X-pand into the Future

BY TELEFAX AND COURIER (001-202-418-5521)

Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

Attention: Ms. Jean A. Webb
Secretary

COMMENT

Frankfurt, April 27, 1999

Re: Proposed Rules 1.71 and 30.11 Concerning Order Routing and Electronic Access to Futures Exchanges Operating Primarily Outside the United States (64 Fed. Reg. 14159, March 24, 1999)

Dear Ms. Webb:

Eurex Deutschland ("Eurex")[1] is submitting this letter in response to the Commodity Futures Trading Commission's (the "Commission") release (the "Release") of March 24, 1999, proposing new Rules 1.71 and 30.11 (the "Proposed Rules") Concerning Order Routing and Electronic Access to Futures Exchanges Operating Primarily Outside the United States. Proposed Rule 1.71 would impose new conditions and limitations on the use by futures commission merchants ("FCMs") of automated order routing systems. Proposed Rule 30.11 would treat foreign boards of trade that provide U.S. members with remote terminal access to their electronic execution system as though they were located in the United States. Such foreign boards of trade would be required to demonstrate that they are subject to home country regulation *comparable* to the Commodity Exchange Act ("CEA") as a condition to exemption from the CEA's contract market designation requirement.

Eurex is pleased to have this opportunity to comment on this important rulemaking initiative by the Commission. Eurex is located in Frankfurt, Germany, and is a fully computerized derivatives exchange with members and trading terminals located in many different jurisdictions, including the United States. Eurex is currently the highest volume derivatives exchange in the world. As noted in the Release, on February 29, 1996, Eurex was granted no-action relief by the Commission's Division of Trading and Markets permitting Eurex members to trade Eurex futures contracts on terminals located in the United States (the "Eurex No-Action Letter").

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[1] Eurex, formerly known as the Deutsche Terminbörse ("DTB"), officially changed its name to Eurex Deutschland on June 8, 1998.

The Eurex No-Action Letter was modified by a letter from the Division of Trading and Markets, dated June 3, 1998, to provide that no new terminals could be installed in the United States, and no new products could be traded on existing terminals, without the written permission of the Division of Trading and Markets. This modification reflects the Commission's current moratorium on the placement of new terminals in the United States. Eurex has, over the years, committed significant commercial resources, both financial and other, to implement and support its U.S. membership base. Many of these resources involve fixed costs. In addition, with European Monetary Union, the financial landscape in Europe is changing rapidly. The Commission's moratorium has prevented Eurex from responding fully to these changes. The moratorium has thus had a significant negative impact on Eurex. For these reasons it is a matter of urgency to Eurex that the Commission lift the moratorium.

OVERVIEW

Eurex continues to support the Commission's efforts to implement a uniform framework for permitting terminal access from the United States to foreign boards of trade and thereby promote efficient cross-border trading of futures contracts as well as options thereon. Nevertheless, we believe that the approach proposed in the Release and the Proposed Rules will likely hinder, rather than advance, the objective of fostering efficient cross-border trading.

The Commission's proposed rulemaking must be considered in the context of the current state of development of global futures and derivatives trading. New derivatives exchanges are almost exclusively electronic, rather than floor-based. Nearly all floor-based exchanges are in the process of converting to or expanding to include electronic trading capabilities.

If adopted, the Proposed Rules would, in effect, establish regulatory standards potentially applicable to all exchanges, across the globe. The Commission's proposed approach would subject all exchanges to regulation comparable to the U.S. model. If every jurisdiction adopted the proposed U.S. approach, all exchanges -- U.S. and foreign -- would be required to conform to the regulatory model of each jurisdiction in the world in which they have electronic trading members. It is, of course, also possible that exchanges may encounter inconsistent regulatory requirements in different jurisdictions which it is not possible for them to reconcile and satisfy.

The implications of such an approach are self-evident. The proposed approach would significantly undermine the very benefits in efficiency, reduced cost, and enhanced access that electronic trading offers. The harm would not be limited to foreign exchanges, but would extend to U.S. exchanges, as well as to FCMs and market users.

Specifically, we believe the Proposed Rules are flawed in the following respects:

- The Proposed Rules would, ***for the first time***, treat a foreign board of trade as though it were located in the United States and fully subject to the jurisdiction of the Commission if U.S. members have remote terminal access to the foreign board of trade's execution system.

- A foreign board of trade would be exempted from contract market designation only upon a demonstration that it is subject to home country regulation ***comparable*** to the CEA, a requirement that would, in effect, export U.S. regulatory standards to foreign boards of trade.

- A foreign board of trade would be subject to an application process and ongoing informational requirements that would be onerous.

- The Proposed Rules would ignore important differences between a board of trade's direct execution system (as defined in the Proposed Rules, a "DES") and a member firm's automated order routing system (as defined in the Proposed Rules, an "AORS"), and impose unnecessary burdens on FCMs and foreign boards of trade.

