

Control and Communications Specialist, Consumer Product Safety Commission, Washington, DC 20207; telephone: (301) 504-0800 ext. 1232. Information about this rulemaking proceeding may also be found on the Commission's web site: [www.cpsc.gov](http://www.cpsc.gov).

**SUPPLEMENTARY INFORMATION:** The Consumer Product Safety Commission ("CPSC" or "Commission") has reason to believe that unreasonable risks of injury and death are associated with bunk beds that are constructed so that children can become entrapped in the beds' structure or become wedged between the bed and a wall.

On March 3, 1999, the Commission proposed a rule that, if issued, would mandate bunk bed performance requirements to reduce this hazard. 64 FR 0245.<sup>1</sup> These requirements would be issued under both the Federal Hazardous Substances Act ("FHSA"), for bunk beds intended for use by children, and the Consumer Product Safety Act ("CPSA"), for beds not intended for children.

During the course of the February 3, 1999 decision meeting, the Commissions unanimously indicated an interest in receiving public comments as to the interpretation of substantial compliance with a voluntary standard. The Commission has taken no position on the interpretation proffered by the Office of General Counsel in its memorandum to the Commission dated December 16, 1998, or on the factors that the Office of Compliance suggested for consideration in the March 3, 1999 **Federal Register** notice, and seeks public comment on both. The Commission's findings on this issue can be determinative as to when it may proceed with a rulemaking with regard to a product for which there is an existing voluntary standard.

As required by Section 9(d)(2) of the Consumer Product Safety Act, 15 U.S.C. 2058(d)(2), there will be an opportunity for interested parties to present oral comments on the proposal. See the information under the headings **DATES** and **ADDRESSES** at the beginning of this notice. Any oral comments will be part of the rulemaking record.

Commenters should limit their presentations to approximately 10 minutes, exclusive of any periods of questioning by the Commissioners or the CPSC staff. The Commission

reserves the right to further limit the time for any presentation and to impose restrictions to avoid excessive duplication of presentations.

Dated: March 18, 1999.

**Sadye E. Dunn,**

*Secretary, Consumer Product Safety Commission.*

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## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Parts 1 and 30

#### Access to Automated Boards of Trade

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed rules.

**SUMMARY:** On July 24, 1998, the Commodity Futures Trading Commission ("CFTC" or "Commission") published in the **Federal Register** a "concept release" seeking public comment on issues related to permitting the use in the U.S. of automated trading systems providing access to electronic boards of trade otherwise primarily operating outside the U.S. Following its review of the comments received on the concept release, the Commission has determined to propose new rules concerning automated access to these boards of trade from within the U.S. The Commission is proposing herein a new Rule 30.11 that would establish a procedure for an electronic exchange operating primarily outside the U.S. to petition the Commission for an order that would permit use of automated trading systems that provide access to the board of trade from within the U.S. without requiring the board of trade to be designated as a U.S. contract market. If appropriate in light of the information provided in a petition, the Commission would issue an order under section 4(c) of the Commodity Exchange Act ("Act" or "CEA") that would allow a member of the petitioner board of trade or an affiliate thereof to operate automated trading systems that provide access to the board of trade in the U.S., subject to specified conditions.

The Commission also is proposing a new Rule 1.71, which would apply both to domestic and foreign firms. New Rule 1.71 would clarify that U.S. customers and foreign futures and foreign options customers wishing to trade on or subject to the rules of the automated trading system of a U.S. contract market or on or subject to the rules of the automated trading system of an exchange otherwise

operating primarily outside the U.S. may place orders via automated order routing systems, provided that such systems meet certain minimum requirements and provide certain safeguards such as automated checks for customer trading or position limits and credit limits.

The rules proposed herein are focused on boards of trade with automated order matching/execution, often referred to as "electronic exchanges," and do not address the use of order routing systems or other communication devices that provide access to traditional open outcry exchanges.

**DATES:** Comments must be received on or before April 23, 1999.

**ADDRESSES:** Comments on the proposed rules may be sent to Jean A. Webb, Secretary of the Commission, Commodity Futures Trading Commission, 1155 21st Street, NW., Washington, DC 20581. In addition, comments may be sent by facsimile transmission to facsimile number (202) 418-5521 or by electronic mail to [secretary@cftc.gov](mailto:secretary@cftc.gov). Reference should be made to "Access to Automated Boards of Trade."

**FOR FURTHER INFORMATION CONTACT:** David M. Battan, Chief Counsel, Lawrence B. Patent, Associate Chief Counsel, or Charles T. O'Brien, Attorney Advisor, Division of Trading and Markets, Commodity Futures Trading Commission, 1155 21st Street, NW., Washington, DC 20581. Telephone (202) 418-5450.

#### SUPPLEMENTARY INFORMATION:

##### I. Introduction

Significant developments in technology in recent years have made automated trading methods a significant addition or alternative to traditional open outcry for trading commodity futures and option products on or subject to the rules of foreign and domestic boards of trade. In February 1996, the Commission's Division of Trading and Markets ("Division") issued a no-action letter to the Deutsche Terminborse ("DTB" or "Eurex"),<sup>1</sup> an automated international futures and option exchange headquartered in Frankfurt, Germany, in which the Division agreed, subject to certain conditions, not to recommend enforcement action to the Commission if Eurex placed computer terminals in the U.S. offices of its members for principal trading<sup>2</sup> and, where the Eurex member

<sup>1</sup> The Commission approved the notice publishing the proposed rule by a vote of 2-0-1. Chairman Ann Brown and Commissioner Thomas H. Moore voted to approve the notice; Commissioner Mary Sheila Gall abstained. Each commissioner issued a statement concerning his or her position on the proposal. Copies of the statements can be obtained from the Commission's Office of the Secretary.

<sup>1</sup> In June 1998, DTB changed its name to Eurex Deutschland ("Eurex").

<sup>2</sup> A "principal" trade under Eurex rules is limited to a trade made by a Eurex member for its own

is also an FCM registered under the Act,<sup>3</sup> for trading on behalf of U.S. customers as well, without Eurex being designated as a U.S. contract market ("Letter").<sup>4</sup> Since the Division's issuance of the Letter, several other boards of trade that have heretofore operated outside the U.S. have requested similar relief.

In light of these requests, the Commission determined that it is appropriate to address, through the Commission's rulemaking process, the subject of the use in the U.S. of automated trading systems that provide access to boards of trade whose primary operations otherwise take place outside the U.S. The Commission began this process in July 1998 by publishing in the **Federal Register** a concept release seeking public comment on a wide variety of questions concerning the use of automated trading systems in the U.S. and on a possible regulatory structure to address these questions. After reviewing the comments received and engaging in discussions with industry participants, the Commission has decided to propose rules that incorporate many of the general principles set forth for comment in the concept release. However, based upon the comments received and the Commission's further consideration of the issues, the proposal contains a number of refinements to the model set forth in the concept release.

The Commission's purpose in issuing these proposed rules is to create a framework for addressing the regulatory issues that arise from the increasing globalization of futures exchanges. The procedures set forth herein are intended to provide an exemption from the contract market designation requirement for boards of trade that are established in a foreign country and that have historically operated solely within that country other than the U.S., but that as a result of a desire to take advantage of technological advancements, now wish to make their products accessible from within the U.S. via trading screens, the Internet, or other automated trading systems. Boards of trade that are

accessible within the U.S. in this manner are not "located outside the U.S." for purposes of section 4(a) of the Act and might, accordingly, be required to be designated as contract markets absent an exemption under Section 4(c) of the Act.<sup>5</sup> However, the Commission does not believe that it would be appropriate to require these exchanges to be designated as contract markets as long as they would be subject to generally comparable regulation in their home countries. Exemption from the contract market designation requirement and other related requirements under the Act and Commission regulations would avoid duplicative regulation, would encourage other countries to allow access to the automated trading systems of U.S. exchanges and would encourage global competition and open markets in the industry. The Commission believes that the petition approach set forth below would provide the Commission with the information necessary to identify those boards of trade that would be "located in the U.S." by virtue of being accessible from within the U.S. via automated trading systems, but that otherwise would continue to be primarily operated outside the U.S. The Commission would exercise its power under section 4(c) of the Act to exempt such boards of trade from regulation under the Act if the requirements described below are satisfied. Further, the process described herein is flexible enough that, if the locus of the board of trade's activities is such that it should be subject to all requirements of the Act and the

Commission's regulations, if the board of trade is not subject to a generally comparable regulatory structure, or if the board of trade has been established and structured purposefully to evade U.S. regulation, the Commission can require it to become a designated contract market.

