

Financial Services Authority

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From the Chairman  
Howard Davies

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CFTC

Direct line: 0171 676 3000  
Local fax: 0171 676 1011

1999 APR 21 P 11



SECRETARIAT

Ms Brooksley Born  
Chairperson  
Commodity Futures Trading Commission  
3 Lafayette Centre  
1155 21st Street NW, 4th Floor  
Washington D.C. 20581  
USA

16 April 1999

Our Ref: LC/2912

COMMENT

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*John Gooding*

**PROPOSED RULES ON US ACCESS TO OVERSEAS AUTOMATED BOARDS OF TRADE – FSA RESPONSE**

I was very pleased we were able to meet on Wednesday and I hope that you found the discussion as useful as I did.

On the matter of a public or informal response to the proposed rules, the FSA's response for the public record is attached. This response does not refer to the many bilateral discussions that we have had on this issue. In particular, Gay Wisbey and Phillip Thorpe appreciated being able to discuss the proposed rules with you on a preliminary basis in Boca Raton. However, we thought that it might not be entirely appropriate, in this case, to include reference to these discussions in our response for the public record.

Nevertheless, in the course of these discussions we have drawn considerable comfort from what you and your colleagues have given us to understand, including:

- ◆ confirmation that you already consider the FSA to be a comparable regulator for the purpose of these proposed rules;
- ◆ the CFTC's undertaking, given at both the Boca Raton bilateral and the international regulators' meetings, to confirm that the current information sharing arrangements between us are satisfactory (although we agree with you that it would be surprising if they were to prove unsatisfactory);
- ◆ assurance from the CFTC that the fact that the FSA does not explicitly 'certify' an exchange's IT systems should not pose you any practical difficulties (your confirmation of this point at our meeting was also welcome).

On this last point, the CFTC's proposed rule has raised interest in the FSA on certain aspects of the CFTC's own approach to the regulation of U.S. exchanges. In particular, it would be useful to have an understanding of the approach the CFTC takes to assessing its exchanges against the IOSCO principles for the supervision of screen-based trading.

I hope that you will find the attached response useful and am very happy to discuss this matter further with you.

*The info*

*How*

Howard Davies

*Thanks for breakfast!*

# Financial Services Authority

# Fax

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1999 APR 21 P 15



Local Fax: 0171 676 9729

## COMMENT

To: Brooksley Born

Date: 19 April 1999

Fax number: 202 418 5520

Company: CFTC

From: Samantha Barrass

Extension: 65912

Total number of pages (including this page): 16

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### Message:

I attach a copy of HMT's guidance for ROIEs applicants which should have been included in the fax we sent you on Friday.

Regards

Sam

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F.S.C.**FINANCIAL SERVICES ACT 1986**

1999 APR 21 P 10:11

**GUIDANCE FOR APPLICANTS FOR RECOGNITION AS AN OVERSEAS  
INVESTMENT EXCHANGE OR OVERSEAS CLEARING HOUSE**

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1. This note outlines the procedure for applicants for recognition, the criteria against which the decision on recognition will be made and the conditions and requirements which will apply once an overseas investment exchange or overseas clearing house has been recognised. Potential applicants should, however, also examine the provisions of the Financial Services Act 1986 (the Act) itself, and cross-references to the Act are therefore given in the text below.

Introduction

2. The Act prohibits any person carrying on, or purporting to carry on, investment business<sup>1</sup> in the United Kingdom unless that person has been "authorised" or "exempted" under the Act.

3. There are two principal regulatory routes under the Act for an investment exchange or clearing house with a head office outside the United Kingdom which wishes to carry on investment business in the United Kingdom:

- (a) authorization by the Securities and Investments Board (SIB) using powers delegated to it under Sections 26-30 of the Act;
- (b) recognition by the Treasury as an "overseas investment exchange" or an "overseas clearing house" under Sections 37 and 39 of the Act which, in effect, provide exemption.

