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The London International Financial Futures and Options Exchange

30 April 1999

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
United States of America

Dear Ms. Webb:

COMMENT

"Access to Automated Boards of Trade" - 64 Fed. Reg. 14159 (24 March 1999)
(the "Proposed Rules")

LIFFE Administration and Management ("LIFFE A&M"), which operates the market known as The London International Financial Futures and Options Exchange ("LIFFE"), appreciates the opportunity to comment in response to the Commodity Futures Trading Commission's (the "Commission" or "CFTC") publication of the Proposed Rules.

Overview

LIFFE has several fundamental concerns with the approach outlined in the Proposed Rules. First, LIFFE disagrees with the underlying premise of the Proposed Rules, namely, that placing a direct execution system ("DES") or automated order routing system ("AORS") in its members' offices in the U.S. would constitute the establishment by LIFFE of an exchange in the U.S. Second, the CFTC's Proposed Rules encroach upon the authority of the home-country regulatory systems under which foreign boards of trade are regulated and impose the CFTC's standards on matters that should be left to the determination of each home-country regulator. Third, the Proposed Rules are unduly complex, burdensome and overreaching and will impose unnecessary regulatory costs on our members that wish to use DESs and AORSs in the U.S. As presently drafted, the Proposed Rules have raised serious questions for US futures commission merchants ("FCMs"), U.S. contract markets, and foreign boards of trade. We urge the Commission to reconsider its Proposed Rules in light of the comments set forth below and the comments of other futures industry participants. In the interim, the Commission should promptly grant no-action relief to foreign boards of trade and their members based on the guidelines proposed by the Futures Industry Association in its letter to the Commission dated April 19, 1999.

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The Commission Should Promptly Grant Interim Relief to Foreign Boards of Trade

The implementation of electronic trade matching and order routing systems has been a driving force in the development and growth of futures markets globally. Investors, market intermediaries and exchanges worldwide desire the efficiency, immediacy, and cost-savings offered by such systems. To the best of our knowledge, the increased use of such systems has not resulted in any customer abuses, customer losses, or systemic risks directly attributable to the transmission or execution of U.S. customer orders through such systems. Moreover, certain attributes of such systems, such as the availability of more precise audit trails may provide for increased customer protections.

Nevertheless, eighteen months ago the CFTC imposed a "moratorium" on the granting of further foreign terminal no-action relief and determined that the issues relating to access to DESs in the U.S. should be addressed through the CFTC's rule making process. During the rulemaking process, however, LIFFE's primary foreign competitors, Eurex and MATIF, have continued to enjoy access to the U.S. investment community through electronic trading terminals in the U.S., while LIFFE remains excluded. Thus, LIFFE is not permitted by the CFTC to make its main contract, the Euribor short-term interest rate future, available through LIFFE CONNECT™ in the U.S., while MATIF's competing Euribor contract is currently available in the U.S. on GLOBEX. Due to the delays to-date in the rulemaking process and/or the "moratorium" on the issuance of no-action relief, LIFFE has been effectively barred from competing for US customers for the past several years, and unless immediate action is taken, may be irrevocably harmed.

The process necessary for the Commission to consider fully all of the issues raised by the rulemaking process will undoubtedly result in further delay. We do not advocate that the CFTC adopt a rule simply for the sake of adopting a rule. The Commission should be afforded the time necessary to arrive at an appropriate resolution of the issues raised in the Concept Release and the Proposed Rules. But, foreign boards of trade and their U.S. members and customers should not be held hostage to the rule making process and should be granted interim no-action relief expeditiously.

Elements of the Proposed Rule that the CFTC Should Reconsider

Set forth below are a number of issues relating to the Proposed Rules that the Commission should reconsider. We have limited our comments on the Proposed Rules to issues related to the conditions for access to DESs in the U.S. because we understand that the FCM community will be providing comprehensive comments on the issues relating to AORSs.