In determining whether to exercise its section 4(c) exemptive authority with respect to a particular petitioner, the Commission believes that it is essential to its customer protection obligations under the Act to ensure that certain general standards have been met. Specifically, the Commission intends to ensure that: (1) The petitioner is an established board of trade that wishes to place within the United States an automated trading system permitting access to its products but whose activities are otherwise primarily located in a particular foreign country that has taken responsibility for regulation of the petitioner; (2) the petitioner's home country has established a regulatory scheme that is generally comparable to that in the U.S. and provides basic protections for customers trading on markets and for the integrity of the markets themselves; (3) except for certain incidental contacts with the U.S., the petitioner is present in the U.S. only by virtue of being accessible from within the U.S. via its automated trading system; (4) the petitioner is willing to submit itself to the jurisdiction of the Commission and the U.S. courts in connection with its activities conducted under an exemptive order; (5) the petitioner's automated trading system has been approved by the petitioner's home country regulatory following a review of the system that applied the standards set forth in the 1990 International Organisation of Securities Commissions ("IOSCO") report on screen-based trading systems (as may be revised and updated from time-to-time) or substantially similar standards; and (6) satisfactory information sharing arrangements are in effect between the Commission and the petitioner and the petitioner's regulatory authority. As discussed further in the description of the petition procedure below, a petitioner which satisfies these standards may be issued an order under section 4(c) of the Act that exempts the petitioner from the contract market designation requirements of section 4(a) of the Act and related statutory and regulatory provisions.

## II. The Concept Release

The July 1998 concept release raised general questions concerning, among other things, how to define an

<sup>5</sup> Section 4(a) of the Act states in relevant part:

\* \* \* [I]t shall be unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the U.S., its territories or possessions, for the purpose of soliciting, or accepting any order for, or otherwise dealing in, any transaction in, or in connection with a contract for the purchase or sale of a commodity for future delivery (other than a contract which is made on or subject to the rules of a board of trade, exchange, or market located outside the U.S., its territories or possessions) unless—

(1) such transaction is conducted on or subject to the rules of a board of trade which has been designated by the Commission as a "contract market" for such commodity;

(2) such contract is executed or consummated by or through a member of such contract market; and

(3) such contract is evidenced by a record in writing \* \* \*.

Section 4(c) of the Act provides the Commission with authority "by rule, regulation, or order" to exempt "any agreement, contract or transaction" from the requirements of Section 4(a) of the act if the Commission determines that the exemption would be consistent with the public interest, that the contracts would be entered into solely by appropriate persons and that the exemption would not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act. 7 U.S.C. 6(a) and 6(c) (1994).

account. Eurex's definition of "principal" is thus narrower than the definition of "proprietary" found in Commission Rule 1.3(y). A proprietary trade under Commission rules includes not only transactions made by futures commission merchants ("FCMs") for their own accounts, but also those made by certain affiliates and insiders of the FCM for their respective accounts carried by the FCM.

<sup>3</sup> 7 U.S.C. 1 *et seq.* (1994).

<sup>4</sup> See CFTC Interpretative Letter No. 96-28, (1996-1997 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 26,669 (Feb. 29, 1996). For a thorough discussion of prior Division actions concerning automated trading system use in the U.S., see the Commission's concept release, discussed below. 63 FR 39779 (July 24, 1998).

automated system that would be subject to Commission rules, how to treat the use of automated order routing systems located in the U.S. when they are employed to enter orders through a futures commission merchant ("FCM") (or through a firm exempt from registration pursuant to Commission Rule 30.10, also referred to as a "Rule 30.10 firm")<sup>6</sup> for execution on a board of trade operated primarily outside the U.S., and how to determine if a board of trade's activities in the U.S. are such that it should be subject to all of the requirements of the Act and the Commission's regulations. The concept release also set forth for comment a possible regulatory approach that was intended to promote discussion on the appropriate means to resolve these and related issues.

The Commission initially provided a 60-day comment period on the concept release, through September 22, 1998. On September 18, 1998, the Commission extended the comment period for fifteen days, through October 7, 1998. The Commission received 31 comments on the release: 19 from futures exchanges, three from FCMs, two from futures trade associations, two from commodity trading advisors (one of which is also a registered commodity pool operator), one from a futures self-regulatory authority, one from an exchange member and three from foreign

securities/futures regulatory authorities. In addition, the Commission was aided significantly in the development of these proposed rules by the work of the Commission's Global Markets Advisory Committee which held two public meetings on these issues, as well as the Committee's Working Group on Electronic Terminals which prepared a report for the Commission on these issues. The Commission's Financial Products Advisory Committee also held a public meeting at which these issues were discussed.

In general, most commenters supported the Commission's effort to develop uniform rules concerning the use from within the U.S. of automated trading systems that provide access to boards of trade operated primarily outside the U.S. For example, Her Majesty's ("HM") Treasury, the regulator that is authorized to grant foreign exchanges the right to have their automated trading systems placed in the U.K.<sup>7</sup> indicated in its comment letter that the approach set forth in the concept release is similar to that applied by HM Treasury when processing similar requests in the U.K. Other commenters, however, took issue with various aspects of the possible regulatory approach set forth in the concept release. Certain specific comments concerning the approach set forth in the concept release and the issues related thereto are discussed in the description of the proposed rules which follows.

The Commission believes that the rules proposed herein will establish a regulatory approach that addresses the important issues presented by the use of automated trading systems in the U.S. by boards of trade otherwise operated primarily outside the U.S. in a manner that will foster growth of the global marketplace while fulfilling the Commission's obligations under the Act to protect U.S. customers and to maintain the integrity and competitiveness of U.S. markets. The Commission looks forward to the comments on the proposed rules herein and will consider such comments carefully in adopting any final rules.

### III. The Proposed Rules

#### A. Definitions

Proposed Rules 30.11(a) (1) and (2) distinguish between two major types of automated trading systems and establish two mutually exclusive definitions, "direct execution system" ("DES") and "automated order routing system" ("AORS"). As explained more fully below, DES is a term that encompasses any system that allows entry of orders from within the U.S. for an automated board of trade, except those systems that satisfy the definition of AORS. AORSs generally are systems on which customers or their representatives would submit orders through an FCM or rule 30.10 firm for automated execution, although the definition covers every system on which an order is transmitted to another party and then transmitted to an automated board of trade. It should be noted that the definitions of DES and AORS, and these rules generally, only apply in the context of automated or "electronic" boards of trade where orders are matched and executed at the board of trade without substantial human intervention. Order routing or other devices that are used to enter or to communicate trades to be executed on traditional open outcry exchanges are not within the ambit of these rules.<sup>8</sup> If one exchange organization operates both an electronic exchange and an open outcry exchange, the proposed rules would apply to the former but not to the latter. The Commission wishes to emphasize that the definitions of DES and AORS are structured so that every device, system or software upon which orders for products traded on boards of trade can be entered from within the U.S. for any electronic exchange would fall into one or the other category.<sup>9</sup>

It should be noted further that, while those rules provide standards for exemptive relief to certain boards of trade with respect to their exchange-traded products, these rules do not sanction the trading of off-exchange products, nor do they alter, restrict or

<sup>6</sup> Commission Rule 30.10 provides for a process whereby any person affected by any requirement in the Commission's part 30 rules may petition the Commission for an exemption from such requirement. Appendix A to the part 30 rules provides an interpretative statement that clarifies that a foreign regulator or self-regulatory organization ("SRO") can petition the Commission under Rule 30.10 for an order to permit firms that are members of the SRO and subject to regulation by the foreign regulator to conduct business from locations outside the U.S. for U.S. persons on non-U.S. boards of trade without registering under the Act—based upon substituted compliance with a foreign regulatory structure found comparable to that administered by the Commission under the Act. In considering a request from a foreign regulatory or self-regulatory authority for Rule 30.10 comparability relief, the Commission considers, among other things: (1) Registration, authorization or other form of licensing, fitness review, or qualification of persons through whom customer orders are solicited and accepted; (2) minimum financial requirements for those persons that accept customer funds; (3) minimum sales practice standards, including disclosure of risks and the risk of transactions undertaken outside of the United States; (4) procedures for auditing compliance with the requirements of the regulatory program, including recordkeeping and reporting requirements; (5) protection of customer funds from misapplication; and (6) the existence of appropriate information-sharing agreements. The Commission has issued orders to permit certain foreign firms that have comparability relief under Rule 30.10 to engage in limited marketing activities of foreign futures and option products from locations within the United States. See orders of October 28, 1992, 57 FR 49644 (Nov. 3, 1992), and August 4, 1994, 59 FR 42156 (Aug. 17, 1994).

