SYDNEY FUTURES EXCHANGE LIMITED
ACN 000 299 392

98-30 T3M
(30)

AJD80909.01L\kmac

30–32 Grosvenor Street
Sydney NSW 2000
Australia
Telephone (02) 9256 0555
Facsimile (02) 9256 0666

14September, 1998

COMMENT

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

Dear Ms. Webb

Foreign Board of Trade Terminals

The Sydney Futures Exchange Limited (the "SFE") and its wholly-owned subsidiary New Zealand Futures & Options Exchange Limited (the "NZFOE") welcome this opportunity to comment on the Concept Release (the "Release") of the Commodity Futures Trading Commission (the "Commission") regarding placement at locations within the United States of computer terminals through which orders can be transmitted for execution on the electronic market system of a foreign board of trade (63 *Federal Register* 39779 (July 24, 1998).[1]

Background on the SFE and NZFOE

The Sydney Futures Exchange was incorporated in 1960. Originally called the Sydney Greasy Wool Futures Exchange, it changed to its current name in 1972. Initially developed as a wool futures exchange and later for other commodity futures as well, it evolved to its current role as primarily a financial and equity futures market. It is consistently ranked within the top twelve futures exchanges of the world and is currently the most active (by contract volume) financial futures exchange in the Asia Pacific region.

[1] On March 21 1997 the SFE and NZFOE formally filed with the commission a petition for no-action relief to place their SYCOM® terminals with members and affiliates in the Untied States (hereinafter the "March 1997 Petition"). The 43-page petition proposed substantially the same terms that had been accepted by Commission staff in its February 29, 1997 no-action letter to the Deutsche Terminbörse authorizing its placement of terminals in the U.S., which is reprinted at [1194-96 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,669. Substantial subsequent filings were made at the request of Commission staff on July 24, September 23, and November 3, 1997, after which the Commission decided to cease using the no-action process for this purpose and further review of the SFE/NZFOE proposal was suspended. The SFE and the NZFOE urge that the substantial progress made by the Commission in reviewing the proposal prior to suspension be credited to the SFE and the NZFOE when we renew our request under the Commission's new regime

Regulated by the Australian Securities and Investments Commission ("ASIC"), it has strong and long-established self-regulatory functions and Business Rules. It is mandated by statute and by its Business Rules to regulate all futures business of its members *wherever traded.* It is the only approved Futures Exchange and Futures Association in Australia. Membership of the SFE or other such approved body is currently mandatory for all licensed Futures Brokers.

In 1991, the SFE established its own mutually backed clearinghouse and in 1992 acquired the New Zealand Futures and Options Exchange.

In 1989, the SFE became the first open outcry futures exchange to introduce an after-hours screen dealing system and has successfully operated the system (SYCOM®) ever since. SYCOM® currently accounts for approximately 15-20% of exchange volumes. In 1997 the SFE made a decision to fully move to screen trading by the end of the first quarter of 1999, although implementation will begin in December 1998.

NZFOE is a wholly-owned subsidiary of the SFE. It was the world's first futures market to operate entirely with a screen dealing system, and it is subject to regulation under New Zealand law by the New Zealand Securities Commission. The NZFOE utilizes the central processing unit at the SFE for execution of transactions, and relies on the SFE's clearinghouse for the clearance of its transactions.

Both the SFE and the NZFOE enjoy the privileges bestowed by the Commission under its Regulation §30.10.

Executive Summary of Comments

While we will elaborate more extensively on each of the points made below, our views on the Concept Release can be summarized as follows:

First, the central processing unit (the "CPU") where buying and selling orders for SFE and NZFOE instruments are matched and executed resides in Sydney, Australia. All executed trades are cleared and guaranteed in Sydney, while the principal offices and preponderance of SFE and NZFOE staff are likewise situated in their home jurisdictions. The terminals of the Exchanges simply transmit bids and offers to the CPU; they are fast and efficient but satisfy the same basic function heretofore performed by other methods whereby members communicate with each other for trade execution purposes.[2]

Second, the Commission's observations about the speed with which technological change is occurring argues *against* developing regulatory policy that might become obsolete for that very reason. In our view, the challenge facing the Commission is how to assure the continued delivery of its regulatory protections irrespective of structural changes in the industry.

Third, the regulatory objective articulated above appears to be addressed effectively by the Commission's proposed requirements that terminals situated in the United States must be located at registered futures commission merchants and must be operated by registered associated persons, if customer orders are involved.