- The Proposed Rules would extend more favorable treatment to foreign boards of trade that permit trading in their contracts through a shared electronic trading platform with a U.S. contract market than to foreign boards of trade that do not have similar arrangements with a U.S. contract market.

- The Proposed Rules would provide no transition period under which Eurex members who currently operate terminals in the United States pursuant to the Eurex No-Action Letter would be able to continue to do so until Eurex obtains an exemption under the new rules.

Accordingly, Eurex urges that the Proposed Rules be withdrawn or fundamentally restructured and that the current moratorium on approving placement of new terminals, and on trading new products from existing terminals, be lifted, pending further consideration of rulemaking initiatives in this area. In the interim, foreign boards of trade should be permitted to place terminals in the United States on a basis more consistent with CEA Section 4(b), such as the approach taken by the Division of Trading and Markets in the Eurex No-Action Letter.

DISCUSSION

The comments in Section I below focus on the conceptual underpinnings of the Proposed Rules. Section II focuses on certain of the more specific elements of the Proposed Rules. Finally, Section III summarizes Eurex's recommendations for further action by the Commission.

I. Conceptual Flaws in the Proposed Rules

A. "Foreign" boards of trade

In the Release and the Proposed Rules, the Commission has for the first time suggested that a board of trade organized and located outside the United States is *not* located "outside of the United States" for purposes of Section 4(a) of the CEA, if members located in the United States have remote terminal access to the board of trade's DES.[2]

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[2] The Commission, in fact, goes even further by imposing limits on the use of an AORS by a member of a foreign board of trade that would, among other consequences, in effect subject the foreign board of trade to the Commission's jurisdiction or preclude trading in the foreign board of trade's contracts. We also disagree with this element of the proposed rulemaking. (See Section I.D below.)

This position is inconsistent with the longstanding policy and practice of the Commission and its staff,[3] and is inconsistent with the objectives that IOSCO is pursuing with respect to the mutual recognition and, where appropriate, harmonization of regulatory standards across different jurisdictions.

A foreign board of trade with a DES located in the United States should not be regarded as "located in the United States" any more than a European shoe manufacturer should be regarded as located in the United States merely because U.S. distributors have electronic systems for placing electronic orders. Clearly, the placement of a DES in the United States constitutes a form of U.S. contact that raises potential regulatory considerations. The challenge, however, is to develop a regulatory response that is appropriately tailored to the incremental regulatory considerations presented by the character of these U.S. contacts in light of the policies underlying the CEA and the existence of home country regulation.

In contrast, by concluding that foreign boards of trade providing DES access from the U.S. are not "foreign" for purposes of the CEA, the Commission is vesting itself with authority to regulate, directly or indirectly, potentially all aspects of the operation of such boards of trade. In this regard, as discussed more fully in Section I.B below, we believe that the Commission's proposed approach is fundamentally at odds with the policies underlying Section 4(b) of the CEA.

We also do not believe that the Commission's proposed approach is a practical one. If each jurisdiction in the world were to adopt a similar approach, electronic exchanges -- U.S. and foreign -- would be required to satisfy an impossible panoply of local regulatory standards. Such an approach is unworkable. It would be costly, time consuming and burdensome. In all these respects, the Commission's proposed approach would undermine the economic and technological efficiencies sought to be achieved through electronic trading, and increase costs for users of and all participants in these markets.[4]

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[3] For example, the Commission approved Chicago Mercantile Exchange ("CME") rules permitting cross-trading on the Marche à Terme Internationale de France ("MATIF") from Globex terminals located in the United States, without requiring MATIF to obtain designation as a U.S. contract market or otherwise obtain a Section 4(c) exemption. The Commission could not have made this determination consistent with the CEA unless it had concluded that MATIF was a *foreign* board of trade for purposes of Sections 4(a) and 4(b), regardless of the trading of its contracts on terminals located in the United States. The fact that the Commission intends to permit the CME-MATIF arrangement to continue and other similar arrangements to be effected without obtaining an exemption under the Proposed Rules is inconsistent with the Commission's position that foreign boards of trade with a DES in the United States are not located "outside the United States" for purposes of Section 4(a) of the CEA.

[4] An approach requiring the Commission to evaluate and monitor, on an ongoing basis, the evolving regulatory regimes in each jurisdiction in which electronic exchanges are located would also have potentially staggering resource implications for the Commission itself.

B. CEA Section 4(b)

Section 4(b) of the CEA prohibits the Commission from adopting rules or regulations that require Commission approval of any contract, rule, regulation or action of any foreign board of trade or clearinghouse or that govern any rule, contract term or action of any foreign board of trade or clearinghouse.[5] By adopting these provisions, Congress explicitly limited the authority of the Commission to oversee foreign boards of trade. Even in 1982, Congress took the position that the CEA should foster U.S. participation in foreign markets and not impose undue burdens on doing so. The development of electronic systems such as DES's and AORS's clearly enhance the efficiency of, and promote, cross-border trading, consistent with the objectives of Section 4(b).[6] It would be ironic indeed if these technological developments, which enhance the efficiency of cross-border trading, were used as a predicate to erect barriers to cross-border trading and undermine Congress's very objectives in adopting Section 4(b).