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<sup>1</sup> See definitions in Annex (and paragraph 13 of Schedule 1 to the Act)

The concept of recognition as an overseas investment exchange was devised to allow the participation of foreign investment exchanges and clearing houses in United Kingdom markets. By relying substantially on the supervisory and regulatory arrangements in the country where the applicant's head office is situated, recognition reduces intervention by the United Kingdom authorities in the day to day affairs of an overseas investment exchange or clearing house.

Overseas exchanges and clearing houses which consider that they will be carrying on investment business in the United Kingdom are advised to discuss authorization with the SIB before deciding whether to apply to the Treasury for recognition. SIB are located at Gavrelle House, 2-14 Bunhill Row, LONDON EC1Y 8RA; telephone 071 638 1240.

4. Overseas investment exchanges and clearing houses which do not intend carrying on investment business in the United Kingdom need take no action. Part IV of Schedule 1 to the Act also provides certain exclusions for persons without a permanent place of business in the United Kingdom.

Overseas investment exchanges may however consider whether they wish to explore with the SIB the possibility of seeking the non-statutory status of "designation", explained in paragraph 22 below, which will relieve firms in the United Kingdom effecting customer transactions on their exchange from daily reporting requirements.

#### Applications

5. Applications for recognition as an overseas investment exchange or as an overseas clearing house should be addressed to:

SIS Group  
HM Treasury  
Parliament Street  
LONDON SW1P 3AG

6. Applications should be accompanied by:
- (a) the address of the applicant's head office;
  - (b) the address of a place in the United Kingdom for the service on the applicant of notices or other documents required or authorised to be served on it under the Act;
  - (c) one copy of each of the following documents:
    - (i) the most recent information relating to its financial position or to its future prospects which it is required, under the law of the country in which its head office is situated (the head office country), to submit to the authorities in that country on an annual basis (and an English translation if appropriate). (Applicants who are overseas companies within the meaning of Section 744 of the Companies Act 1985 are exempted from this requirement);
    - (ii) the applicant's memorandum or articles of association, or constitution;
    - (iii) the applicant's current rules for members and users, and any guidance issued by it in writing or other legible form which is intended to have continuing effect;
  - (d) particulars of the following (if not contained in the documents listed in (c) above):
    - (i) the kind of investment business which the applicant envisages carrying on in the United Kingdom;

- (ii) the date by which the applicant wishes the recognition order to take effect;
- (iii) the supervisory bodies to which the applicant is subject under the law of the head office country; the status of the applicant under that law; and the legal provisions under which the supervision is conducted;
- (iv) the persons responsible for monitoring compliance with the applicant's rules and the supervisory arrangements for monitoring compliance with the rules in so far as those rules apply to investment business carried on in the United Kingdom;
- (v) in the case of an applicant for recognition as an overseas investment exchange -
  - (a) the categories of investments<sup>2</sup> dealt with on the exchange; and
  - (b) any arrangements made, or proposed to be made, by the applicant for the provision of clearing services; and
- (vi) in the case of an applicant for recognition as an overseas clearing house -
  - (a) the clearing, settlement and guarantee services provided by the applicant; and

- (b) any investment exchange recognised under the Act with which the applicant proposes to make clearing arrangements and of any other person (whether or not such an exchange) for whom the applicant provides clearing services.

7. To allow sufficient time for applications to be processed and for the necessary contacts to be made with the appropriate overseas authorities, applications should be made not later than 3 months before recognition is desired to take effect. No guarantee can be given that a decision will be reached within this time, although the Treasury will endeavour to meet applicants' timing requirements.

8. On receipt of the application, the Treasury will invoice the applicant for the application fee. The Treasury will advise prospective applicants of the current level of the application fee.