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[2] In this respect, characterizing the units as "trading" terminals is a misnomer and can encourage misunderstanding of their limited purpose as inter-member communications devices.

Fourth, both the SFE and the NZFOE have been awarded relief under the Commission's Regulation §30.10. If the Commission determines to include a review of foreign boards of trade and their regulatory programs as part of its terminal-placement program, our Exchanges should surely be "grandfathered" for this purpose to avoid a costly repetition and duplication of the same analysis already made.

Fifth, once the Commission has decided to conduct a proposed rulemaking with specific policies and procedures, it should entertain at that time requests for interim relief from foreign boards of trade that can demonstrate a commercial need to place terminals in the U.S. and a willingness to conform with the standards as proposed.[3] Both the SFE and the NZFOE are or imminently will be reliant on electronic trading as the *sole and exclusive* method for conducting business; exclusion from the important U.S. market except through incompatible communication systems (*e.g.*, telephonic transmission) that are unable to interact with SYCOM® threatens to undermine a substantial percentage of our market share. Moreover, it deprives U.S. persons of the opportunity to manage risks efficiently.

Sixth, the SFE and the NZFOE support keen competition, creativity, innovation and dynamic marketing. These are the ingredients that will assure a high level of patronage for our products within the United States. It is the national public policy of the United States to promote competition and the Commission is expressly directed by the Commodity Exchange Act to conform with that policy.[4] As a result, it would be wholly inappropriate for the Commission to embrace any program whereby a foreign board of trade's successful penetration of the U.S. market could trigger wholesale application of its regulatory requirements, including the commercially impracticable establishment of a U.S. contract market.

Seventh, the SFE and NZFOE favor taking into consideration the treatment by a petitioner's home jurisdiction of exchanges in other nations that seek to place terminals in that country. A universally consistent practice (though methodologies may differ) will benefit the international exchange community and discourage protectionism. For our part, we note that ACCESS® trading screens of the New York Mercantile Exchange ("NYMEX") have been placed with Australian Securities Commission[5] ("ASC") authorization in Australia.

Finally, the SFE and NZFOE encourage the Commission to allow placement of SYCOM® trading terminals with affiliates of their member firms as well as with U.S. organizations that are direct members. And, with respect to the audit and inspection of their activities, we urge the Commission to allow foreign boards of trade to employ internal electronic surveillance systems as well as to retain the expert services of U.S. self-regulatory agencies like the National Futures Association to assist in that effort.

In summary, we seek the ability to facilitate access to our markets through screens placed in the offices of either our members or affiliates of our members in the United States, provided that in relation to customer orders a member or affiliate is a Commission registrant.

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3 See also note 1, *supra*.

4 Act §15, 7 U.S.C. §19.

5 The ASC has been succeeded by the Australian Securities & Investments Commission.

1. SFE and NZFOE Trades Are Executed and Cleared in Australia

The central processing unit (the "CPU") where buying and selling orders for SFE and NZFOE instruments are matched and executed resides in Sydney, Australia. All executed trades are cleared and guaranteed in Sydney, and the principal offices and preponderance of SFE staff are located there (NZFOE staff are headquartered in Auckland, New Zealand). The terminals of the Exchanges simply transmit bids and offers to the CPU; they are fast and efficient but satisfy the same basic function heretofore performed by other methods whereby members communicate with each other for trade execution purposes.

In the case of proprietary or third-party order entry systems, the remoteness from the Exchanges is even greater. They are subject to the willingness of a member firm to accept and to process their orders; the member firm is entitled to interrupt at any time the ordinary flow of orders so that they never reach the market for execution. That power exists notwithstanding that the member firm may use an automated screening process to monitor such things as credit limits, position size, margin compliance, etc. In every case those parameters will be decided in the first instance (and may be adjusted from time to time) by officials at the member firm. And the seemingly "passive" nature of the subsequent monitoring process differs not at all from the common practice of member firms today of setting general limits and tolerances on a customer-by-customer basis which remain opaque until a breach occurs.