The Commission should also recognize that the approach it has taken diverges significantly from the policy of regulators in many other countries. In the European Union, for example, regulators have generally adopted the principle that the home country regulator for a board of trade should be the primary regulator of that board of trade, even if its products are traded from other member (and non-member) countries. This approach of deference to the home country regulator and mutual recognition of its standards has been facilitated by the requirements of the European Union Investment Services Directive (the "ISD")[7] and other multilateral arrangements, such as those involving the Forum of European Securities Commissions ("FESCO"). With respect to the regulation of securities or commodities intermediaries, the ISD has required harmonization of standards across the EU member countries. Together, these principles have enhanced cross-border trading throughout the European Union.

We believe that it is not in the long-term interest of the Commission, or of U.S. boards of trade or other market participants, to take a position inconsistent with that of most foreign regulators of futures and derivatives. Accordingly, we urge that the Commission recognize explicitly that the primary regulator for a board of trade, whether or not the board of trade has terminals in the United States, should be the home country regulator, and that the Commission extend deference to that regulator and its home country regime. While we appreciate that the Commission has legitimate concerns about attempts to evade U.S. jurisdiction and the requirements of the CEA by forming boards of trade in jurisdictions with limited or no regulation, it cannot seriously be contended that this problem exists for boards of trade in countries with established regulatory systems.

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5 This provision has no direct parallel under the U.S. securities laws.

6 See, *e.g.*, Statement of Ian Domowitz, Professor, Pennsylvania State University, before the U.S. House of Representatives Committee on Banking and Financial Services, Subcommittee on Capital Markets, Securities and Government-Sponsored Enterprises, March 25, 1999.

7 See Investment Services Directive, Article 14, Section 5.

The principle of extending deference to home country regulation of a foreign board of trade is consistent with Section 4(b) of the CEA. Moreover, it has proven to be good practice. The home country regulator of a board of trade is in the best position to provide comprehensive regulation with the least burden on the board of trade, because of proximity to the management and operating institutions of the board of trade, familiarity with its operations developed through experience, and cultural affinities. The principle of deference to home country regulation, and the benefits to be derived therefrom, are effectively undermined, however, if deference is conditioned on a merit review by the Commission of the home country regulatory regime, particularly a review based on a determination by the Commission that the home country regulatory regime is comparable to the Commission's own regime.[8]

The Commission, of course, has a legitimate interest in protecting customers and the integrity of U.S. markets. But the best way to achieve this goal is through regulation of the intermediaries that deal with U.S. customers and operate in the United States—*i.e.*, FCMs and firms with an exemption under Rule 30.10. Such an approach has the advantage of being consistent with home country regulation of the foreign board of trade, in that the Commission's focus would be on activities conducted directly with U.S. customers in the United States, rather than on the operations of the foreign board of trade generally. It would also comport with Section 4(b) of the CEA, which does not permit direct regulation of foreign boards of trade, but does not prohibit the Commission from supervising intermediaries operating in the United States with respect to the contracts of foreign boards of trade.

Section 4(b) also reflects a judgment by Congress that the Commission should not expend its limited resources evaluating and attempting to regulate boards of trade in other jurisdictions. To the extent the Proposed Rules would require or permit the Commission to do so, even indirectly, they are inconsistent with Congress's mandate. Moreover, as a practical matter, it is simply not efficient for the Commission to assume the burden of making such evaluations on an ongoing basis throughout the world. Deference to the home country regulator is a much more cost-effective option that would permit the Commission to concentrate its efforts where they can be the most productive.

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[8] The failure of the Proposed Rules to recognize the principle of deference to the primary home country regulator is compounded by the fact that the Commission's regulatory authority under the Proposed Rules is essentially open-ended. Nothing in Section 4(c) of the CEA or the Proposed Rules would prohibit the Commission from exercising its discretion to make additional rules applicable to exempted foreign boards of trade. Although we understand that the Commission needs some discretion to alter rules as market conditions change, development and installation of a DES or an AORS in the United States entail significant costs for foreign boards of trade and their members. As a result, foreign boards of trade and their members need, and should be entitled to, some certainty as to the regulatory environment they will face when they make the decision to seek approval for a DES under the Proposed Rules. In addition, vesting such broad discretion in the Commission could lead to arbitrary and inconsistent standards applicable to boards of trade from different jurisdictions, whether inadvertently or as the result of a Commission practice of evaluating the merits of different regulatory systems. We urge the Commission to consider a more limited and well-defined set of rules more consistent with the principle of deference.