#### Criteria

9. Before granting recognition, the Treasury needs to be satisfied that the information specified in paragraph 6 above has been provided, that the application fee has been paid, and that the following requirements (set out in Sections 40(2) and 119(1) of the Act and Schedule 21, paragraph 15 of the Companies Act 1989) have been met:

- (a) the applicant is, in the head office country, subject to supervision which together with the applicant's rules and practices is such that investors in the United Kingdom are afforded protection in relation to the applicant at least equivalent to that provided by the Act in relation to recognised investment exchanges or clearing houses whose head offices are situated within the United Kingdom;
- (b) the applicant is able and willing to co-operate, by the sharing of information and otherwise, with the authorities, bodies and persons responsible in the United Kingdom for the supervision and regulation of



investment business or other financial services;

- (c) adequate arrangements exist for such co-operation between those responsible for supervising the applicant in the head office country and the appropriate supervisory and regulatory authorities etc in the United Kingdom;
- (d) copies of the rules and regulations which are furnished by the applicant do not have, and are not intended or likely to have, any significant anti-competitive effect (other than the minimum such effect which may be necessary to protect investors);
- (e) the rules and practices of the applicant, together with the law of the head office country must be such as to provide adequate procedures for dealing with the default of persons party to market contracts connected with the applicant. For overseas recognised investment exchanges and clearing houses market contracts are as defined in Section 155 (2) and (3) of the Companies Act 1989 <sup>3</sup>.

10. In order to satisfy itself on these points, the Treasury may need to request further information from the applicant, and to enter into discussions with the appropriate supervisory and regulatory authorities etc in the head office country. The Treasury is statutorily bound to consult the Director General of Fair Trading as to whether in his view the criterion in paragraph 9(d) above is satisfied.

11. In determining whether to recognise the applicant as an overseas investment exchange or overseas clearing house, the Treasury may - under Section 40(3) of the Act - have regard to the extent to which persons in the United Kingdom and persons in the head office country have access to the financial markets in each others' countries.

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<sup>3</sup> As amended by the Financial Markets and Involuntary Regulations 1991

### Decision by the Treasury

12. If it appears to the Treasury from the information furnished by the applicant and any other information in its possession that the requirements of the Act are satisfied, it may make a recognition order, which will state the date on which it takes effect. If the Treasury refuses an application for recognition, it must give the applicant written notice to that effect stating the reasons for the refusal.

### Information Requirements

13. Having been recognised, the overseas exchange or overseas clearing house will be required to notify certain information to the Treasury either on a regular basis or when certain specified events occur. The following information is required:

#### Annually

Any information relating to the financial position of the recognised body or to its future prospects which it is required under the law of the head office country to submit to the authorities in that country or territory (and an English translation if the information is not in English). This requirement will not apply to a recognised body which is an overseas company within the meaning of Section 744 of the Companies Act 1985.

#### On Occurrence

- (i) Any change in the kind of the business which the recognised body is, or anticipates, carrying on in the United Kingdom;
- (ii) Any change as to the supervisory bodies to which the recognised body is subject under the law of the head office country; the status of the recognised body under that law; or the legal provisions under which the supervision is conducted;

- (iii) Any change in the recognised body's memorandum or articles of association or constitution;
- (iv) Any amendment, revocation or addition to the recognised body's rules<sup>4</sup> or to any guidance<sup>5</sup> issued by it intended to have continuing effect;
- (v) Any change as to the persons responsible for monitoring compliance with the recognised body's rules or as to the supervisory arrangements for monitoring compliance with those rules insofar as those rules apply to investment business being carried on in the United Kingdom;
- (vi) Any event which means that the recognised body is no longer able to cooperate, by the sharing of information or otherwise, with the authorities, bodies and persons responsible in the United Kingdom for the supervision and regulation of investment business or other financial services;
- (vii) In the case of an overseas investment exchange only:-
  - (a) the making, termination or variation of any clearing arrangements;
  - (b) any change in the category of investments dealt with on the exchange; and
  - (c) the discontinuation or suspension of dealings in any category of investments; and
- (viii) In the case of an overseas clearing house only, any change in the nature or extent of the clearing, settlement and guarantee services to be provided by the clearing house (including any change in the persons to whom it provides

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<sup>4</sup> See definitions in Annex

<sup>5</sup> See definitions in Annex

clearing services).

