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OFFICE OF THE SECRETARIAT

October 6, 1998

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

COMMENT

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Re: Foreign Board of Trade Terminals

Dear Ms. Webb:

The Commission published its Concept Release on the Placement of a Foreign Board of Trade's Computer Terminals in the United States (the "Release") in 63 Federal Register 39779 (July 24, 1998) and invited public comment on the issues raised in the Release. The Chicago Mercantile Exchange ("CME" or "Exchange") is pleased to offer these comments on those issues.

Background

Section 4(b) of the Commodity Exchange Act ("Act" or "CEA") states as follows:

The Commission may adopt rules and regulations proscribing fraud and requiring minimum financial standards, the disclosure of risk, the filing of reports, the keeping of books and records, the safeguarding of customers' funds, and registration with the Commission by any person located in the United States, its territories or possessions, who engages in the offer or sale of any contract of sale of a commodity for future delivery that is made or to be made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions. Such rules and regulations may impose different requirements for such persons depending upon the particular foreign board of trade, exchange, or market involved. No rule or regulation may be adopted by the Commission under this subsection that (1) requires Commission approval of any contract, rule, regulation, or action of any foreign board of trade, exchange, or market, or a clearinghouse for such board of trade, exchange, or market, or (2) governs in any way any rule or contract term or action of any foreign board of trade, exchange, or market, or clearinghouse for such board of trade, exchange or market.

The concept of a board of trade "located outside the United States" is easy to understand in the context of an exchange trading by open outcry in a particular physical location. However, as noted in the Release, the situation becomes more complicated for exchanges that operate an electronic trading system. In that situation, the physical location of the exchange itself becomes less important, and the location of the computer terminals that offer direct access to the exchange becomes more important.

In recent months, a number of foreign boards of trade have asked the CFTC staff to take no-action positions regarding the placement and usage of trading terminals in the U.S. offices of foreign board of trade members and their affiliates. The purpose of such requests is to provide direct electronic access by U.S. participants to the foreign board of trade's market. Because these requests raise significant regulatory and policy issues, the Commission stated its intent to address the issues through a notice and comment rulemaking process. The issuance of the Release is the first step in that process.

The CME fully supports the process being followed by the Commission in this matter. The Release raises a number of substantive issues with important regulatory and policy implications. We believe that it is appropriate first to solicit public comment on the broader, conceptual issues, to be followed by a specific rulemaking proposal.

The CME believes that the CFTC has clear statutory authority to adopt rules in this area. The first sentence of Section 4(b) of the CEA authorizes the Commission to adopt rules in several broad categories (e.g., proscribing fraud and requiring minimum financial standards) with respect to "any person located in the United States" who "engages in the offer or sale" of a futures contract made on a foreign board of trade. It is significant that this authority is not restricted to intermediaries who deal with customer orders, but instead covers "any person" in the U.S. who trades foreign futures contracts. The third sentence of Section 4(b) limits the CFTC's authority in certain respects. The CFTC may not govern the rules or contract terms of a foreign board of trade, nor may it require that any contract or rule of a foreign board of trade be approved by the Commission. Yet, in determining how its rules and regulations will apply to persons in the U.S., the CFTC is permitted to examine foreign boards of trade individually. The second sentence of Section 4(b) specifically authorizes the CFTC to impose different requirements for persons located in the U.S. depending on the particular foreign board of trade involved.

Comments on CFTC's Proposed Approach

The Release suggests a possible approach involving a two-step procedure. In the first step, a foreign board of trade would petition the CFTC for an order to place its computer terminals in the U.S. without being designated as a U.S. contract market. If the Commission

issued the requested order, the second step would be for a member of the foreign board of trade or an affiliate thereof to request confirmation that such member or affiliate could place and operate in the U.S. a computer terminal providing access to the foreign board of trade. The CME supports the two-step procedure, and we believe that the CFTC has appropriately identified in the Release the types of information that it should obtain from a foreign board of trade.

The Release noted that the CFTC "could" publish petitions in the Federal Register for public comment. The CME believes that such petitions should always be published for comment because of their importance. In addition, members of the public might well have information concerning the regulatory practices of a foreign board of trade that will be highly relevant to the CFTC's decision.

The CFTC requested comment as to whether specific tests should be used to evaluate each required item of information, or whether all of the information should be reviewed based upon a "totality of the circumstances" standard. The CME recommends a hybrid approach. We believe that a foreign board of trade's petition should be denied if it fails to meet certain requirements specified below. If the petition meets the requirements in those areas, then it would be appropriate for all of the information provided to be evaluated based upon the "totality of the circumstances" standard.

In our view, the first requirement that must be met is that the foreign board of trade must have trade practice rules that are substantially equivalent to those required of U.S. futures exchanges. This requirement is needed for "proscribing fraud," the first and most important basis for Commission rulemaking set forth in Section 4(b). The CME believes that the same standards that the CFTC requires for electronic trading systems operated by U.S. exchanges to prevent fraud should also apply to such systems operated by foreign exchanges in the U.S. For example, the CFTC requires that an electronic trading system must maintain an accurate audit trail. An electronic trading system, foreign or domestic, that fails to meet that standard, should not be allowed to operate in the U.S. This requirement is needed both for the sake of customer protection and for competitive fairness. It would be highly unfair, and would put U.S. exchanges at a severe competitive disadvantage, if a foreign electronic trading system were permitted to operate in the U.S. without the same trade practice rules that impose regulatory costs on U.S. exchanges and/or make it more cumbersome for traders to use the U.S. electronic trading system.