C. Generally comparable regulatory structure

As noted above, the Proposed Rules would condition an exemption on the existence and demonstration by the applicant of a generally comparable regulatory structure in the home country of the foreign board of trade.[9] We believe that any analysis of "comparability" is inappropriate in the context of determining whether to permit members of a foreign board of trade to install DES terminals in the United States.

As an initial matter, such an evaluation would be inconsistent with Sections 4(a) and 4(b) of the CEA. Eurex, like other foreign boards of trade in Europe and elsewhere, is subject to a well-established, comprehensive regulatory system. Section 4(b) does not authorize the Commission to review the merits of the rules of a foreign board of trade. Accordingly, whether or not such rules and regulatory system are strictly "comparable" to those applicable in the United States should not be relevant to the Commission's determination with respect to the placement of terminals in the United States. It should be sufficient for the Commission to determine that the foreign board of trade is in fact a *bona fide* foreign market subject to *bona fide* regulation. There can be no question that the regulatory environments applicable to Eurex and other established foreign markets satisfy these basic criteria. The Commission does not need to require licensed boards of trade to submit exhaustive information in order to demonstrate that fact. Requiring the existence of comparable regulation is simply an unnecessary burden on access to foreign boards of trade of the type that Congress sought to avoid through Section 4(b) of the CEA.

Comparability can, however, be a useful standard. In the Rule 30.10 context, for example, it is relevant in determining the extent to which the Commission will exempt from U.S. regulation an intermediary dealing directly with U.S. customers. This application of a comparable regulatory standard is within the scope of the Commission's regulatory authority under Section 4(b). Eurex endorses the principle embodied in Section 4(b) and adopted by the Commission of regulating those intermediaries that market foreign futures products to, and deal directly with, U.S. customers. In this context, Eurex believes it is appropriate to condition exemptions from U.S. regulation on the existence of reasonably comparable regulatory protections.[10] In light of the fact that the Proposed Rules would require that U.S. customers only trade using a DES or an AORS through a registered FCM or a Rule 30.10 firm, for whom the Commission will already have made a comparability determination, we do not see any need to require a separate review of comparability in the context of a Rule 30.11 exemption.

There is, however, a legitimate question as to what ***incremental*** regulatory concerns are presented by the use of electronic trading terminals in the United States, this being the single feature that distinguishes foreign boards of trade with terminals located in the United States from foreign non-computerized boards of trade.

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9 Among other considerations, the country-by-country approach set forth in the Proposed Rules ignores important international developments, such as European Union initiatives to harmonize or extend mutual recognition to the systems of regulation applicable in the EU member countries.

10 In this regard, we note that there is a significant difference between an approach that looks to the existence of regulatory measures that, taken as a whole, afford reasonably comparable protections, on the one hand, and an approach that looks to the existence of specific comparable regulatory provisions, on the other hand.

The exemption for foreign boards of trade contained in CEA Section 4(b) is not predicated on any requirement that the relevant boards of trade have any particular operating or rulemaking structure, or be subject to any qualifying character of regulation. The exemption applies whether or not the foreign board of trade has rules similar to those in effect in the United States regarding clearing facilities, upstairs trading, order allocation, negotiated execution prices, average pricing, cross trading, dual trading, prearrangement, or the like.

Because these considerations are not relevant to the exempt status of a foreign board of trade that has no trading terminals in the U.S., and U.S. customers may trade on such a board of trade without condition, we do not see any basis on which they should become relevant to the exempt status of a foreign board of trade with U.S. trading terminals. The fact that a U.S. customer's order is communicated through a computer terminal located in the United States, rather than through a phone, facsimile or other electronic means in the United States to a broker located on the floor of a board of trade or sitting at a terminal located outside the United States, does not warrant such a fundamental distinction in regulatory treatment.

On the other hand, the use of such trading terminals arguably gives rise to other *bona fide* regulatory considerations that the Commission should appropriately address. These include confirmation that the electronic trading capability that is being offered provides fair market access to U.S. customers and assuring system integrity and the like. Accordingly, information regarding these considerations could be included in the application process.

Going beyond considerations of this kind to address issues that are not unique to the use of electronic trading terminals in the U.S., but that instead are equally applicable to trading by U.S. customers on foreign floor-based boards of trade is inconsistent with CEA Section 4(b). We are not aware of any other jurisdiction that imposes conditions comparable in scope and detail to those presented in the Proposed Rules. We believe the U.S. Congress recognized that such an approach would establish a highly undesirable and counterproductive precedent.

We agree entirely with that judgment and are seriously concerned that the adoption of a process similar to that described in the Proposed Rules by the Commission and, subsequently, in other jurisdictions would present an untenable international regulatory climate in which to promote cross-border trading.

D. Distinctions between a DES and an AORS

The Proposed Rules do not adequately distinguish between a DES, which provides direct, non-intermediated access to a foreign board of trade's matching and execution facility, and an AORS, which allows electronic entry of orders through an intermediary to the foreign board of trade's matching and execution facility.