<sup>7</sup> Specifically, HM Treasury is authorized to grant a foreign exchange status as a "recognized overseas investment exchange" ("ROIE") and to monitor ROIEs operating in the U.K. through automated trading systems placed in the U.K. HM Treasury's responsibilities with respect to ROIEs are to be transferred to the Financial Services Authority ("FSA") with the enactment of the Financial Services and Markets Bill, which is anticipated to take place some time toward the end of 1999.

<sup>8</sup> The definitions of DES and AORS apply to systems that access boards of trade where trade execution takes place "without substantial human intervention." See proposed Rules 30.11(a)(1) and 1.3(tt) (emphasis added). The word "substantial" is included to make clear that an automated or electronic exchange cannot evade the application of these rules by inserting clerical or trivial human action into the trade matching/execution process. Execution on traditional open outcry exchanges involves substantial human intervention and, as noted above, is beyond the scope of these rules.

<sup>9</sup> A determination as to whether a system is a DES or an AORS is not dependent on who designs, maintains or provides the system. That a particular system implementation uses third-party hardware, networks or services will not prevent it from being a DES or AORS.

expand the coverage of existing Commission exemptions for particular classes of products. For example, an illegal off-exchange futures product that is traded in violation of the Act may not lawfully be traded via an AORS, even if such AORS satisfies the requirements of the proposed rules. Likewise, a product that has been exempted from relevant provisions of the Act need not satisfy the requirements of these rules unless the Commission rule or order exempting the product so indicates.<sup>10</sup>

Paragraph (a)(1) of proposed Rule 30.11 defines a DES as any system of computers, software or other devices that allows the entry of orders for products traded on a board of trade's computer or other automated device where, without substantial human intervention, trade matching or execution takes place. One common example of a DES is a board of trade's proprietary computer terminal (e.g., a dedicated Eurex computer terminal where members place orders that are then executed in the exchange's matching system). However, the term DES would also include any other device that currently is being used or may be used in the future to provide access to a board of trade's automated matching engine. Such devices might include, for example, computer software that facilitates access via a personal computer or other electronic device, an automated telephonic system that is connected, or can be used to connect, to the main computer of a board of trade primarily operated outside the U.S. for order matching and execution, and direct Internet access to such a board of trade through a personal computer, telephone or similar device. Thus, for example, if a board of trade that is otherwise primarily operated outside the U.S. were to provide its members in the U.S. with personal identification numbers or passwords that permitted such members to access and to place orders on the board of trade via an automated telephone system or Internet connection, the board of trade would be covered by the proposed rules.

Paragraph (a)(2) of proposed Rule 30.11 defines AORS. This term is defined by reference to a definition that is being proposed herein to be added as new Rule 1.3(tt).<sup>11</sup> Proposed rule 1.3(tt)

in turn would define an AORS as any system of computers, software or other devices that allows entry of orders through another party for transmission to a board of trade's computer or other automated device where, without substantial human intervention, trade matching or execution takes place. The Commission anticipates that the most common form of an AORS will be computer software that is provided by an FCM (or Rule 30.10 firm) to customers, foreign futures and options customers, or their representatives such as CTAs to enter orders on a board of trade or on several boards of trade. This rule is intended to cover an AORS used by any person for trading on a designated contract market's automated system, whether the person, his or her representative or the AORS is located in the U.S. or outside of the U.S. The AORS in these circumstances must provide for trading through an FCM. The rule also is intended to cover trading by a person located in the U.S. on a board of trade that otherwise primarily is operated outside the U.S. and that has received a Commission exemptive order under these rules or whose products are accessible as part of an automated trading system pursuant to rules of a designated contract market that have been submitted to the Commission and are in effect pursuant to section 5a(a)(12)(A) of the Act and Rule 1.41 (hereinafter referred to as a "linked exchange"). The AORS in the latter circumstances must provide for trading through an FCM or a Rule 30.10 firm.

Rule 30.10 firms may not solicit or accept orders from U.S. persons for trading on designated contract markets, and these proposed rules are not intended to affect that prohibition. Under these rules, however, Rule 30.10 firms would be authorized to solicit or accept orders from U.S. customers for products traded on automated boards of trade that obtain a Commission order under these rules or products traded on linked exchanges. To this end, the Commission is proposing Rule 30.11(g), which would deem products traded on a board of trade that received a Commission order or on a linked exchange to be foreign futures or foreign options, notwithstanding the board of trade's or linked exchange's presence in the U.S.<sup>12</sup> Further, these rules would

not expand the boards of trade for which a Rule 30.10 firm may solicit or accept orders beyond those provided in the relevant Commission order issued under rule 30.10 and any confirmation thereof for a particular firm. Thus, if the Commission's order issued under Rule 30.10 permits a firm to solicit or accept orders for products traded on boards of trade in its home country and Countries B and C (but not Country D), the restriction on soliciting or accepting orders for products traded on a board of trade in Country D would remain in effect even if the Country D board of trade were to obtain a section 4(c) exemption order in accordance with Rule 30.11.

The proposed rules would not permit customer use of DESs; however, they would allow customers and their representatives to obtain AORSs and to enter orders via those AORSs. Under the proposal, a customer order for a contract traded on or subject to the rules of an exempted board of trade under proposed Rule 30.11 or a linked exchange that is made via an AORS would be required to be made through a registered FCM or through a Rule 30.10 firm.

The Commission requested comment as to whether it should consider imposing any requirements that would enable it to ensure that board of trade members who would have DESs are *bona fide* members (i.e. to ensure that petitioning boards of trade do not create membership categories that do not meaningfully differentiate between traditional "members" and "customers").<sup>13</sup> In response to this request, one commenter suggested that the Commission should require information concerning a board of trade's membership standards and closely examine those standards to ensure that they are meaningful. Another commenter stated, among other things, that the Commission should not impose formal limits on exchange membership qualifications and that no limitations should be imposed as long as a board of trade primarily operated outside the U.S. does not have special membership categories (i.e., as long as all members have the same rights and obligations).

The Commission has determined to require that petitioners under the proposed rule provide information concerning their membership rules and classes. The information should include any financial requirements (e.g., net worth requirements and fees for

<sup>10</sup> For example, the Commission could decide in the future that a particular class of products should be exempt from some Commission regulations, but that, to the extent such class of products will be traded through automated trading systems, these proposed rules should apply.

<sup>11</sup> Since this term and the requirements applicable thereto would, as recommended by some commenters, apply uniformly and not only to boards of trade primarily operated outside the U.S.,

the Commission is proposing to define AORS in a new paragraph (tt) of Commission Rule 1.3, which contains the Commission's general definitions.

<sup>12</sup> Consistent with current regulations regarding linked exchanges, Rule 30.10 firms could handle U.S. customer orders for products traded on the linked exchange but not for products traded on the

designated contract market to which that exchange is linked.