A. Jurisdictional Issues

1. Foreign Boards of Trade that are Accessible by a DES Are Not Located in the U.S. for Purposes of Section 4(a) of the Act

The Proposed Rules are premised on the belief that a foreign board of trade that makes its products accessible to its members in the U.S. through a DES would be deemed to be located in the U.S. for purposes of Section 4(a) of the Act and, therefore, would be subject to the full range of CFTC regulation applicable to a U.S. contract market absent an exemption under Section 4(c) of the Act. In his concurring opinion to the Proposed Rules, Commissioner Newsome states that "there are troublesome jurisdictional issues inherent in the proposed regulation, specifically, the use of the Commodity Exchange Act's §4(c) exemptive authority and the possible conflict with the Act's §4(b) jurisdictional limitations." Proposed Rules, at 14178. We agree with Commissioner Newsome's assessment.

Currently, a foreign board of trade that is accessible by its U.S. members by telephone is clearly deemed to be located outside of the U.S. We fail to see any principled reason for concluding that if that same foreign board of trade becomes accessible through a different technology, such as a DES, that such foreign board of trade is somehow transported to the U.S. for purposes of Section 4(a) of the Act. The problem with the CFTC's approach is that it leads it to focus on regulating the technology and the technology provider (such as foreign boards of trade), rather than the trading activities that are facilitated by such technology and the intermediaries of such trading activity. Significantly, Section 4(b) of the Act specifically prohibits the Commission from adopting any rule that governs in any way any rule or contract term or action of any foreign board of trade.

It is not necessary, however, for the CFTC to assert jurisdiction over foreign boards of trade under Section 4(a) of the Act in order to achieve its customer protection goals. The CFTC currently is authorized under Section 4(b) of the Act to regulate persons located in the U.S. who engage in the offer and sale of foreign futures to U.S. persons, and in connection therewith, to adopt rules proscribing fraud and requiring minimum financial standards, risk disclosures, reporting, recordkeeping and registration. Thus, the CFTC should be able to provide for adequate customer protection in connection with the use of DES and AORS by FCMs and Rule 30.10 exempt firms through its existing framework of regulation of FCMs and the exercise of its exemptive authority under Part 30. In lieu of the Section 4(c) petition process outlined in the Proposed Rules, we propose that foreign boards of trade be permitted to apply to the Commission under Part 30 on behalf of their U.S. members and their affiliates (and members and their affiliates that are Rule 30.10 exempt firms) for an order permitting such members and affiliates to provide U.S. persons with access to the foreign board of trade through a DES and/or AORS.

2. Foreign Boards of Trade Should Not be Required to Consent to Jurisdiction.

The Proposed Rules would require foreign boards of trade to submit unnecessarily to jurisdiction in the U.S. Proposed Rule 30.11(d)(7) would require a foreign board of trade to file a written statement that, for the duration of the exemptive order, "the board of trade irrevocably agrees to and submits to the jurisdiction of the Commission and state and federal courts in the United States with respect to the board of trade's activities conducted under the section 4(c) exemptive order." We believe it is inappropriate to require a foreign board of trade to submit to the jurisdiction of the Commission and state and federal courts simply by virtue of having provided its members with a DES. Rather, it should be sufficient for a foreign board of trade to file with the Commission an agreement appointing an agent in the U.S. to accept delivery and service of communications issued by the Commission.

B. Independent Certification of IOSCO Standards Should Not Be Required

The Commission proposes to include in its criteria for granting relief a finding that the petitioner's automated trading system has been reviewed and approved by the exchange's home country regulator and that such review applied the standards set forth in the 1990 International Organisation of Securities Commissions report on screen-based trading systems (the "IOSCO Principles") or standards equivalent thereto. Proposed Rule 30.11(b)(1)(v). In addition, the Commission would include as a required disclosure in the petition, "a discussion of the nature of any technical review of the board of trade's order matching/execution system or direct execution system performed by the board of trade's home country regulator, including a copy of any order or certification received and any discrepancies between the standard of review and the [IOSCO Principles]." Proposed Rule 30.11(b)(2)(viii).