Proposed Rule 1.71 (together with the proposed amendment to Rule 30.3), *sub silentio*, but in effect, takes the position that a foreign board of trade accessible by either a DES or an AORS in the United States is no longer located "outside the United States" for purposes of Section 4(a) of the CEA. As noted above, we do not believe this conclusion follows from the placement of a DES in the United States. It follows even less in the context of an AORS that is installed by and under the control of the member, not the board of trade. Under the Proposed Rules, even a board of trade with no U.S. members may be subject to the jurisdiction of the Commission if one of its members has an AORS accessible from customers in the United States.

Alternatively, FCMs in the United States and abroad would be precluded from using an AORS to solicit or accept U.S. customers' orders to buy and sell a foreign board of trade's contracts. These outcomes demonstrate the degree to which the Proposed Rules have exceeded the jurisdictional bounds imposed by Section 4(b). These proposed provisions should therefore be withdrawn by the Commission.[11]

A foreign board of trade should not become subject to the full panoply of U.S. regulations simply because a member decides to implement an automated system for its customers. The Commission has adequate existing authority to regulate the customer-intermediary relationship through requirements imposed on FCMs and Rule 30.10 firms. While the Commission may have special concerns about the integrity of an AORS that FCMs and Rule 30.10 firms operate, it should be able to address these concerns through its existing regulatory framework.

The Proposed Rules would also require exempted foreign boards of trade to provide to the Commission, at any time on request of the Commission, information concerning those of their members that allow the use of an AORS in the United States. Foreign boards of trade should not be in the position of policing compliance with the rules relating to the use of an AORS, particularly when the member could be required to report this information directly to the Commission.

E. Equal treatment of foreign boards of trade

Any final rules should subject all foreign boards of trade seeking to install a DES inside the United States to similar requirements and conditions. The Proposed Rules, however, create two different approval processes, one for foreign boards of trade with an electronic trading arrangement through a designated U.S. contract market, and one for foreign boards of trade without such an arrangement.

This two-track approach misapprehends the nature of certain types of exchange linkage. A linkage under which contracts of a foreign board of trade are traded subject to the rules of a linked contract market is ***not*** the same as a linkage in which two boards of trade merely share a common trading platform and extend cross trading privileges to each other's members. In the latter case, approval of the contract market's rule permitting member access to the linked exchange's products is tantamount to a determination that the linked foreign board of trade is not located in the United States for purposes of Section 4(b), unless the linked foreign board of trade is required itself to obtain contract market designation or an exemption therefrom.

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[11] We note that, under Proposed Rule 1.71, FCMs and Rule 30.10 firms would be required, among other requirements, to implement credit and trading or position limit checks that are performed, either by a natural person or by the system itself, prior to the execution of an order entered through an AORS. If these controls are automated, the member firm must implement proper internal controls to ensure that limits appropriate to each customer are properly entered into the AORS and updated as appropriate. We believe the Commission should afford such member firms greater flexibility in determining how to implement internal controls to limit unauthorized trading and address credit risk concerns.

In either case, there is no basis to differentiate substantively between the position of a linked foreign board of trade under such an arrangement from the position of foreign boards of trade that do not have such linkages.[12] Thus, to the extent boards of trade without a linkage to a U.S. contract market are required to obtain new approvals to install new terminals or continue using existing terminals in the United States, a foreign board of trade that has a linkage to a U.S. contract market should be required to obtain the same approvals. Ultimately, the Release provides no justification, and we do not think any justification exists, for treating foreign boards of trade differently, either prospectively or retrospectively, depending on whether they affiliate with a U.S. contract market.

II. Additional Comments on the Proposed Rules

If the Commission decides to continue with its current rulemaking, the Proposed Rules raise several other significant issues that we believe should be addressed in any final rules.

A. Scope of activities inside the United States

The Proposed Rules would require that an applicant's core exchange functions, such as exchange governance, operation of the central processing systems comprising the exchange market or effecting the execution of transactions, performance of market surveillance and compliance functions and the like, be located outside of the United States. The Proposed Rules contemplate that a foreign board of trade might be permitted to have "incidental contacts" with the United States and still maintain its exemption. However, the Proposed Rules and the Release provide no guidance as to what qualifies as an "incidental contact." Instead, applicants are to describe the scope of contacts they propose to have, with no idea as to the parameters for permissible contacts. As a practical matter, it is essential that foreign boards of trade be permitted to conduct a range of promotional, product development, educational and market research activities and provide local assistance for members and prospective members. Because of the risk that activities in the United States could jeopardize an exemption under the Proposed Rules, any final rules must provide a safe harbor or other definitive guidance on the basis of which foreign boards of trade can make decisions as to the extent of their activities in the United States.

