

**CFTC Letter No. 00-64****May 8, 2000****No-Action****Division of Economic Analysis**Re: Electronic Commodities Trading Platform

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Dear :

This is in response to your letter dated April 7, 2000, to the Division of Trading and Markets of the Commodity Futures Trading Commission (the Commission), as supplemented by subsequent telephone conversations. Your letter has been reviewed by the staffs of both the Division of Trading and Markets and the Division of Economic Analysis (Divisions).

In your April 7, 2000 letter you seek confirmation that the Divisions will not recommend that the Commission authorize or commence enforcement action under the Commodity Exchange Act, 7 U.S.C. § 1 et seq. (Act), or the regulations thereunder in connection with a proposed electronic platform (the Platform) for the trading of physical commodities and derivatives products in connection with the operation of the Platform, any transactions effected through the Platform, or any participants in such transactions.

*Facts*

Your letter represents the facts to be as follows. The Platform, which will be referred to as "X," is in the process of being developed by commercial participants in the markets for physical commodities and derivative products<sup>1</sup> and will be operated by a newly organized entity that will be controlled by a number of the participants and the provider of the Platform technology. The founding members of "X" include the following companies or their affiliates, [names of companies redacted]. Among the derivative products to be traded through the Platform will be "swap agreements," as defined in Commission Rule 35.1, relating to physical commodities.<sup>2</sup> The Platform will be available only to approved participants that satisfy specified criteria, which will be designed to limit participants to commercial entities. In particular, participants will be limited to those "eligible swap participants" that are commercial entities and are encompassed within subsections (i), (ii), (iii), (vi) or (viii) of Commission Rule 35.1(b).<sup>3</sup> For this purpose, a "commercial entity," with respect to a given product, will be defined to include (i) any party that, in connection with its business, makes and takes delivery of the underlying physical commodity and regularly incurs risks related to such commodity, and (ii) entities whose business includes regularly providing hedging, risk management or market-making services to

entities encompassed within (i) above. Moreover, commercial entities will be permitted to enter into transactions through the Platform only as principals and not as intermediaries on behalf of third parties.

The Platform will be password-protected and will be accessible only by approved participants. Each participant will be required to identify those other participants that it has approved as counterparties. The approval of other participants as counterparties, however, as well as the standards to be applied in making such determinations (which may include credit or other considerations), will be left to each participant in its discretion. The Platform will then employ "filters" to ensure that each participant enters into transactions only with those other participants that it has approved as counterparties.

Each participant will be permitted to post on the Platform bids and offers for transactions relating to various commodities and derivatives on such commodities. If another participant enters an opposite bid or offer, and the posting participant has approved such other participant as a counterparty, a transaction will result with the posting participant at the specified price. If a participant has not been approved as a counterparty by the posting participant, such participant either will not be able to view the posted bid or offer, or will see an indicator reflecting the fact that the bid or offer is not available to it. Each participant posting bids or offers, therefore, will be making such quotations available only to those other participants that it has approved as counterparties. In addition, a participant may be permitted to submit "requests for quotations," or "RFQs," in which such participant expresses an interest in entering into a particular transaction for which no bids or offers are posted and requests other participants to make bids or offers. Like bids and offers posted on the Platform, however, RFQs will be available only to those participants that have been approved as counterparties by the requesting participant for the proposed transaction.

The Platform will utilize an electronic trading and matching system that participants will access either through the Internet or through dedicated communication lines and that will allow participants to post bids and offers on a real-time basis. The Platform will be available on a 24-hour, 5-day per week basis (subject to maintenance requirements and prevailing market conventions). The technology to be utilized by the Platform will provide all participants (subject to approval of their credit by the posting participants) with fair and impartial access to posted bids and offers and no preferential access will be afforded to any participants. Bids and offers will be matched based on time and price priority. The Platform will provide a blotter for each participant or sub-groups within such participant, which will display completed transactions, as well as tools to view, change, withdraw and add orders. All orders will be capable of being withdrawn from the market at any time before a match is completed. In addition, the technology is being reviewed by an independent, expert technology consultant and the written results of that review will be made available to the staff of the Commission.