Second, the CME believes that the CFTC should insist on reciprocity. If the jurisdiction in which the foreign exchange is located does not allow U.S. exchanges to place terminals in that country, then the CFTC should not allow the foreign exchange to place terminals in the U.S.

If the CFTC grants a foreign board of trade's petition, it proposes to do so subject to certain conditions. The first condition is that any computer terminals placed in the U.S. must be located in the offices of members of the foreign board of trade or their affiliates, or in a member's or affiliate's firm booth on the floor of a U.S. exchange. The Release also asked for comment as to how the CFTC can determine whether a firm is a bona fide member or affiliate of a member of a foreign board of trade. Recognizing that exchanges have different ownership and membership structures, the CME believes that a particular membership status should not be a prerequisite for obtaining a terminal with access to an electronic trading system. For example, CME rules allow entities holding an "ETH permit" to obtain a GLOBEX® terminal in order to trade for their own accounts, even though ETH permit holders are not "members" of the Exchange. ETH permit holders must agree in writing to comply with all the applicable rules of the Exchange when effecting transactions through the GLOBEX system. We believe that the same approach can be used by a foreign board of trade so long as it demonstrates that it can exercise its jurisdiction and regulatory control over the activities of any participant allowed to have electronic access to its market.

We believe that the other conditions suggested in the Release are reasonable and appropriate. For example, any member or affiliate thereof that executes trades from a U.S. terminal must be registered as an FCM unless it trades solely for its proprietary account. The reporting of trading volume originating from U.S. computer terminals, as compared with the total volume of contracts traded on the foreign board of trade, is needed in order to enable the CFTC to determine whether the level of the foreign board of trade's activity in the U.S. has reached the threshold (discussed later in this letter) requiring the board of trade to seek designation as a U.S. contract market.

As noted in the Release, the legislative history concerning Section 4(b) of the Act makes it clear that the foreign futures contracts that may be offered or sold in the U.S. must be bona fide foreign futures contracts traded in a regulated exchange environment. Nothing in the CFTC's proposed approach would permit the offer and sale in the U.S. of foreign futures that are not executed on or subject to the rules of a foreign board of trade. Accordingly, an entity such as the EBS Partnership, which is not regulated as a board of trade in any jurisdiction, would not be allowed to offer or sell standardized forward rate agreements in the U.S. that constitute contracts of sale of a commodity for future delivery within the meaning of the CEA.

Definitional and Other Issues

1. Types of Computer Terminals

The CFTC asked for comment on what types of computer terminals should be covered in its proposed rulemaking. The CME believes that the CFTC rule should cover all types of

systems that provide electronic access for participants in the U.S. to the foreign board of trade. The specific type of technology is not relevant to the CFTC's regulatory concerns. Any type of system that provides such access, whether it be labeled an electronic trading system or an order routing system, is intended to solicit trading by U.S. participants and thus raises the same regulatory need for rules proscribing fraud and performing the other functions specified in Section 4(b) of the Act.

2. Level of U.S. Activity Requiring Contract Market Designation

The CFTC correctly observed that, at some level of U.S. activity, a board of trade can no longer claim to be located outside the U.S. and should be required to be designated as a U.S. contract market. The CME believes that the primary basis for making that determination should be what percentage of the foreign board of trade's overall trading volume originates from computer terminals located in the U.S. We considered having such determination made on a contract-by-contract basis, but decided that it would not be appropriate to require a foreign board of trade to be designated as a U.S. contract market simply because a high percentage of its trading volume in a particular contract originated from computer terminals located in the U.S., when such volume represented only a small portion of the board of trade's overall trading volume for all contracts. We believe that if a substantial portion (e.g., 20-25 percent) of the overall trading volume of a board of trade for two consecutive quarters (to eliminate an unusual one-time event that might skew the percentage for one quarter) originates from computer terminals in the U.S., then the board of trade should be required to be designated as a U.S. contract market.

3. Linkages with U.S. Exchanges

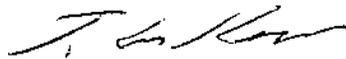
The CFTC requested comment as to how its proposed rulemaking should accommodate situations where a foreign board of trade and a U.S. exchange would each offer its products for trading on the same electronic trading platform in the U.S. The CME believes that the same requirements should be applied to the foreign board of trade sharing an electronic trading platform with a U.S. exchange as to a foreign board of trade placing its proprietary trading terminals in the U.S. With respect to the CME-MATIF cross-exchange trading arrangement through GLOBEX terminals, we note that the full Commission approved such arrangement after an intensive review of the MATIF trading rules, the applicable French regulatory requirements, and how such requirements would be enforced.

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Conclusion

The CME supports the need for Commission rulemaking in this important area. We appreciate having the opportunity to give our preliminary comments on how the rulemaking should be shaped.

Sincerely,



T. Eric Kilcollin
President and Chief Executive Officer