In particular, Eurex, like other boards of trade with terminals in foreign jurisdictions, maintains and should be able to continue to maintain a representative office in the United States that performs certain marketing, promotional and educational activities and provides information and assistance to prospective and existing members in relation to admission to membership, contract terms, rules and electronic trading requirements.[13] The Release notes that such a representative office might qualify as an "incidental contact," depending on its size, purpose and activities. Any final rules should make it clear that such a representative office is a permitted "incidental contact" and provide more definite standards as to the permissible size, purposes and activities of such an office.

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[12] In light of the fact that under the Globex2 system, the core operating functions in the CME-MATIF electronic linkage, including market surveillance and related activities, are based on the NSC-VF system of MATIF and are run from outside the United States, this distinction is even less tenable.

[13] See letter of October 7, 1997, from Edward J. Rosen of Cleary, Gottlieb, Steen & Hamilton to Andrea Corcoran, Director, Office of International Affairs, discussing these contacts.

B. Significance of U.S. terminal-originated trading volume

We support the Commission's decision not to impose a ceiling on the volume of trading on an exempt foreign board of trade that may originate from a DES or an AORS in the United States. Nevertheless, we are concerned about the suggestion in the Release that if U.S. terminal-originated trading volume increases beyond a certain unspecified level, the exemption under the Proposed Rules might cease to be available. In that case, the foreign board of trade would have to obtain designation as a U.S. contract market or discontinue access to its DES in the United States, or somehow limit U.S.-originated trading volume.

As an initial matter, we believe that if a foreign board of trade satisfies the other requirements for an exemption, a mere increase in U.S.-originated trading volume should not cause it to lose that exemption. So long as the core operations of the foreign board of trade, such as market governance, administration, operation of the central electronic processing systems and surveillance, are conducted outside of the United States, as would be required by the Proposed Rules, and the foreign board of trade has an operating history abroad and is regulated abroad, the level of U.S. trading volume should not be significant in determining whether a board is trade is "foreign" or whether it should be entitled to an exemption.[14]

U.S. volume might, together with other considerations, be relevant in determining whether a board of trade is "foreign" for purposes of the CEA for a newly formed board of trade in a jurisdiction with limited or no regulation where there is substantial evidence of an effort to circumvent U.S. regulation. In the case of a *bona fide* foreign board of trade that has existed for a number of years in a foreign jurisdiction subject to broad regulatory oversight, however, emphasis on U.S.-originated volume is wholly inappropriate. Just as it would be inappropriate for the CME to be deemed a foreign board of trade because it succeeded in marketing its contracts abroad, foreign boards of trade whose products are traded through a DES or an AORS in the United States should not be treated as domestic because they succeed in attracting increased U.S. business through competitive prices, products, services or other factors.

C. Uncertainty about extent of U.S. regulation

The Commission's new position also creates other substantial uncertainties about the treatment of foreign boards of trade under U.S. law. For example, the Proposed Rules do not clearly indicate what other provisions of the CEA would apply to an exempted board of trade. At one point in the Release, for example, the Commission mentions, without discussion, that its antifraud authority would apply to an exempted foreign board of trade. While it may be appropriate to apply U.S. antifraud rules to FCMs or Rule 30.10 firms with respect to activities in the United States, it is not clear what exactly the Commission intends by applying such rules to an exempted board of trade itself. It is also not clear whether (and if so, which) other provisions of the CEA and Commission regulations, other than the contract market designation requirement, remain applicable to exempted foreign boards of trade. At a minimum, foreign boards of trade applying for and receiving an exemption are entitled to know with certainty what provisions of the CEA and Commission Rules apply to them and in what contexts.

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[14] The fact that for most contracts traded on foreign boards of trade the bulk of the underlying assets have principal markets other than in the United States further supports the notion that trading volume from the U.S. should not be relevant to determining whether a board of trade is "foreign."

D. Pre-execution screening

In the Release the Commission requests comment as to whether it should require that automated order matching and execution systems have the ability to provide pre-execution credit and trading or position limit screening. It is our understanding that no board of trade, foreign or domestic, currently has the technological and operational ability to implement such screening. We share the Commission's objective of identifying opportunities to minimize risks to the integrity of clearing members. The issues raised by the failure of Griffin Trading are difficult but not unique to electronic boards of trade. Rather, they are endemic to give-up arrangements throughout the global futures industry. Eurex is willing to work with the Commission in addressing these issues, but we do not believe it is appropriate for the Commission to impose a new regulation on this subject at this time or as part of a rulemaking that is specific to foreign boards of trade.

E. Approval of automated trading systems

Under the Proposed Rules, an applicant would be required to provide to the Commission detailed information concerning the extent to which its home country regulator performed a technical review of its automated trading system on the basis of the 1990 IOSCO report on screen-based trading systems or substantially similar standards. The Release does not specify the extent to which the Commission would independently review the trading systems of a board of trade whose systems had not received a thorough review by its home country regulator. Although we welcome the Commission's willingness to recognize IOSCO standards, we do not think it is necessary or appropriate for the Commission to explore the extent to which the home country regulator approved the automated trading system or to conduct an independent review of its compliance with IOSCO or other standards, particularly in the case of a board of trade supervised by an IOSCO member.