14. The above information must be given in writing to the Treasury not later than 7 days after the date on which it is required to be submitted to the relevant overseas authorities (in the case of the material to be provided annually) or not later than 7 days after the occurrence (in the case of other material specified); with the exception of notifications falling within paragraph 13(vi) above which would have to be made forthwith eg by telex or equivalent means.
15. The recognised body must notify the Treasury in writing in advance of any change of address of the recognised body's head office or of the address in the United Kingdom given by the recognised body for the service of notices or other documents required or authorised to be served on it under the Act.
16. By virtue of Section 162 of the Companies Act 1989 (as amended by the Financial Markets and Insolvency Regulations 1991) a recognised investment exchange or recognised clearing house will be under a duty to report to the Treasury on the completion of default proceedings in relation to market contracts, where the Treasury determines that such a report is required for the purpose of instructing insolvency proceedings in the United Kingdom.
17. The Treasury has power - under Section 104(2) of the Act - to require a recognised body to furnish it also with other information which may reasonably be required for the exercise of its functions under the Act.

#### Periodical Fees

18. Overseas investment exchanges and overseas clearing houses will be required to pay annual fees to the Treasury. Fees will be payable at the commencement of each 12 month period starting from the date on which the recognition order takes effect. The Treasury will advise prospective applicants of the current level of the annual fees.

### Revocation of Recognition Orders

19. The Treasury may revoke recognition of any overseas investment exchange or overseas clearing house if at any time it no longer appears to it that -

- (a) the recognised body is, in the head office country, subject to supervision which, together with the rules and practices of that recognised body, is such that investors in the United Kingdom are afforded protection in relation to the recognised body at least equivalent to that provided by the Act in relation to recognised investment exchanges and clearing houses with head offices within the United Kingdom; or
- (b) the recognised body is able and willing to co-operate, by the sharing of information or otherwise, with those responsible in the United Kingdom for supervision and regulation of investment business or other financial services; or
- (c) the criteria in paragraph 15 of Schedule 21 to the Companies Act 1989 are met;

or if it appears to it that -

- (d) the recognised body has failed to comply with any obligation to which it is subject by virtue of the Act or Part VII of the Companies Act 1989;
- (e) any rules or guidance issued by the recognised body, any practices of the recognised body or of persons who are members of or otherwise subject to the rules of the recognised body, or (in the case of a clearing house) any clearing arrangements made by the recognised body have, or are likely to have, a significant anti-competitive effect (other than the minimum such effect which may be necessary to protect investors). The Director General of Fair Trading has a statutory duty under the Act to keep this matter under

review, or;

- (f) revocation is desirable in the interests of investors and potential investors in the United Kingdom.

20. The Treasury may alternatively and where appropriate apply to the United Kingdom courts for an order requiring the recognised body to take such steps as the courts may direct to ensure that the requirements or obligations referred to in paragraph 19 (a) - (e) above are satisfied or complied with. The Treasury may also itself, as an alternative to revocation, direct a recognised body to take specified steps for securing that any anti-competitive effect such as referred to in paragraph 19(e) above is avoided.

#### Public Register

21. SIB maintains a register, available for inspection by the public, in accordance with Sections 102 and 103 of the Act which specifies the overseas investment exchanges and overseas clearing houses which have been recognised by the Treasury. The entries will give the following particulars:-

- (a) the name of the recognised body; and
- (b) the address of its head office and the address in the United Kingdom given by the recognised body for service of notices or other documents required or authorised to be served on it under the Act.

#### Designation

22. SIB has indicated its willingness to "designate" investment exchanges whose head offices are situated outside the United Kingdom. Designation does not itself confer authorization or recognition. The main beneficiaries of such designation are those firms which effect customer transactions on a designated exchange because they will be relieved of the obligation to report transactions on the designated exchange to SIB at the close of

business each day: transactions on designated exchanges will be treated for the purpose of SIB rules as though they had been effected on a recognised investment exchange. Because designation does not itself confer authorization or recognition of the exchanges, overseas exchanges which are only designated will be prohibited from carrying on investment business in the United Kingdom unless otherwise excluded from the Act's requirements to be authorised or exempted unless they are otherwise exempted by virtue of the provisions of Part IV of Schedule 1 to the Act. Designation is thus not a straight substitute for recognition as an overseas investment exchange or overseas clearing house.

