only to foreign exchanges that have been recognized by the Commission.

With respect to the foregoing, we urge the Commission to adopt regulations that would ensure that only members of a recognized foreign exchange may provide automated order routing systems to their direct customers located in the US. Such clients, in turn, should not be permitted to provide these systems to their customers.

2.3 The Commission raises the question as to whether a client's on-site terminal qualifies as a trading terminal if the market member performs no human intervention.

This viewpoint cannot be shared if a procedure exists to verify the orders entered by the client into the trading system. The essential factor is whether the verification exists and is effective, irrespective of whether it is performed manually or electronically. Furthermore, the possibility of performing electronic controls – made by filters – is particularly desirable since they are highly reliable and will eventually feature in the systems of most foreign exchanges.

The Commission's attention should also be drawn to the fact that electronic controls can be performed *a priori*.

Many order routing terminals have a number of risk management features such as filters to limit the number of orders and the spread relative to the market price. If a foreign exchange permits electronic interfaces between its trading terminals and automated order routing systems, its rules should require the existence of such filters.

In short, the dividing line between a trading terminal and an order routing terminal lies in the functions they perform and in the verification procedures that a member must carry out on the terminal installed on the client's premises.

Therefore, our recommendation to the Commission is that members should have trading terminals and clients should have order routing terminals.

2.4 The Commission believes that "computer terminals" should be placed only with foreign market members and their affiliates and should not be accessible to clients.

We regard this to be a legitimate restriction provided – once again – that there is a clear-cut distinction between trading terminals and order routing terminals.

3. Market members

We approve of the possibility offered by the Commission that affiliates of members of the foreign exchange may obtain trading terminals and thereby gain direct access to the exchange.

However, we note that the Commission does not indicate whether the 50% figure refers to share capital or voting rights. We consider the 50% threshold to be appropriate, provided that it refers to voting rights. Subject to the foregoing, we urge the Commission to apply the broadest definition possible concerning the term "affiliate" and propose that in definition (4) in the Concept Release,[5] that the Commission clarify that "control" can be either direct or indirect.

II. PROCEDURE

The Commission proposes that the procedure to be followed for U.S. terminal placement should be based on similar procedures currently in effect. Initially, the board of trade concerned would request the Commission's general authorization (petition for an order) and, subsequently, the Commission would individually confirm that authorization to board of trade members or their affiliates (confirmation of relief under the order). Such authorization would be granted by the Commission after reviewing a duly completed application.

We believe the principle of a two-step procedure is relevant and justified. However, we draw the Commission's attention to a number of information requests that could be streamlined without detracting from the underlying regulatory concerns that the information request seeks to address.

1. Information to be provided by the market

The Commission proposes that the market seeking to obtain the right to place computer terminals in the United States should supply the Commission with certain information, divided into six broad categories.

We do not question the legitimacy of the need for this information *per se*; we recognize that a foreign exchange seeking to operate in the United States should be identified to U.S. regulators. However, we question the advisability and fairness of requiring such information from exchanges that, pursuant to existing arrangements in place, already provide similar or identical information to the Commission. Therefore, we recommend that the Commission avoid unnecessary duplication of effort and exempt foreign exchanges from having to supply legal, technological, and financial information to the Commission if they have already provided such information pursuant to a previous procedure. Moreover, as discussed below, we believe the procedures and analysis proposed herein should not apply to foreign exchanges whose products trade on computer terminals in the U.S. pursuant to a link arrangement with a U.S. contract market.

[5] See 63 Fed. Reg. at 39787.

2. Conditions for order of exemption

The Commission poses a number of requirements on which a foreign exchange's authorization to place terminals would be contingent. We recognize the suitability and legitimacy of this approach. However, we would also like to emphasize that first and foremost, *bona fide* foreign exchanges are subject to their home-country's regulatory requirement and their own exchange rules regarding whether and how they may place trading computer terminals outside their home jurisdiction. We further note that compliance with a number of the specified conditions is already addressed by the home regulatory authority of the foreign exchange requesting authorization to place trading computer terminals. Moreover, pursuant to the principle of reciprocity in France, it would be appropriate that the conditions imposed on French markets placing computer terminals in the U.S. should determine what conditions will apply to U.S. markets requesting similar authorization in France.

Our comments to the Commission concerning conditions for issuing an order of exemption are as follows.

We concur with the conditions concerning the placement of trading computer terminals in the offices and booths of the foreign board of trade member and its affiliates, as well as the condition that orders flow through a registered FCM unless the member or affiliate trades solely for its proprietary account. Likewise, we believe that the foreign board of trade's on-site biennial review of its members operating in the U.S. (details to be defined) could be delegated to the NFA or a U.S. self-regulatory organization.

We question certain other matters related to the information requested by the Commission. Specifically, we seek clarification on what the Commission views to be "material" and what timeframe is meant by "immediate" in respect of notices of information on changes in legal or regulatory requirements.

In general, we believe information should be provided on a regular, not immediate, basis and that foreign boards of trade should be allowed a reasonable timeframe for providing such information. Furthermore, we believe that the foreign board of trade should be required to inform the Commission of rule infractions only when they involve rules within the Commission's jurisdiction or rules governing its members which are likely to affect U.S. investors.