Instead, there are several ways in which the Commission can obtain confirmation of compliance with IOSCO standards consistent with the principle of deference to the home country regulator. The simplest would be for the Commission to accept a foreign board of trade's licensing by an IOSCO member as evidence that IOSCO standards have been satisfied. It should also be sufficient if the foreign board of trade certifies that its trading systems comply with IOSCO standards, or if the home country regulator or a competent third party provides such a certification. So long as there is evidence of this kind, the Commission should not need to undertake an independent review.[15]

Demonstrating compliance with IOSCO standards in this manner would also establish to the Commission that the relevant automated trading system provides fair access to all investors, including U.S. investors, as required by such standards, an issue of legitimate concern to the Commission.

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[15] As the Commission noted in the Eurex No-Action Letter, Germany was one of the members of the working group responsible for the adoption of the IOSCO standards. Upon request, DTB provided to the Commission at the time of the Eurex No-Action Letter information with respect to its compliance with those standards. We do not believe that additional information should be required as part of a new approval process.

F. Membership rules

The Commission should not put itself in the position of vetting a foreign exchange's membership rules and establishing appropriate criteria for membership, other than in the case of those members that act in the capacity of an FCM. Where a board of trade has no "special" membership categories and requires that all members be engaged in the business of trading derivatives contracts, such scrutiny is particularly inappropriate.

G. Reporting requirements

The Proposed Rules would require an exempted foreign board of trade to provide to the Commission written notice within 30 calendar days of any known violation of any obligations under the terms of the exemption by a member or an affiliate of a member operating in the United States under the exemption. Because the determination that there has been a violation may be more of a process than a definite event, we would suggest that the notice period begin following a formal determination by the board of trade that a term or condition of the exemption has been violated.

H. Information Sharing

The Proposed Rules would also require an exempt foreign board of trade, on an ongoing basis, to the provide to the Commission other information requested by the Commission to evaluate the board of trade's compliance with the exemption and for any other reason. In light of the principle that the Commission should not be the primary regulator for a foreign board of trade, including one with a DES in the United States, we believe that the Commission should not be able to demand additional information unrelated to the activities of a foreign board of trade in the United States.

I. Submission to jurisdiction

Pursuant to Section 4(b) of the CEA and consistent with the principle of deference to home country regulation, a foreign board of trade should not be subject to any of the provisions of the CEA. Accordingly, it is not appropriate for a foreign board of trade to be required to submit to the jurisdiction of the Commission and U.S. courts as a condition of an exemption under the Proposed Rules. The appropriate remedy for a violation of the terms of any Commission relief, as determined by an appropriate administrative proceeding, is withdrawal or modification of that relief.

J. Commission authority to terminate an exemption

The Proposed Rules would allow the Commission to condition, modify, suspend, terminate or otherwise restrict the terms of an exemption if the Commission determines that the foreign board of trade is in material violation of any term or condition of the exemption, that the continued effectiveness of the exemption would be contrary to public policy or the public interest, or that circumstances do not warrant continuation of the exemption. Unfortunately, the Proposed Rules and the Release give no guidance as to what circumstances, other than a material violation, might justify termination of an exemption.

While we recognize the need for the Commission to maintain flexibility, providing DES access from the United States entails significant expense on the part of a foreign board of trade and its U.S. members. As a result, the Commission should provide foreign boards of trade and their U.S. members with some degree of certainty that they will be able to rely on the continued existence of an exemption so long as they comply with its terms. As a result, we would suggest that the final rules limit the Commission's ability to modify or terminate an exemption to material violations of the exemption or pursuant to subsequent rulemaking. This approach would provide foreign boards of trade and their U.S. members with the certainty to which they are entitled while still permitting the Commission to address its investor protection and market integrity concerns.

In addition, any final rules should provide an appropriate administrative procedure before any decision is made to modify, suspend, terminate or otherwise restrict an existing exemption, including, at the very least, notice and a reasonable opportunity to respond to allegations.

K. Transition rules

If the Commission does not lift the current moratorium on new terminal placement and new product listing by Eurex,[16] Eurex respectfully requests that the Commission provide in any final rules for a transition period to ensure that Eurex members who currently have terminals in the United States will be able to continue to use these terminals until Eurex obtains an exemption under final rules adopted by the Commission.

L. Public availability of information

Eurex does not object to the general principle that information submitted to the Commission by a foreign board of trade seeking an exemption under the Proposed Rules should be available to the public. However, the exception contained in the Proposed Rules, which would apply to the extent the Commission determined that such information constitutes a trade secret or that disclosure would result in material competitive harm to the applicant, is too narrow. There may be other policies, procedures and systems, particularly with respect to market surveillance and enforcement activities, that should be covered by the exception as well. In particular, we are concerned that the efficacy of such surveillance and enforcement systems and procedures might be compromised by public disclosure.