This certification requirement is inconsistent with one of the fundamental premises of the Proposed Rules, namely, that the petitioner is subject to a bona fide regulatory system and is adequately monitored and supervised by a foreign futures authority. By way of illustration, the requirement is inconsistent with the U.K. regulatory process and the relationship between a Regulated Investment Exchange ("RIE"), such as LIFFE, and its primary regulator, the U.K. Financial Services Authority ("FSA"). The FSA places the onus on each RIE to undertake a rigorous self-audit of its systems to ensure that such systems are sound; the FSA does not, however, engage in any specific certification of each of its RIE's systems to ensure compliance with the IOSCO Principles. By insisting on an independent certification requirement the CFTC is essentially imposing its regulatory scheme on a foreign regulator. Such an approach is not consistent with principles of international comity, which support reasonable deference to a home country's governance of its own markets. Nor should a foreign board of trade be required to incur the substantial expense of an independent certification if the foreign board of trade has undertaken an internal review of the system and is willing to certify to the CFTC its conformance with the IOSCO Principles or equivalent standards.

C. Position / Credit Limit Functionality Should Not Be Required at the DES Level

The Commission requests comment as to whether a provision should be included in Proposed Rule 30.11 that would require a DES to have the ability to provide pre-execution credit and trading or position limit screening. A requirement to impose such risk filters at the DES level would not be appropriate. The FCMs and Rule 30.10 exempt firms, and not the exchanges, are in direct contact with their customers and are best situated to establish internal policies, standards and controls for the management of their credit exposure to their clients. Thus, to the extent that credit filters may be deemed appropriate, they belong at the FCM or Rule 30.10 exempt firm level so that the FCM or Rule 30.10 exempt firm may apply consistent standards and controls across all markets accessed by its customers and the screening system can be integrated with the firm's back office and risk management systems. LIFFE's DES will permit its members and their affiliates to install front-end risk management systems should such automated front-end controls be deemed necessary or desirable, and LIFFE would generally expect its members to utilize such controls in linking an AORS to LIFFE's DES.

D. Information Sharing and Reporting Requirements

As currently drafted, it is unclear as to who would be required to be a party to the information sharing arrangements contemplated by the Proposed Rules. The only parties to an information sharing arrangement should be the CFTC and the appropriate foreign futures authority. Accordingly, the Commission should revise proposed rule 30.11(b)(1)(vi) to clarify that only the foreign futures authority, and not the foreign board of trade, is required to enter into an information sharing arrangement with the Commission as a condition to an order allowing a foreign board of trade to place its DES in the U.S. Foreign boards of trade would only be required to report directly to the CFTC routine information that is required to establish its continued eligibility for relief under the order. Other event-based information, such as changes in the legislation or regulation in the home-country of the foreign board of trade relevant to the order, or notification relating to the occurrence of system failures, should be reported by the home-country regulator to the CFTC.

Proposed Rule 30.11(d)(3)(i) would require foreign boards of trade to submit to the CFTC on a quarterly basis the total volume for each contract available to be traded through a DES or an AORS in the U.S. and, on a per contract basis, the total volume originating from a DES or AORS in the U.S. It may be difficult for foreign boards of trade to provide such information. LIFFE will be able to identify the volume of contracts originating out of each of its member's application program interfaces ("API") located in the U.S. or elsewhere but will have no knowledge of the ultimate origin of the business coming through such APIs, or whether such business was originated through an AORS in the U.S. The Commission should provide sufficient flexibility in its volume reporting requirements to accommodate the particular system capabilities of DESs.

In addition, Proposed Rule 30.11(d)(3)(iii) would require a foreign board of trade to provide the CFTC, on a quarterly basis, with the identity and main business addresses of their members and affiliates that have been provided with a DES in the U.S.and/ or permit the use of AORSs by their U.S. customers. The compilation of such information on a quarterly basis is unduly burdensome and should only be required annually, or upon request.

Finally, Rule 30.11(d)(8) requires a petitioner to provide the Commission with any information requested by the Commission to evaluate the petitioner's continued compliance with the conditions of the exemptive order "*or for any other reason.*" This requirement is overbroad and would permit the Commission to request information that is outside the scope of the information sharing arrangements between the US and the relevant foreign futures regulatory authority and outside the scope of the conditions of the exemptive order. Accordingly, Proposed Rule 30.11(d)(8) should be revised to delete the phrase "or for any other reason."