<sup>13</sup> 63 FR at 39787.

membership) as well as any experience or professional requirements or certifications established by the board of trade. The Commission's proposed rules require that, for customer protection purposes, the trades of U.S. customers on automated trading systems must be intermediated by an FCM or by a Rule 30.10 firm. Accordingly, the Commission wishes to ensure that access to DESs is limited to commodity professionals and large sophisticated users trading their proprietary accounts. The Commission would review the information received concerning a petitioner's membership requirements with a view toward ensuring that the petitioner's membership criteria did not provide a means for avoidance of intermediation for U.S. retail investors. In the event that the commission concluded from the information received that U.S. retail customers could be "members" under a particular petitioner's rules and could, therefore, have access to DESs if the Commission were to issue a section 4(c) exemption order to the petitioner, the Commission could refuse to issue such an order or could condition its order accordingly. In the latter regard, the Commission could take into account relevant market structures and financial protections and controls that potentially could serve the same customer protection objectives as professional intermediation.

As technology continues to evolve, the available means to provide direct access from within the U.S. to boards of trade otherwise primarily operating outside the U.S. undoubtedly will further develop. By using broad definitions, the Commission hopes to create a regulatory approach that provides a flexible means to incorporate the changing nature of technology. The Commission has no desire to dictate particular technology choices to market participants, nor does it wish to restrict innovation, and these rules were crafted accordingly.

#### *B. The Petition Procedure*

The Commission's proposal would establish a uniform procedure to enable a board of trade that primarily is operating outside the U.S. to request a Commission order that would permit access, via DESs or AORSSs, to the board of trade's products from within the U.S. without requiring the board of trade to be designated as a U.S. contract market. The Commission wishes to emphasize that the proposed rules would not alter a board of trade's obligations to: (a) Receive a no-action position from the Commission prior to authorizing the offer or sale of any stock index futures or options contracts in the U.S. or (b)

have any foreign government debt obligation first designated as an "exempt security" by the Securities and Exchange Commission ("SEC") before authorizing the offer or sale of any futures contract or option thereon in the U.S.

The approach set forth for discussion in the concept release envisioned a two-step procedure. Under this approach, a board of trade that primarily is operated outside the U.S. would first petition the Commission for an order that would permit the use of automated trading systems in the U.S. to facilitate trading of the board of trade's products without requiring the board of trade to receive U.S. contract market designation. Next, if the Commission issued an exemptive order to a particular board of trade, a member of that board of trade or an affiliate thereof would be able to make a written request to the National Futures Association ("NFA") for confirmation to operate under the order.<sup>14</sup>

The concept of a confirmation process was derived from the procedure currently required of Eurex members for their compliance with the Letter. Pursuant to this procedure, if a Eurex member located in the U.S. wishes to install a Eurex terminal in its office, Eurex must make a written filing to the NFA on behalf of that member, including certain information and declarations.

The potential approach set forth in the concept release suggested the possibility of codifying confirmation process similar to that from the Eurex Letter. Although the Commission received few comments regarding the confirmation process, upon reconsideration of this procedure the Commission has determined that such a process is unnecessary. A simpler alter-native to this procedure, the proposed rules would require only that, as a condition to any section 4(c) exemption order, a board of trade primarily operating outside the U.S. must maintain and provide to the Commission's on a quarterly basis, and at any other time upon request of a Commission representative, a current list that includes (1) the names and main business addresses in the U.S. of its members and affiliates thereof that have DESs in the U.S. indicating which of such persons allow their customers to use AORSSs, and (2) the names and main business addresses of its members and affiliates thereof that allow their U.S. customers to use AORSSs but who do not have DESs in the U.S.<sup>15</sup> Thus, under the proposed rules, after the Commission

issues an exemption order,<sup>16</sup> any member, or affiliate thereof,<sup>17</sup> of the petitioner may take advantage of the Commission's order immediately.<sup>18</sup> Additionally, as discussed below in Section III. B. 3. concerning the use of AORSSs, after the Commission issues an order under these rules, any FCM or Rule 30.10 firm may provide U.S. customers with AORSSs that provide access to the products of the board of trade that received the Commission order provided that the AORS meets certain minimal requirements and contains certain safeguards.<sup>19</sup>

This release is not intended to alter Commission Rule 30.4 that requires, generally, that a foreign firm be a registered FCM or a Rule 30.10 firm if it solicits or accepts orders for or involving any foreign futures contract or foreign options transaction and, in connection therewith, accepts money, securities or property to margin, guarantee or secure any trades or contracts that result therefrom

<sup>16</sup> Proposed Rule 30.3(c) makes clear that a board of trade that primarily operates outside the U.S. that is accessible from a DES in the U.S. must be designated as a U.S. contract market unless it has received a section 4(c) exemption order under Rule 30.11. The Commission believes that this rule is necessary to ensure its ability to enforce proposed Rule 30.11 adequately.

<sup>17</sup> Proposed Rule 30.11(a)(3) defines an affiliate of a board of trade member for purposes of the rule as: (1) A person that owns 50% or more of a member (e.g., a board of trade member's parent company with an ownership interest in the board of trade member of 50% or more); (2) a person owned 50% or more by a member (e.g., a board of trade member's 50%-or-more-owned subsidiary); or (3) a person that is owned by a third person that also owns 50% or more of a member (e.g., a member's sister company where both the member and the sister company are owned 50% or more by a third person).

<sup>18</sup> Because any person who solicits or accepts orders and funds related thereto from U.S. customers for trading pursuant to a Commission order under Rule 30.11 must be registered as an FCM or operate pursuant to an order of exemption under Rule 30.10, the Commission would have appropriate means to discipline such a person for any violation of the Act or rules thereunder relating to the operation of board of trade DESs or AORSSs in the U.S.

<sup>19</sup> Proposed Rule 30.3(d) would provide that, except as provided in Rule 30.11, it shall be unlawful for any person to solicit or accept orders for, or to accept money, securities or property in connection with the purchase or sale of, foreign futures or foreign options by a foreign futures or options customer that are placed via an AORS (as defined in proposed Rule 30.11(a)(2) by reference to proposed Rule 1.3(tt)) unless the board of trade through which the transaction will be executed has been designated as a contract market under section 5 of the Act. As noted above proposed Rule 30.11 is not intended to allow Rule 30.10 firms to solicit or to accept orders from U.S. customers to be placed on a U.S. contract Market. To obviate any limitations on the use of AORS by Rule 30.10 firms, Rule 30.11(g) would deem products traded on a board of trade that received a Commission order under Rule 30.11 to be foreign futures or foreign options.

<sup>14</sup> 62 FR 47792, 47795 (Sept. 11, 1997)

<sup>15</sup> See proposed Rule 30.11(d)(3)(iii).

(including where the U.S. person is a nonclearing member of an exempt board of trade trading solely for its own account).<sup>20</sup> The Commission also wishes to make clear that the Commission's issuance of a Rule 30.11 order would not affect the Commission's ability to bring appropriate actions for fraud or manipulation, nor would it alter the obligations of the board of trade that received the order, its members, FCMs or any other persons under applicable provisions of the Act or the Commission's regulations, except as specifically provided in these rules or in a section 4(c) exemption order. For example, an FCM who solicits or accepts orders from U.S. customers for trading on a board of trade exempted under proposed Rule 30.11 or on a linked exchange would remain responsible for complying with the risk disclosure requirements set forth in Rule 30.6 regarding, among other things, the risks associated with trading foreign futures or foreign options contracts.<sup>21</sup>

#### 1. Application Procedure

Paragraph (b) of proposed Rule 30.11 establishes the petition procedure discussed above, whereby a board of trade may petition the Commission for an exemption order under section 4(c) of the Act. Such an order would enable DESs or AORSs that provide access to the board of trade's products to be used in the U.S. without requiring the board

of trade to be designated as a contract market.

The approach set forth in the concept release requested comments on six general categories of information that could be included in a petition by a board of trade: (1) General information concerning the petitioner and its products; (2) information concerning the petitioner's rules and regulations, the laws and regulations in effect in the petitioner's home country, and the methods for monitoring compliance therewith; (3) information related to the board of trade's technological system and standards; (4) financial and accounting information; (5) information concerning the ability of U.S. contract markets to operate in the petitioner's home country; and (6) information concerning the petitioner's U.S. activities and presence. The concept release suggested that this information would be used to determine whether a board of trade that is subject to regulation by a foreign regulator and whose primary locus of operations is abroad should be exempt from contract market designation requirements if it places automated trading systems in the U.S. accessing such board of trade.