M. Reciprocity

Irrespective of the legal constraints imposed on the Commission by the General Agreement on Trade in Services and other applicable trade agreements, Eurex would not be opposed to the Commission's conditioning an exemption on some level of reciprocity with respect to the placement of U.S. terminals in the foreign board of trade's home country. Nevertheless, the Commission should not make any evaluation of the existence of reciprocity on the basis of a detailed evaluation of the comparability to the U.S. model of another regulator's approach to the issue of foreign trading terminals.

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[16] Given that Section 4(b) does not permit the Commission to regulate the products offered on a foreign board of trade, the moratorium on trading of new products from existing terminals should in any event be lifted immediately.

Instead, the Commission should focus on whether the foreign regulator's approach ultimately affords relief to U.S. applicants that is substantially similar to that afforded foreign applicants by the Commission. In this regard, it is worth noting that most European countries do not currently restrict the placement of terminals in those countries by foreign boards of trade.

III. Conclusion and Recommendations

Because the Proposed Rules take the position that a foreign board of trade with terminals in the United States is not "foreign," fail to defer meaningfully to home country regulation, insist on comparability as a condition to an exemption, do not treat all foreign boards of trade equally and do not recognize key distinctions between the use of a DES and an AORS, we believe that the Proposed Rules are fundamentally flawed and should be withdrawn or fundamentally restructured.[17] We nonetheless support the Commission's initiative to create a uniform framework for the use of a foreign board of trade's DES terminals in the United States. We believe that the best way to move forward constructively would be for the Commission to lift its current moratorium on the placement of terminals in the United States and on the trading of new products from existing terminals and grant relief to foreign boards of trade on a basis more consistent with Section 4(b) of the CEA, such as the approach set forth in the Eurex No-Action Letter, which strikes a more appropriate balance between giving the Commission the information it needs to protect U.S. customers and recognizing that foreign boards of trade should be regulated by their home country regulators.

Once the ability to install terminals in the United States is open to all *bona fide* foreign boards of trade such an approach, the Commission could revisit the issues raised in the Concept Release in a more formal rulemaking. Any ultimate rules adopted by the Commission should, as Eurex and others have previously proposed,[18] reflect the following fundamental principles:

- A *bona fide* foreign board of trade does not become subject to the Commission's jurisdiction because a DES or an AORS through which its contracts may be traded is located in the United States.

- The decision to permit placement of terminals should not be conditioned on the comparability of the home country regulatory environment to that applicable in the United States.

- The Commission's inquiry in determining whether to approve trading terminals in the United States should focus on whether the applicant is a *bona fide* foreign board of trade subject to *bona fide* regulation in its home country consistent with minimum international regulatory standards, such as the IOSCO principles, and on whether adequate information sharing arrangements exist between the home country regulator and the Commission.

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[17] If the Commission proceeds with this rulemaking, we would be pleased to address in more detail our comments with respect to the other individual provisions in the Proposed Rules, but we believe the Commission should reconsider the proposed rulemaking in its entirety.

[18] See Comment Letter of Eurex Deutschland, dated October 6, 1998, with respect to the Concept Release on the Placement of a Foreign Board of Trade's Computer Terminals in the United States.

- An applicant should be required to provide to the Commission only that information necessary to demonstrate that it satisfies the conditions for approval.
- The Commission should defer to the judgment of the home country regulator that the rules applicable to the foreign board of trade are adequate.
- The foreign board of trade should provide the Commission periodic reporting of the names of its members with a DES in the United States and periodic information concerning U.S.-originated trading volume, but should not be subject to any volume ceiling, whether or not specified in advance.
- The foreign board of trade should not be required to submit to U.S. jurisdiction.

Adopting final rules along these lines will enable the Commission to ensure market integrity and protection of investors while minimizing the regulatory burden on foreign boards of trade and promoting cross-border trading. We would be pleased to engage in further dialogue with the Commission, other boards of trade and other industry participants to achieve this goal.

Eurex appreciates the opportunity to submit these comments in response to the Proposed Rules and the accompanying Release. If the Commission or its staff has any questions regarding this letter, please do not hesitate to contact the undersigned (Volker Potthoff, General Counsel of Eurex (tel. 011-49-69-2101-4867), Dr. Ekkehard Jaskulla, Legal Counsel of Eurex (tel. 011-49-69-2101-5133) or our U.S. counsel, Edward J. Rosen (tel. 212-225-2820) or Geoffrey B. Goldman (tel. 212-225-2234) of the New York office of Cleary, Gottlieb, Steen & Hamilton.

Very truly yours,

Volker Potthoff

Dr. Ekkehard Jaskulla

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