Accordingly the SYCOM® system of the SFE and the NZFOE cannot properly be characterized as existing in the United States. Those markets are the *only* regulated futures markets in Australia and New Zealand, and they answer respectively to the pervasive regulatory programs of the Australian Securities and Investments Commission and the New Zealand Securities Commission in regulatory environments that the Commission has found to be comparable in quality and coverage to the U.S. futures regulation model.[6]

2. Regulatory Policy Designed To Address Specific Technological Developments Will Fail

To paraphrase, the Commission appears to be inquiring whether the current state of trading technology has advanced to the point where the order-entry phase and the execution phase have effectively *combined* so that each terminal should be regarded as a proxy for the execution facility itself, i.e., as a "board of trade" warranting full-scale regulation as a U.S. contract market. This analysis is based on a faulty premise, as explained above, since no such merger of functions has occurred. But this approach also seems to require that a judgement be made by the Commission as to where, along the continuum of technological change, there is "too much" blending of those functions to treat them any longer as separate. That answer would necessarily depend on what technological architecture exists at any given time, and the rapid pace of change in that field creates a great risk that the decision made today will be woefully outdated - and wrong - tomorrow.

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[6] See 53 Fed. Reg. 44856 (November 7, 1988) for the SFE, reprinted at [1987-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,349; and 61 Fed. Reg. 64985 (December 10, 1996) for the NZFOE, reprinted at [1994-96 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,824.

In our view, the Commission should not be guided by technology in this matter. Rather, we suggest that the Commission should strive for a regulatory policy that has durability irrespective of what structural changes take place in the derivatives world. Those changes will not require the Commission to alter any of its ethical standards; whatever may be the structure of the business at any given time, the Commission's objectives will continue to be the elimination of fraud, manipulation and poor business practices that threaten injury to customers. What *could* change along with the industry's structure is to whom *accountability* and *responsibility* for delivering the regulatory benefits is assigned. Because electronic markets or other structural changes may render some intermediaries redundant, the Commission should properly be concerned with assuring that there continues to exist a cadre of market professionals who bear the burden of carrying out the Commission's customer-protection policies. As noted below, the Commission has proposed a means to accomplish that goal, and it is not entangled with technology issues.

3. Requiring That Foreign Exchange-Sponsored Terminals Must Be Controlled By Commission Registrants When Handling Customer Orders Assures Regulatory Accountability and Responsibility Irrespective of Market Structure

One of the Commission's proposals is that Exchange-sponsored terminals placed in the United States that may be used to facilitate nonproprietary orders (*e.g.*, for customers) must be under the control and on the premises of a registered futures commission merchant and must be operated only by registered associated persons. Such a requirement comports closely with the Commission's existing registration policy as it related to activity on domestic markets as well.

The SFE and the NZFOE support adoption of this regime by the Commission. First, it appears to provide a bright line on the matters of accountability and responsibility. Second, it is uncoupled from any particular system or technology of market operation, thus avoiding the obsolescence risk discussed above. And, finally, it harmonizes well with the SFE and NZFOE policies that require our own members to assume a similar responsibility with respect to SYCOM® terminals.

However, the Commission must bear in mind the existing rights of SFE and NZFOE member firms that enjoy relief under Regulation §30.10[7] which entitles them to carry customer accounts directly for U.S. investors without registration as an FCM or AP so long as they do not maintain a U.S. location. The Commission should make clear that such exemption from registration will remain in effect for U.S. customer orders received from U.S. affiliates via SYCOM® terminals or received directly from U.S. customers via proprietary or third-party order entry systems.

4. If the Commission Determines to Examine the Home Jurisdiction and Its Market's Regulatory Structure Before Awarding Terminal Relief, Exchanges With Existing Relief Under Commission Regulation §30.10 Should Be Exempted From that Stage of Review

Both the SFE and the NZFOE enjoy relief pursuant to Commission Regulation §30.10.[8] The process leading to that relief was lengthy and arduous, involving massive amounts of

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[7] See note 6, *supra*.

[8] See note 6, *supra*.

information and explanation, coordination with home market regulators, numerous meetings or other communications with Commission staff, and a variety of commitments and stipulations. If the Commission undertakes to conduct such a review for terminal placement purposes, our Exchanges should certainly be "grandfathered" automatically in the absence of dramatic adverse change in the facts previously examined.

We urge caution, however, in replicating the Regulation §30.10 procedures here. While Regulation §30.10 is an entirely *elective* program where a foreign board of trade can, but need not, apply for special benefits based on the existence of a comparable regulatory regime in the home jurisdiction, the Commission's concept release describes a *mandatory* system for vetting the placement of terminals at U.S. locations by potentially dozens of different markets and scores of separate member firms. It would be a far greater burden to the Commission and to the Exchanges than the concept release appears to appreciate. A better approach would be to adopt the plan utilized by regulators in the United Kingdom where, following a relatively simple process of recognition, exchanges placing terminals there must simply keep the regulators informed of relevant developments.