Commenters generally agreed that the Commission has a legitimate regulatory interest in examining automated boards of trade that are primarily operated abroad, but that nonetheless wish to have a presence in the U.S. by becoming accessible from within the U.S. via computer screens or other automated trading systems. However, some commenters took issue with certain of the specific information included in the categories above, generally based upon concerns regarding the information's relevance or based upon concerns that collection of the information would be unnecessarily duplicative or burdensome. In light of the comments received and the Commission's own assessment of the information that it believes would be necessary in reviewing a board of trade's petition, the proposed rules provide for a modified set of information that would be required in a petition. Additionally, the proposed rules contain certain provisions that are intended to eliminate the filing of duplicative information.

#### a. General Approach

At the outset, the Commission wishes to reiterate its general view that it supports technological innovation and does not wish to make it unduly burdensome for U.S. customers to access global future and option markets. The Commission does believe, however, that in order to make the determinations

required before it can issue an order under section 4(c) of the Act concerning the public interest, customer protection and its ability to discharge its regulatory duties, the Commission has an obligation to obtain and to review certain basic information. This basic information relates to, among other things, a board of trade's regulatory structure, its automated trading systems, and the extent of its contacts and operations in the U.S. Likewise, in an era where fully computerized exchanges are becoming common, the Commission has an interest in ensuring that operators of these exchanges are not using developments in technology and global communications to evade U.S. regulatory requirements.

Generally, as noted above, section 4(a) of the Act requires that futures and option contracts offered or sold in the U.S. be: (1) Traded on or subject to the rules of a designated contract market; (2) executed or consummated by or through a member of such contract market; and (3) evidenced by a written record that includes the date, the parties and their addresses, the property covered and its price, and the delivery terms. An exception from these requirements is provided for contracts that are made on or subject to the rules of a board of trade located outside of the U.S. or for which the Commission has granted an exemption from the section 4(a) requirements pursuant to section 4(c) of the Act. The Commission believes that, if contracts of a board of trade otherwise primarily operated outside of the U.S. are accessible from within the U.S. via a DES or an AORS, the board of trade is no longer "located outside of the U.S." for purposes of section 4(a) of the Act. The Commission also believes, however, that regulating boards of trade that satisfy the requirements set forth below would be largely duplicative of their home country regulations and unnecessary. Thus, the Commission proposes to establish an exemption process.

Proposed Rule 30.11 would establish a framework for the consideration of petitions for exemption pursuant to section 4(c) of the Act for boards of trade otherwise primarily located outside of the U.S. section 4(c) of the Act requires the Commission to make certain determinations prior to granting an exemption thereunder. In the context of a petition under Rule 30.11, the Commission would be required to determine that: (1) The requirements of Section 4(a) of the Act should not apply to the contracts for which the exemption is requested and the exemption would be consistent with the public interest and the purposes of the Act; (2) the

<sup>20</sup> Commission staff have interpreted this rule to provide an exception if (1) the foreign firm is either a member of the relevant board of trade or is a foreign affiliate of a registered FCM and its sole contact with a U.S. customer is that it carries the FCM's customer omnibus account or (2) the foreign firm solely carries accounts on behalf of U.S. customers that are proprietary accounts (as defined in Rule 1.3(y)) of the foreign firm. See CFTC Interpretative Letter No. 87-7, Comm. Fut. L. Rep. (CCH) ¶23,972, (Nov. 17, 1987), and CFTC Interpretative Letter No. 88-15, Comm. Fut. L. Rep. (CCH) ¶24,296 (August 10, 1998).

<sup>21</sup> Rule 30.6 refers to Rule 1.55 which requires, among other things, that an FCM provide a risk disclosure statement to each of its customers that provides certain disclosures regarding the risks associated with trading in commodity futures contracts. Paragraphs (b) (7) and (8) of Rule 1.55 contain required language specifically related to risks concerning trading in foreign futures and foreign options. In particular, paragraph (b)(7) requires disclosure that, because "[n]o domestic organization regulates the activities of a foreign exchange . . .", customers who trade on these exchanges may not be afforded the same protections (e.g., protections regarding the safety of margin funds) that may apply to domestic transactions. Rules 4.24 and 4.34 require similar risk disclosure language to be provided by commodity pool operators and commodity trading advisors to their customers if the offered pool may trade in foreign futures or foreign options contracts or the offered trading program permits the trading of foreign futures or foreign option. See also Rule 30.6, as proposed to be amended by 64 FR 1566 (Jan. 11, 1999).

contracts will be entered into solely between appropriate persons; and (3) the contracts will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act. As noted above, the standards that will guide the Commission in determining whether a petitioner meets the requirements under section 4(c) of the Act are that: (1) The petitioner is an established board of trade that wishes to place within the United States an automated trading system permitting access to its products but whose activities are otherwise primarily located in a particular foreign country that has taken responsibility for regulation of the petitioner; (2) the petitioner's home country has established a regulatory scheme that is generally comparable to that in the U.S. and provides basic protections for customers trading on markets and for the integrity of the markets themselves; (3) except for certain incidental contacts with the U.S. the petitioner is present in the U.S. only by virtue of being accessible from within the U.S. via its automated trading system; (4) the petitioner is willing to submit itself to the jurisdiction of the Commission and the U.S. courts in connection with its activities conducted under an exemptive order; (5) the petitioner's automated trading system has been approved by the petitioner's home country regulator following a review of the system that applied the standards set forth in the 1990 International Organization of Securities Commissions ("IOSCO") report on screen-based trading systems (as may be revised and updated from time-to-time) or substantially similar standards; and (6) satisfactory information sharing arrangements are in effect between the Commission and the petitioner and petitioner's regulatory authority.

**b. Statutory Standards for Exemptive Relief under Section 4(c)**

As noted above, section 4(c) of the act provides the Commission with authority "by rule, regulation or order" to exempt "any agreement, contract or transaction" from any of the requirements of section 4(a) of the Act, if the Commission determines that the exemption would be consistent with the public interest and that the contracts would be entered into solely by appropriate persons and would not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act.

As discussed more fully below, the Commission has crafted standards to apply in evaluating exemptive petitions under the proposed rules that will enable it to make the requisite findings under section 4(c) if appropriate. If a petitioner is subject to a regulatory structure in its home jurisdiction that the Commission finds to be generally comparable to that in the U.S. in terms of protecting customers and the integrity of markets, as well as meeting IOSCO standards or similar standards for screen-based trading, and finds that the regulator in that other jurisdiction monitors and enforces compliance with that regulatory structure, the Commission appropriately can determine that automated trading by U.S. customers pursuant to that foreign regulatory structure is consistent with the public interest and the purposes of that Act. the Commission appropriately could permit anyone who can participate in contract market transactions to be deemed to be an "appropriate person" for such automated trading and thus to be eligible to participate in the petitioner's markets. Further, the various provisions that the Commission would establish under Rule 30.11 with regard to information sharing arrangements (access to books and records, notice of enforcement or disciplinary actions and notice of default, insolvency or bankruptcy), the petitioner's appointment of an agent for service of process and consent to U.S. jurisdiction, the Commission's retention of antifraud authority concerning these transactions, as well as the limitations on the petitioner's U.S. presence to DESs or AORs that provide access to its products and incidental U.S. contacts, would provide a basis for the Commission to determine that granting the petition would not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory duties under the Act. A more detailed description of the requirements for a petition follows.

**c. Foreign Regulatory Requirements**

The Commission believes that the establishment of automate trading systems in the U.S. that provide rapid and proximate access to boards of trade otherwise primarily located outside the U.S. will cause a fundamental change in the nature of global trading and raise substantial issues regarding the regulation of increasingly international or multinational exchanges. Thus, the Commission believes that one essential factor in determining whether an automated board of trade that wishes to establish trading systems in the U.S.

should be exempt from contract market designation is whether such board of trade is subject to a *bona fide* regulatory system *i.e.*, a structure that is generally comparable to that in the U.S. in terms of customer protections and market integrity and that is adequately monitored and supervised by a foreign futures authority.