E. Publication and Confidentiality of Petitions

We support the Commission's proposal to publish notices in the Federal Register of the availability of each petition in lieu of requiring a formal public comment period for each petition. The publication of an entire petition and the subsequent comment period that would accompany such publication would simply result in unnecessary delays in the review process without any corresponding public benefit. The Commission's rulemaking process will have provided the public with ample opportunity to comment on the standards and guidelines to be followed by the Commission in reviewing and approving petitions. The publication of notices of availability will also afford interested members of the public the opportunity to review the petitions, subject to the confidentiality safeguards discussed below.

We also agree with the intent of the proviso contained in Proposed Rule 30.11(e), which would permit the Commission to maintain the confidentiality of certain information submitted to the Commission in connection with a petition upon a determination that the "information sought to be restricted constitutes a trade secret or that public disclosure of the information would result in a material competitive harm to the petitioner." We do not understand however, why Proposed Rule 30.11(e) provides for a different confidentiality standard or procedure for such petitions than currently exists under the CFTC's rules promulgated pursuant to the Freedom Of Information Act (CFTC Rule 145.00, et seq.).

F. Risk Disclosures

The Commission requests comment concerning any specific risk disclosures relating to the risks of electronic trading and order routing systems that should be required. In this regard, LIFFE has circulated General Notice No. 1576 to its members requiring its members that will be utilizing LIFFE CONNECT™ to inform their clients of the exchange's rules relating to: (i) exclusion of liability on the part of the exchange in the event trading is curtailed or halted; (ii) the types and characteristics (including when such orders are cancelled) of orders that are permitted to be entered on LIFFE CONNECT™; (iii) the exchange's powers to suspend trading by a member following a single warning or terminate a member's access in certain conditions;

and (iv) the potential adverse ramifications to clients if any of the events described above occurs. Additionally, LIFFE has been in communication with representatives of the U.S. Futures Industry Association ("FIA") regarding the possibility of LIFFE's members utilizing the joint industry-NFA proposed generic disclosure statement for electronic trading systems. We do not believe that it is necessary for the Commission to adopt any specific disclosure provisions with respect to DESs and AORSs.

G. Location of Warehouses in the U.S.

Proposed Rule 30.11(b)(xi) would require petitioners to inform the Commission of the address of any warehouses in the US where the petitioner maintains underlying commodities for physical delivery. Similarly, Proposed Rule 30.11(d)(8) would compel petitioners to "provide information regarding the stocks held at any warehouse maintained by the board of trade in the U.S. for products that require physical delivery." The rules should be clarified so that petitioners should only be required to provide warehouse information with respect to warehouses containing physical commodities that are deliverable against futures contracts that are actually eligible to be traded through the foreign exchange's DES in the U.S. For example, if a foreign board of trade lists markets in financial products and physical commodities, and maintains warehouses for product that is deliverable against the physical commodity futures contracts, if only the financial products are eligible to be traded in the U.S. through such foreign board of trade's DES, the foreign board of trade should not be required to provide information relating to such warehouses to the CFTC.

H. Registration Requirements

Neither the Concept Release nor the Propose Rules address whether order entry personnel will be required to be registered with the Commission in any capacity. It is our understanding that order entry personnel that do not solicit customer business and do not exercise any discretion over customer orders need not register as associated persons of an FCM.[1] We request confirmation that the same registration standards will be applied to order entry personnel of member firms of foreign boards of trade and therefore, personnel acting in a purely clerical capacity or only handling the proprietary trading of a member will not be required to register in any capacity with the Commission.

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[1] *See* for example, CME Rule 574.

Conclusion

The approach taken by the Commission in the Proposed Rules has raised serious concerns among futures industry participants. The Commission should reconsider its approach, particularly with respect to jurisdictional issues and the burdens that the Proposed Rules would impose on the futures industry. While it formulates a final policy, the Commission should grant interim relief to foreign boards of trade.

We stand ready, of course, to discuss any questions the Commission or its staff may have regarding our comments.

Yours sincerely

N P Weinreb
Principal, Market Secretariat