More importantly, with respect to information deemed non-public, such information should be shared pursuant to the terms of existing information sharing arrangements that the Commission has with relevant regulatory authorities in that jurisdiction.

Lastly, we question the nature of the information required by the Commission on trading volume. Such information does not seem to us relevant to the aim of regulatory supervision; accordingly, we do not view its transmission to the Commission as advisable. That said, it should be noted that foreign boards of trade already publish a great deal of easily accessible information of this type.

3. Procedure to be followed by the market member

Once the order of exemption is granted to the foreign board of trade, the Commission envisages individually authorizing foreign board of trade members who seek to place computer terminals in the U.S. The member or affiliate must then send a request for confirmation of relief to the National Futures Association (NFA). The request must include certain affidavits, information items, and documents.

We regard as perfectly legitimate the Commission's desire to supervise the members who use such trading computer terminals. However, we would like to point out that certain members already have access to products of French derivative markets from computer terminals in the U.S. under the existing link arrangement with the CME and existing arrangements between the CFTC and COB. This issue is addressed in more detail in Section III below. Finally, we believe that more liberal reporting timeframes would serve the Commission's needs as well as the aims of flexibility and efficiency.

III. TRADING LINK ARRANGEMENTS

The Concept Release proposes that the contents of the Concept Release would apply not only with respect to a single foreign board of trade but also where the products of multiple foreign boards of trade are traded from a single system. SBF Group agrees with this approach. The Concept Release also requests comment as to whether different requirements should apply to a foreign futures exchange's products which are traded on the computer terminals of a U.S. contract market.[6] For the reasons set forth below, and subject to the terms of the link arrangement, SBF Group believes the CFTC should apply a different test in these circumstances. The SBF Group also believes there is no regulatory basis to distinguish between linkage arrangements that use the computer terminals of a U.S. or foreign futures exchange.

The Concept Release seeks to institute formal procedures to replace the staff no-action approach that permitted a foreign futures exchange that had not entered into an arrangement with a U.S. futures exchange to locate its terminals in the U.S. Absent such procedures, formal or otherwise, the CFTC would have no mechanism for determining which foreign exchanges that seek to place their computer terminals in the U.S. are subject to certain core regulatory protections and which are not.

[6] Id., at 39789.

However, when a U.S. futures exchange seeks to enter into a link arrangement with a foreign exchange, the U.S. Commodity Exchange Act (CEA) requires the CFTC to assess that the terms of the link arrangement will not affect the integrity of U.S. exchanges or affect customer

protection. The exact nature of this analysis will depend on the specific terms of each arrangement. In the case of the CME/MATIF link proposal to use the same trading platform and to permit members of each exchange to access the products of the other exchange without becoming direct members, the CFTC, among other things: (1) analyzed the rules and regulations governing the operation of MATIF; (2) ensured the harmonization of certain trading and disciplinary rules of each exchange; (3) reviewed the plans for allocation of regulatory functions between French and U.S. authorities; and (4) relied on its understanding of the regulatory protections in place in France based on the negotiations leading to the execution of the MRMOU. This comprehensive analysis was deemed necessary as the CFTC determined to rely on the French regulatory system and French market authorities to monitor persons in France who had direct access to the products of a U.S. futures exchange. Also important was the fact that this link was completely reciprocal.

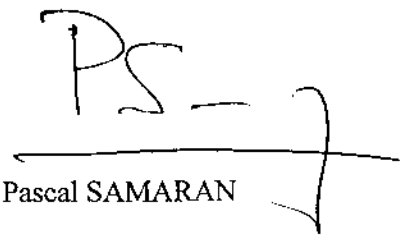
In the end, SBF Group believes that this analysis and the current procedures under existing arrangements have operated to serve customers, markets and regulators in both jurisdictions. The types of information and regular reporting proposed by the CFTC in the Concept Release to assure itself that the foreign exchange remains a *bona fide* regulated foreign exchange are simply not as relevant in the context of a linkage arrangement similar to that in effect between the CME and French derivative markets. Nor should the Commission seek to collect additional information on a routine basis and impose other regulatory burdens on the operations of the existing link when they would serve no identifiable regulatory purpose or public interest.

SBF Group does not advocate that all link arrangements be analyzed in a similar manner. Our experience has been that the terms of cross-border link arrangements vary based on the commercial goals of the relevant exchanges and that, therefore, each link raises unique regulatory issues. It will be very difficult, we believe, for the CFTC to adopt one standard that would be appropriate for all cross-border links in all circumstances. Indeed, in recognition of the flexibility necessary in reviewing such cross-border arrangements, the CFTC's Part 30 rules expressly exempts transactions undertaken pursuant to a link between a U.S. and foreign futures exchange from the automatic application of those rules.[7] Under the approach of the Part 30 rules, each link would be evaluated on its own terms and the Commission could determine on a case-by-case basis whether and how the Part 30 rules should apply. We urge the Commission to adopt a similar approach as it moves forward on the Concept Release.

[7] See CFTC rule 30.3(a).

SBF Group has the aim of protecting U.S. investors and provides these comments in the hope that they can contribute to the drafting of regulations that will further this aim. We stand ready to provide additional information the Commission might deem useful in evaluating the matters addressed in this letter.

Sincerely,



Pascal SAMARAN