To assist the Commission in making the required determinations under Section 4(c) of the Act and the judgments concerning the general standards set forth above, the Commission is proposing that a petitioners submit certain information. With respect to whether the petitioner is an established board of trade primarily operating outside the U.S., the petitioners would be required to include the following basic business information: (1) The address of the petitioner's main business office and the name, address, telephone number, facsimile number and electronic mail address of a person to contact for additional information concerning the petition; (2) the petitioner's articles of association, constitution, or other similar organizational documents along with the date and place of its establishment; (3) the name and address of the petitioner's home country regulatory; and (4) a complete description of the contracts that initially would be traded through DESs and/or AORs located in the U.S.<sup>22</sup>

In order for a petitioner to be eligible for an exemption, petitioner's home country regulatory regime should be generally comparable to that in the U.S. in providing for: (A) Prohibition of fraud, abuse and market manipulation relating to trading on the petitioner's markets; (B) recordkeeping and reporting by the petitioners and its members; (C) fitness standards for intermediaries operating on petitioner's markets, members or others; (D) financial standards for the petitioner's members; (E) protection of customer funds, including procedures in the event of a clearing member's default or insolvency; (F) trade practice standards; (G) rule review or general review of board of trade operations by its regulatory authority; (H) surveillance, compliance, and enforcement mechanisms employed by the board of trade and its regulatory authority to ensure compliance with their rules and regulations; and (I) regulatory oversight of clearing facilities.<sup>23</sup> Information concerning the petitioner's rules, including its membership rules, the laws and regulations of the home

<sup>22</sup> Proposed Rule 30.11(b)(2)(i)-(iii).

<sup>23</sup> Proposed Rule 30.11(b)(2)(iv)-(vi).



country applicable to the petitions and its operations, and the mechanisms available for ensuring compliance with all such rules, laws and regulations should be provided in the petition. The Commission would review such information in order to determine whether it is consistent with the public interest, customer protection and its ability to discharge its regulatory duties to issue an order under section 4(c) of the Act to permit U.S. customer access to petitioner's products from automated systems within the U.S.

In response to the Commission's request for comment concerning ways to avoid the filing of unnecessarily duplicative information with the Commission, several commenters argued that, if a petitioner or its regulator has received an exemption from the Commission pursuant to Commission Rule 30.10, the petitioner should not be required to submit duplicative information to the Commission. The Commission agrees that, if a petitioner or a regulatory authority that governs the petitioner has received an exemption under Rule 30.30, the Commission may already have received much of the information referred to above. Accordingly, the proposed rules provide that, in such a case, a petitioner would not be required to submit its organizational documents, its current rules, and the information concerning the regulatory scheme in the petitioner's home country, if such information was provided to the Commission as a basis for the Rule 30.10 exemptive order and remains the same in all material respects and if the petitioner provides a statement in its petition to this effect that also specifies the date(s) the information was provided and the name of the petitioner who received the Rule 30.10 order.<sup>24</sup> Such a petitioner, however, would be required to provide all other information set forth in the rules unless a particular provision of the rules provides to the contrary. It should be noted that it is only where the information as to a *particular* board of trade's regulatory and self-regulatory program has previously been provided to the Commission under Rule 30.10 that a petitioner under Rule 30.11 need not provide all required information. Only where provision of information would, in fact, be duplicative may a petitioner rely on information provided in a prior Rule 30.10 application.<sup>25</sup>

<sup>24</sup> See proviso to proposed Rule 30.11(b)(2)(vi).

<sup>25</sup> If a petitioner is aware that another board of trade in its home jurisdiction has recently provided information to the Commission in a petition that, in fact, duplicates specific information that would

The Commission wishes to emphasize that it remains very concerned about, and committed to, the protection of the positions and funds of U.S. customers who trade on boards of trade whose primary locus of operations is outside the U.S. Any U.S. customer who trades on such boards of trade may face additional risks, as various Commission-mandated risk disclosure statements make clear. There may also be an impact even on customers who do not themselves trade on such boards of trade, but have their accounts carried at FCMs that clear trades for other customers who do. The recent financial failure of Griffin Trading Company has heightened the Commission's concern in this area. Although the Commission recognizes that the events leading to Griffin's insolvency began on automated trading systems outside of the U.S., the Commission believes that this incident should serve as a reminder of the importance of establishing and enforcing trading and credit limits, rules to address the insolvency of intermediaries, and methods to transfer accounts of non-defaulting customers when there is a customer default. The protection of customer funds remains one of the Commission's major goals in its regulatory regime.

In light of the issues raised by the failure of Griffin, the Commission is considering the appropriateness of adopting a provision, in connection with its rules concerning automated trading systems, that would require that the automated order matching/execution system of contract markets, linked exchanges or boards of trade operating pursuant to proposed Rule 30.11 exemption orders have the ability to provide pre-execution credit and trading or position limit screening. The Commission's intention would be to insure that DESs could not be used to execute trades in violation of give-up or clearing agreements with credit and trading or positions limits. (This is to be distinguished from the trading or credit checks performed by FCMs' or Rule 30.10 firms' AORs.) The Commission is not including such a requirement in these proposed rules, but requests comment on the appropriateness of such a requirement.

#### d. Technological Systems and Standards

The Commission's concept release also requested comment concerning what information should be requested regarding the technological systems and standards related to a petitioner's

be required in the petitioner's petition, the petitioner may, in its petition, request that it not be required to include such duplicative information.

automated trading systems. The concept release suggested that this information could include a discussion of the petitioner's order processing system and its system integrity and architecture. Commenters varied in their suggested approaches to this issue. One commenter stated that petitioners should be required to provide information concerning their home country regulator's technological standards and suggested, by example, that a petitioner be required to specify whether such regulator has adopted the principles for screen-based trading set forth by IOSCO.<sup>26</sup> Another commenter suggested that the Commission's rules should not require any review or inquiry concerning the technological features of a petitioner's systems unless special circumstances warrant such attention. This commenter stated further that, if the home country regulator has satisfied itself that a trading system meets or surpasses the standards set forth by IOSCO in its report, no purpose is served by the Commission requiring any further demonstration of compliance by the petitioner.

The Commission believes it is generally appropriate to respect the judgment of home country regulators in these matters and does not wish to conduct a *de novo* review of the technological decisions made by petitioning boards of trade. However, the Commission also believes that it has an obligation to assure that any system that will be accessed from within the U.S. is sufficiently sound (e.g., its architecture is sufficient to handle reliably the type and volume of transactions reasonably anticipated) and secure and provides fair access to U.S.

<sup>26</sup> These principles address the following topics:

1. Compliance with applicable legal standards, regulatory policies, and/or market custom or practice where relevant;
2. The equitable availability of accurate and timely trade and quotation information;
3. The order execution algorithm used by the system;
4. Technical operation of the system that is equitable to all market participants;
5. Periodic objective risk assessment of the system and system interfaces;
6. Procedures to ensure the competence, integrity, and authority of system users and to ensure fair access to the system;
7. Consideration of any additional risk management exposures pertinent to the system;
8. Mechanisms to ensure that the information necessary to conduct adequate surveillance of the system for supervisory and enforcement purposes is available;
9. Adequacy of risk disclosure, including system liability; and
10. Procedures to ensure that the system sponsor, providers, and users are aware of, and will be responsive to, relevant regulatory authorities.

See IOSCO report entitled "Screen-Based Trading Systems for Derivative Products" (June 1990).



customers on a nondiscriminatory basis (i.e., U.S. customers are not placed at a competitive disadvantage to others trading on the system). These assurances are necessary in order for the Commission to determine that issuance of a section 4(c) exemption order would not be contrary to the public interest, would serve to ensure protection of U.S. customers and would not adversely affect the Commission's ability to discharge its regulatory duties.

To address these concerns and the recommendations of commenters, the proposed rules would require that a petitioner state in detail in its petition the extent to which a technical review of the system at issue was performed by its home country regulator and identify the standards applied in that review. The petitioner would include a copy of any order or certification received from its home country regulator as a result of such review. If the home country regulator based its approval on a review conducted by a third-party, the petitioner should so indicate and discuss the qualifications of the party that performed the review and the standards applied.