A participant will easily be able to install the necessary software by downloading it from the Internet. The software will protect confidentiality using standard Internet Secure Sockets Layer (SSL) encryption. As noted, the Platform will be accessible only through passwords and will not be available to the general public or to any parties other than approved participants.

Counterparty names will be released to each of the parties to a transaction immediately following a match effected through the Platform, and trade summaries will automatically be generated. Any transactions effected as a result of bids or offers posted on the Platform will be entered into exclusively between the two parties to the transaction. Moreover, each participant will be responsible for entering into bilateral documentation with each other participant with which it trades, and for negotiating and enforcing credit and other material terms, including appropriate payment and delivery arrangements. The Platform, therefore, will serve as a vehicle for executing transactions based on posted bids and offers and will not be involved in any manner in credit matters or the payment and delivery functions.

The Platform will establish the terms and conditions of all trading conducted through the Platform, which will include, but will not be limited to, the eligibility criteria for participants in the Platform as well as the procedures for posting bids and offers and the obligations of participants with respect to matched transactions. Participants will be provided with disclosure of all material aspects of the operation of the Platform and of the terms and conditions of trading. The Platform will also record and maintain detailed records of all transactions effected through the Platform. In the event that participants are found not to be in compliance with these terms and conditions, the Platform will be authorized to take appropriate action, including suspensions of or limitations on access to the Platform, or the complete termination of access. The Platform will provide to participants information regarding prices, bids and offers and other appropriate matters. With respect to actively traded products, the Platform will undertake to make available to the public information regarding price ranges and daily volumes as well as other relevant information. The Platform also will impose and enforce requirements that board members and senior executives of the Platform satisfy specified fitness criteria, including that such persons are not subject to any statutory disqualifications under the Act.

According to your letter, the Platform has not finalized the terms and conditions of trading or completed the hiring of personnel to operate the Platform. You represent that the final terms and conditions will conform to the representations in your letter and that the personnel will satisfy the fitness criteria set forth herein. Further, you represent that the Platform upon request will disclose to the Commission the terms and conditions of trading and fitness criteria compliance and will provide the Commission or its representatives with information concerning the operation of the Platform and with access to the books and records of the Platform.

### *Discussion*

The Divisions have reviewed your representations regarding the operation of the Platform. In our view, granting your request would be consistent with the overall policies of the Act and Commission exemptions thereto.

Accordingly, the Divisions will not recommend that the Commission take any enforcement action against the Platform, its owners and operators or any of its participants based solely on the operation of the Platform or the execution of transactions thereon as described above. The Divisions believe that relief is appropriate in light of the representations that have been made in your letter including

representations that you will provide the Commission upon its request with additional information concerning the operation of the Platform and with access to the books and records of the Platform. Your letter further represents that, following the issuance of this letter, you will promptly notify the Commission of any material change in the facts and circumstances as represented in your letter.

This no-action position is based on our understanding of the facts as represented to us. Any different, changed or omitted material facts might render this position void. Moreover, this letter does not address whether, and you do not concede that, the transactions effected through the Platform will constitute futures contracts or that the Platform itself will constitute a multilateral transaction execution facility for purposes of Part 35 of the Commission's rules. The no-action position taken herein is solely that of the Divisions and does not necessarily represent the views of the Commission or those of any other division or office of the Commission. The terms and conditions of this letter and the operation of the Platform might need to be modified to reflect any applicable rules that the Commission might adopt in this area.

If you have any questions concerning this matter, you may contact the undersigned at 202-418-5000.

Very truly yours,

John C. Lawton  
Acting Director  
Division of Trading & Markets

Richard A. Shilts  
Acting Director  
Division of Economic Analysis

1 We understand that the physical commodities and derivatives products traded on the Platform will not involve any of the agricultural commodities enumerated in Section 1a(3) of the Act, 7 U.S.C. § 1a(3).

2 Your letter notes that a number of additional instruments may be traded on the Platform which are outside the scope of your letter and therefore will not be addressed herein.

3 In addition, the definition of approved participants will exclude (i) private investment companies operating pursuant to Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, (ii) private investment companies organized under the laws of a non-U.S. jurisdiction, and (iii) natural persons.