5. Interim Relief Should Be Provided For Good Cause Once The Commission Has Fashioned a Specific Regulatory Proposal For Possible Adoption

The Commission has described this project as involving two phases. The first phase is the existing Concept Release which solicits public comment on a wide array of topics which may or may not survive further review. In the second phase, the Commission anticipated a formal rulemaking proceeding containing specific detail as to the program that it holds in greatest favor at the time. While the Commission might be reluctant to entertain requests for interim relief during the first phase,[9] its thought processes should be well advanced by the time when specific rulemaking proposals are aired for public comment. At that stage, we urge the Commission to renew active processing of our pending March 1997 Petition[10] and to grant interim relief to the SFE and the NZFOE on appropriate terms and conditions which may parallel the standards proposed in the rulemaking proceeding.

The NZFOE has operated exclusively as an electronic trading market since its founding in 1984. The SFE has operated its own computerized trading system - SYCOM® - since 1989 as an after-hours supplement to normal floor trading but, beginning in December 1998 and on a fully-operational basis by first quarter 1999, the SFE will use SYCOM® as its *exclusive* trading system. When operated as intended and as designed, orders will be input from terminals of SFE and NZFOE members connected with the SYCOM® CPU.

The SFE and the NZFOE view the United States as a major market for their derivative products and believe that a significant percentage of their business originates there. Were we required to confine order transmittal to telephonic and other outdated methods for transactions emanating from the U.S., American participation in our markets would entail cost and complexity not incurred by other users of SYCOM® and, we believe, a material amount of business could be lost due to that anomaly. Interim relief during the rulemaking period would eliminate that risk.

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[9] Interim relief during the Concept Release phase, however, would be wholly appropriate if the comment period is extended on request of an interested party or on the Commission's own initiative, or if progress to the second phase is delayed for any reason.

[10] See note 1, *supra*.

Moreover, compulsory use of disconnected order transmittal methods like the telephone will generate an inferior transaction audit trail and elevate the risk of errors and potential misconduct. It is universally recognized that electronic trading systems with integrated order-entry capability pose fewer regulatory concerns than reliance on greater human intercession. Thus, interim relief will have positive regulatory benefits as well. Moreover, because the Commission's staff already possesses and has reviewed substantial information about the SFE, the NZFOE and the SYCOM® trading system in connection with the March 1997 Petition, sufficient data may exist currently at the Commission to complete any further analysis that might be contemplated by the rulemaking proposal.

6. Detecting False "Foreign" Boards of Trade Does Not Require That Competition Be Stifled

The Commission has expressed concern that any relief provided under its ultimate terminal placement program should be confined to *bona fide* "foreign" boards of trade. There is evidently a concern among Commission officials that the operators or promoters of a market that is fundamentally a U.S. enterprise might flee to an offshore jurisdiction to escape the burdens of "contract market" designation. We concur with the Commission that this possibility deserves attention but we urge the Commission to focus on the practical attributes of the enterprise rather than to adopt the suggestion that U.S.-sourced trading volume on a foreign board of trade is a relevant test.

First, it is not difficult generally to identify *bona fide* foreign boards of trade. Commercial and regulatory recognition should settle most cases. Through the good offices of the International Organization of Securities Commissions and its scores of member regulatory agencies, it should be relatively easy to distinguish between an exchange that is and is not designed to operate as a U.S. market. We see no reason why, for terminal placement purposes, it should be deemed necessary to depart from the same practical approach taken by the Commission in connection with its Regulation §30.10 program, its no-action relief for foreign stock index futures or, until 1997, its approval of foreign option contracts.

Most important, however, we urge the Commission *not* to treat significant U.S.-sourced trading volume on a foreign board of trade as converting that market into a U.S. venture requiring "contract market" designation. It is highly probable that, from time to time, a foreign board of trade will launch a derivative product that captures substantial business from U.S. hedgers and investors. Moreover, foreign boards of trade frequently follow a strategy of trading the products offered on U.S. contracts markets after normal trading hours specifically to serve the overnight needs of U.S. participants. The competitive benefits of international innovation and adaptation cannot be denied, and the Commission should reject any proposal that would discourage that phenomenon.[11]

A volume-origin test for distinguishing between a "foreign" and a "U.S." market clearly has that effect. A foreign board of trade would be penalized for successfully marketing its products into the United States. Knowing that its U.S. market share must remain limited in

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[11] Indeed, section 15 of the Commodity Exchange Act, 7 U.S.C. §19, mandates that the Commission must promote competition unless there is an overriding regulatory need that cannot be addressed except through anticompetitive measures.

order to avoid "contract market" status, it might conclude that many otherwise-promising product developmental projects are no longer commercially viable. And, to the extent that potential business in excess of the "limit" existed, it could be exploited by U.S. contract markets that have incurred none of the costs of development and promotion. In short, treating a foreign board of trade as a U.S. market simply because it has been successful in marketing its products into the United States is a bad, anticompetitive, and unfair idea.