The petition would also be required to include a general description of the automated trading system operated by the board of trade, including at a minimum a general description of the architecture and security features of the system, information as to the length of time the particular system has been operating and a history of significant system failures or interruptions.<sup>27</sup> Depending upon the nature of the technical review performed and the information received concerning the system's operating history, the Commission would determine what additional inquiry, if any, by the Commission is necessary and appropriate in reviewing the petitioner's request. The Commission adopted the IOSCO 1990 Principles on Screen-Based Trading as a formal Commission statement of regulatory policy and would use the IOSCO principles as guidelines for its review to determine whether the petitioner's automated system technology is sufficient to permit the Commission to issue a section 4(c) exemption order.<sup>28</sup> In this regard, the petitioner would be required to describe any differences between the IOSCO principles and those that were used to perform the technical review.

To the extent that the information to be provided to the Commission would be the same for several boards of trade using a shared computer or for a board of trade that lists its products on another board of trade's automated trading system, only one of the boards of trade using the system or making its products available on such system in the U.S. would be required to provide the information regarding technological systems and standards. If a petitioner shares a computer system or platform with another board of trade that has not sought an exemption order and the petitioner has relied on the system analysis performed by the other board of trade's home country regulator, it would not be sufficient for the petitioner simply to state that it relied on such analysis. Rather, the petitioner would be responsible for obtaining and providing the Commission with information concerning the analysis performed by the other board of trade's home country regulator and for describing whether such analysis was consistent with the IOSCO principles. Additionally, if a board of trade does not include all or a portion of the information regarding the type of review that was performed on its system because the information has been or is being provided by another board of trade, the petitioner must include a statement to that effect in its petition and must identify the board of trade that has provided or is providing the information.

#### e. U.S. Activities

Another possible information requirement outlined in the concept release concerned the petitioner's activities in the U.S. The concept release requested comment on whether to require a petitioner to provide information concerning its marketing, education, promotional or other activities in the U.S. including the address of, and number of persons employed by, any office maintained by the petitioner in the U.S., and the extent to which the board of trade makes information available on the Internet that may be relevant to U.S. customers who wish to trade its products. Additionally, if the petitioner maintains a warehouse in the U.S. for any futures contracts that could involve physical delivery of the underlying commodity, the concept release suggested that the petitioner should provide the address for such warehouse and the stocks contain as of the date of the petition.

Commenters generally agreed that the Commission has a legitimate interest in obtaining information to determine whether a board of trade's presence in the United States is more than

incidental such that the board of trade should be required to obtain contract market designation. The Commission has determined to propose generally the submission of the information discussed in the concept release concerning a petitioner's U.S. activities.<sup>29</sup> To qualify for an exemption order, petitioner's management, back office operations, order matching/execution facilities and clearing facilities would have to be located outside the U.S., as would all or the vast majority of its personnel. The presence of an office or offices in the U.S. might or might not be deemed to be incidental contact, depending on the size, purpose, and activities conducted by the office(s). The Commission will evaluate this issue based on the facts described in the petition.

One commenter questioned the relevance of information concerning the address of warehouses in the U.S. and the stocks available at such warehouses. The Commission believes that the location of the underlying cash market and delivery points with respect to products traded through U.S.-located automated trading systems is a pertinent factor in examining the nature and extent of an exchange's activities in the U.S. Presence in the U.S. of some warehouse facilities would not itself render a petitioner ineligible for relief under these rules. Eligibility would depend on the nature of petitioner's U.S. activities taken as a whole.<sup>30</sup>

#### f. Rules Concerning Access by U.S. Exchanges to Foreign Markets

The concept release also requested comment on whether the Commission should require that the petitioner provide a statement from the regulatory authority in its home country with primary responsibility for oversight of the petitioner as to whether such regulator or any other body in that country imposes any restrictions or regulations regarding: (1) The placement or operation of U.S. exchange automated trading systems in the country; (2) the types of products permitted to be traded on such systems; and (3) the sale of U.S. exchange products, generally. If any such restrictions or regulations existed, the concept release suggested that the statement include a description of the restrictions or regulations, copies of any relevant statutes or other relevant legal

<sup>29</sup> See proposed Rule 30.11(b)(2)(ix)-(xi).

<sup>30</sup> The proposed rules require petitioners to identify the addresses of any warehouses maintained in the U.S. for delivery of underlying commodities, but not to specify the stocks on hand at such warehouses. If a petition is granted, an exempted exchange must respond to any Commission requests for information about such stocks. See proposed Rule 30.11(d)(8).

<sup>27</sup> See proposed rule 30.11(b)(2)(viii).

<sup>28</sup> 55 FR 48670 (Nov. 21, 1990). IOSCO is currently undertaking a study to review the principles set forth in its 1990 report in light of new technological developments.

materials and a description of the application process, if any, required for a U.S. exchange and its members to place automated trading systems and/or to sell products in the petitioner's home country.

Commenters generally were in favor of the Commission's collection of the information described above as a means of ensuring electronic access to markets globally. Commenters differed, however, regarding the role such information should have in the Commission's ultimate determination as to whether it should issue an order. Several commenters stated that an order should not be issued to a board of trade primarily located outside the U.S. unless similar electronic access is made available to U.S. exchanges by the board of trade's home country regulator. Other commenters warned that the Commission should not use the request for information concerning the electronic access rules of the petitioner's home country as a means to require, as a prerequisite to issuing an order, that a particular regulatory framework for allowing U.S. exchanges to place automated trading systems in the foreign jurisdiction be in effect in a foreign jurisdiction. Two commenters believed that the Commission should collect information concerning a foreign jurisdiction's rules and policies vis-a-vis a U.S. contract market's ability to place automated trading systems in the foreign jurisdiction, but should not deny electronic access to a board of trade solely on the basis that its home jurisdiction excludes the systems of U.S. exchanges. Rather, these commenters believed that the information should be considered as one element in the Commission's assessment of the entire petition. Another commenter stated its view that the issue of reciprocity should not be a significant factor in the Commission's determination as to whether to issue an exemption order because financial institutions in a country that does not provide electronic access ultimately will be harmed by such a policy, thus effectively forcing the country into developing regulations permitting access. One commenter also noted that any Commission regulations must be consistent with U.S. obligations under the General Agreement on Trade in Services ("GATS") and any applicable annexes thereto.

With respect to the GATS, Commission staff have held discussions with staff of the U.S. Department of Treasury ("Treasury") and the Office of the U.S. Trade Representative ("USTR") on this issue. Treasury and USTR staff have expressed to Commission staff their view that the Commission may not

condition granting an order on reciprocity by the petitioner's home country without violating U.S. legal obligations under the GATS and North American Free Trade Agreement (NAFTA). Indeed, they have expressed concern that even a request for information such as that set forth in the concept release and described above might raise questions relating to U.S. obligations under the GATS and NAFTA.

In light of Treasury's and USTR's view regarding U.S. legal obligations under the GATS and NAFTA, the Commission is not now proposing to impose a requirement that a particular petitioner's home country jurisdiction extend reciprocity to U.S. exchanges' automated trading systems, even though it had intended to do so. The Commission would welcome comment on this issue. Even if U.S. international obligations prevent the Commission from requiring reciprocity, the Commission strongly supports a policy of open and free access to global markets and is committed to aiding U.S. exchanges in gaining the right to place electronic systems in foreign jurisdictions. The Commission encourages any U.S. exchange that believes that it is being wrongfully prevented from placing its automated trading systems in foreign jurisdiction to inform the Commission of this concern. The Commission will work with the exchange, with the foreign jurisdiction, and with Treasury and/or USTR as appropriate to open such jurisdiction to U.S. exchanges and to resolve any dispute over unfair restrictions placed on U.S. exchanges.