### Enquiries

23. Further information or guidance can be obtained from:

**SIS Group  
HM Treasury  
Parliament Street  
LONDON SW1P 3AG**

**Telephone: 0171 270 5282  
Telex: 941 3704  
Facsimile: 0171 270 4365**

**ANNEX****DEFINITIONS IN THE FINANCIAL SERVICES ACT 1986 RELEVANT TO POTENTIAL APPLICANTS FOR RECOGNITION AS AN OVERSEAS INVESTMENT EXCHANGE OR OVERSEAS CLEARING HOUSE**

Investments (Section 1(1)) are any asset, right or interest falling within any paragraph of Part I of Schedule 1 to the Act.

Investment business (Section 1(2)) is the business of engaging in one or more of the activities falling within Part II of Schedule 1 to the Act, with the exception of "excluded activities" listed in Part III of that Schedule.

Carrying on of investment business (Section 1(3)). A person carries on investment business in the United Kingdom if that person:-

- (a) carries on investment business from a permanent place of business maintained by that person in the United Kingdom, or
- (b) engages in the United Kingdom in one or more of the activities falling within Part II of Schedule 1 to the Act, with the exception of "excluded activities" listed in Parts III and IV of that Schedule and that person's doing so constitutes the carrying on by that person of a business in the United Kingdom.

Rules of a recognised overseas investment exchange (Sections 36(2) and 40(4)) are the rules made or conditions imposed by the exchange with respect to matters corresponding to those specified in Schedule 4 to the Act and to admission of persons to or their exclusion from use of the exchange's facilities or otherwise relating to its constitution.



Guidance of a recognised investment exchange (Section 36(3)) is any guidance issued or any recommendation made by the exchange to all or any class of its members or users or persons seeking to become members of the exchange or to use its facilities; which, if it were a rule, would fall within the definition above of rules of an overseas investment exchanges.

Rules of a recognised clearing house (Section 38(2)) are the rules made, or conditions imposed by the clearing house with respect to the provision by it or its members of clearing services under clearing arrangements ie arrangements with any recognised investment exchange for the provision of clearing services in respect of transactions effected on that exchange.

Guidance of a recognised clearing house (Section 38(3)) is any guidance issued, or any recommendation made, by the clearing house to all or any class of its members or persons using or seeking to use its services, which, if it were a rule, would fall within the definition above of rules of a recognised clearing house.

Activities constituting investment business (Part II, paragraph 13 of Schedule 1) include arranging deals in investments. This is defined as making or offering or agreeing to make:

- (a) arrangements with a view to another person buying, selling, subscribing for or underwriting a particular investment; or
- (b) arrangements with a view to a person who participates in the arrangements buying, selling, subscribing for or underwriting investments.

This does not apply to a person by reason of his making, or offering or agreeing to make, arrangements with a view to a transaction to which he will himself be a party as a principal or which will be entered into by him as agent for one of the parties. The arrangements in (a) above are arrangements which bring about or would bring about the transaction in question.

There are exclusions for persons without a permanent place of business in the United Kingdom (Part IV of Schedule 1). Making or offering or agreeing to make the arrangements defined in (a) and (b) above do not require authorisation or exemption if:

- (c) the arrangements are made by an overseas person with, or the offer or agreement to make them is made by him to or with, an authorised person or an exempted person, the arrangements are with a view to his entering into a transaction in respect of which he is exempt; or
- (d) the transactions with a view to which the arrangements are made are, as respects transactions in the United Kingdom, confined to transactions by authorised persons and transactions by exempted persons in respect of which they are exempt.

**NOTE:**

These definitions are drawn from the Financial Services Act 1986 but there may be other provisions which are relevant in a particular case.