7. Considering Reciprocal Treatment Is An Appropriate Feature of the Commission's Terminal Placement Program

The national policies in both Australia and New Zealand toward local placement of foreign boards of trades' terminals are accommodating. As noted earlier, the ASC approved placement at Australian locations of the ACCESS® trading screens of NYMEX. Conversely, SYCOM® terminals have been placed with local regulatory permission in the United Kingdom. And the SFE/NZFOE's March 1997 Petition to the Commission for U.S. placement of SYCOM® terminals remains pending at this time.

The SFE and the NZFOE believe that the Commission is warranted in considering whether the home jurisdiction of a petitioning foreign board of trade affords the same terminal placement opportunity in that country that the petitioner seeks from the Commission. This attention to "reciprocity," however, can be administered fairly and effectively only on the following conditions:

(1) Different jurisdictions may process placement requests in different ways and may apply somewhat different criteria. Variations in methodology should *not* raise concerns at the Commission unless they create an impediment to terminal placement greater than in the United States; and

(2) Reciprocity must become the policy of other jurisdictions as well. It is vitally important that *every* nation, including the United States, understands that obstacles to terminal placement erected by one jurisdiction will provoke similar resistance when its own markets seek placement approval abroad.

Accordingly, we urge the Commission to be flexible in making comparisons of nations' terminal placement practices so long as effective reciprocity of opportunity is achieved, and that the Commission support and encourage other jurisdictions to embrace a similar reciprocity policy so that all markets have an equal stake in the fair administration of that policy.

8. Bona Fide U.S. Affiliates of Member Firms of a Foreign Board of Trade Should Be Eligible For Trading Terminals

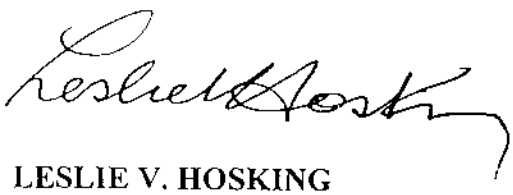
The SFE and NZFOE support including *bona fide* U.S. affiliates of their member firms in the category of persons entitled to possess and operate SYCOM® trading terminals. The decision of a member firm to organize a separate legal entity to conduct business in the United States is rarely if ever motivated by market regulatory considerations. We suggest, however, that the term "affiliate" be defined for this purpose consistent with the formulation

in Commission Regulation §1.3(y),[12] that is, to include any person that controls, is controlled by, or is under common control with the SFE or NZFOE member firm.

Moreover, in respect of the inspection and monitoring of such terminals in the U.S., we encourage the Commission to permit foreign boards of trade to utilize the internal electronic monitoring systems designed for that purpose as well as to enlist the services and expertise of American self-regulatory organizations, such as the National Futures Association ("NFA"), to assist in that effort. In connection with the March 1997 Petition, we advised the Commission of preliminary discussions with the NFA for that purpose.

We would be pleased to discuss with the members and staff of the Commission any of our views expressed in this letter. Placement of SYCOM© terminals in the United States, under the supervision of Commission registrants where customer orders are involved, will offer valuable risk management tools for U.S. participants and will help to maintain the SFE and the NZFOE as leaders in both markets and technology. We urge, moreover, that the Commission understand the time sensitivity of this matter and proceed expeditiously, including implementation of a policy of interim relief where good cause is shown.

Yours sincerely



LESLIE V. HOSKING
CHIEF EXECUTIVE AND DIRECTOR

cc. The Honorable Brooksley Born
The Honorable John E. Tull, Jr.
The Honorable Barbara Pedersen Holum
The Honorable David D. Spears
The Honorable James E. Newsome
Geoffrey Aronow, Esq.
Andrea M. Corcoran, Esq.
I. Michael Greenberger, Esq.
Steven Manaster, Ph.D.
Daniel R. Waldman, Esq.

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[12] 17 C.F.R. §1.3(y).