#### g. Financial Information and Volume Data

The concept release requested comment on a requirement to include in a petition the petitioner's most recent annual financial statements and the total trading volume, on a contract-by-contract basis and in the aggregate, for its most recent year and most recent quarter (or other period if data is not maintained on an annual and quarterly basis). Based upon the concerns of commenters regarding the relevance of the financial statements, the fact that the Commission does not require similar statements from contract markets and the fact that the Commission will review the minimum financial standards and clearing facility oversight in the petitioner's home country, the Commission has determined not to require financial statements from the petitioner in the proposed rules. Neither will the Commission require volume figures in a petition under Proposed

Rule 30.11. The proposed rules, however, would require certain basic U.S. volume data to be reported to the Commission on a quarterly basis as a condition of a section 4(c) exemption order.<sup>31</sup>

#### h. Information Sharing

The prevention of fraud and the protection of U.S. customers, including customer funds, remain major goals of the Commission's regulatory scheme. The Commission's ability to access information regarding trading by persons located in the U.S. that is conducted on a board of trade exempted under proposed Rule 30.11 is essential to achieving these goals. The concept release requested comment on a requirement that a petitioner identify any information sharing arrangement in effect among the relevant regulatory authorities and the Commission, including information concerning any blocking statutes or data protection laws in effect in the petitioner's home country that might impair the Commission's ability to obtain information under such arrangements. The commission has determined that the existence of satisfactory information sharing arrangements between the petitioner and the petitioner's regulator and the Commission is an essential prerequisite for an exemptive order under the proposed rules. Under such arrangements, the Commission and the petitioner and the petitioner's regulatory authority would agree to cooperate with respect to inquiries concerning trading on the petitioner's markets that affects U.S. persons or markets. Relevant information to be provided under such arrangements may include, without limitation, trade confirmation data, data necessary to trace funds related to trading futures and option products subject to regulation in the petitioner's home country, position data, data on a firm's standing to do business in the petitioner's home country, and a firm's financial condition. Mechanisms for cooperating with the Commission and the NFA in inquiries, compliance matters, investigations and enforcement proceedings must be established in the information sharing arrangements. Failure to maintain satisfactory information sharing arrangements could result in revocation of the Commission's order. Proposed Rule 30.11(d)(8) also provides that the Commission may seek information directly from the petitioner to evaluate the petitioner's continued eligibility for or compliance with the

<sup>31</sup> See discussion of conditions of an order in Section III.B.2., below.

conditions of a section 4(c) exemption or for any other reason.

#### i. Arrangements Among Multiple Exchanges

The Commission envisions that its proposed rules would apply not only with respect to individual boards of trade that primarily are operated outside the U.S., but also in circumstances where the products of multiple boards of trade are traded through a single system. In such a case, each board of trade whose products would be made available through U.S.-located automated trading systems generally would be required to comply with the requirements set forth in the proposed rules. For example, if two or more boards of trade share the same system and each wishes to place DESs in the U.S. for its members' (or members' affiliates') use, each would be required to receive an order from the Commission prior to such placement. Similarly, if the products of one or more boards of trade are available through the DES of another board of trade, each board of trade whose products would be available in the U.S. through such DES would be required to receive a section 4(c) exemption order. With respect to AORSs that provide U.S. customers with access to the products of multiple boards of trade, each board of trade whose products would be available through such device or software would have to comply with the rules and receive a section 4(c) exemption order before an FCM or a Rule 30.10 firm could allow its customers to enter trades on the board of trade via an AORS. In the examples discussed above, a petition to the Commission under the proposed rules could be made individually by each board of trade or jointly, provided that the Commission received all required information under the proposed rules with respect to each board of trade whose products would be made available electronically from within the U.S.

In addition to the foregoing, the Commission appreciates that some boards of trade currently allow automated trading of their products from within the U.S. through mutual arrangements with designated contract markets or may in the future do so. In these cases, the arrangements are submitted to the Commission for its prior review as rule changes of the contract market. Because the Commission thus has the opportunity to examine each such arrangement, the proposed rules carve out an exception that would allow a board of trade primarily operating outside the U.S. to have its products traded through

automated trading systems located in the U.S. without obtaining contract market designation and without receiving a section 4(c) exemption order if (1) the board of trade has entered into an electronic trading arrangement with a designated contract market which is submitted to the Commission for review and is in effect as a rule of the contract market and (2) the products of the board of trade that are traded in the U.S. through such trading systems are traded in accordance with such an arrangement. However, a board of trade that has entered into an electronic trading arrangement with a designated contract market would be required to receive a Commission order pursuant to these proposed rules if the board of trade planned to allow automated access to its products in any manner that would fall *outside* the arrangement with a U.S. contract market that has been submitted to the Commission for review.

The Commission wishes to emphasize that, although a "linked exchange" would not be required to comply with these proposed rules if access to its products via automated trading systems from within the U.S. is limited to the terms of an arrangement with a designated contract market, a designated contract market that enters into such a linkage arrangement must submit a rule(s) describing the arrangement and the attendant rights and responsibilities of all parties involved in the arrangement to the Commission for approval. In reviewing such a rule submission, the Commission has applied and will continue to apply substantially the same standards as set forth herein modified as appropriate based on the exact nature of the linkage arrangement. Among other things, the Commission seeks assurances from the designated contract market that the arrangement will conform with the principles for screen-based trading set forth by IOSCO<sup>32</sup> and evaluates what role the U.S. contract market would have in securing its members' compliance with the rules of the board of trade operating primarily outside the U.S. Additionally, the Commission will ensure that any rule(s) it reviews includes language requiring such a board of trade to subject itself to the jurisdiction of the Commission and U.S. courts regarding its activities under the linkage arrangement.

#### j. Public Availability of Petitions

The concept release asked for comment on whether petitions received should routinely be published in the

**Federal Register** for public comment. After reviewing the comments and in light of the nature of the petition process that would be established by the proposed rules, the Commission believes that, as a general matter, it would be beneficial to provide public notice of petitions. Accordingly, pursuant to section 4(c) of the Act, paragraph (e) of proposed Rule 30.11 provides that the Commission will publish a "notice of availability" in the **Federal Register** upon receipt of any petition. The notice of availability would contain a general description of the information discussed in the petition and the exemption sought by the petitioner. Interested parties would thus be aware of each petition and would have the opportunity to request information concerning the petition from the Secretariat of the Commission. The proposed rule further provides that the Commission may, upon the request of a petitioner, limit the public availability of information included in its petition if the Commission determines that such information constitutes a trade secret or that public disclosure would result in material competitive harm to the petitioner.

#### 2. Conditions of an Order

If all standards for exemptive relief are met, exemptive orders under proposed Rule 30.11 would be issued subject to certain conditions. The concept release set forth a number of potential conditions that would be included in each Commission order. The Commission believes that it generally would be helpful to go further and provide in its rules a list of conditions that will apply automatically to each Commission order, unless a particular order indicates otherwise. In light of the comments received on the concept release, the Commission is proposing conditions that vary in certain respects from those discussed in the concept release. These conditions are intended to aid the Commission to fulfill certain basic goals of its rulemaking: (1) To ensure protections for U.S. customers and (2) to ensure that the Commission has ongoing access to data to ensure the continued appropriateness of the Commission's 4(c) exemption order. The conditions that are proposed to be included automatically in each Commission order are as follows:

1. Only members of the board of trade that received a Commission exemptive order and their affiliates may have access to DESs, and the board of trade will not provide, and will take reasonable steps to prevent third parties from providing DESs to any other persons;

<sup>32</sup> See *supra* note 26.

2. Unless otherwise exempt from registration, any member or affiliate thereof that solicits or accepts orders for, or accepts money, securities or property in connection with the purchase or sale of, foreign futures or foreign options by a foreign futures or foreign options customer via a DES or an AORS must be a registered FCM or a Rule 30.10 firm;

3. The board of trade that received the exemptive order must notify the Commission in writing within 30 calendar days of (a) any material changes in the information provided in its petition to the Commission and any changes in its rules or in the laws or rules of its home country that may have a material impact on the order, (b) any known violation by a member (or its affiliate) of the Commission's order; and (c) any disciplinary action taken against a member (or its affiliate) that involves any market manipulation, fraud, deceit or conversion or that results in the member's suspension or expulsion<sup>33</sup> and that involves the use of a DES or an AORS in the U.S., *provided, however*, that the board of trade must notify the Commission at least ten business days prior to allowing any new products (*i.e.*, products other than those discussed in its petition) to be traded through DESs or AORSs located in the U.S. and within 24 hours of any significant system failure or interruption or a member's default, insolvency or bankruptcy;<sup>34</sup>

4. Satisfactory information sharing arrangements must remain in effect between the Commission and the petitioner and the petitioner's regulatory authority;

5. The board of trade that received the order must provide to the Commission, on a quarterly basis and at any other time upon the request of a Commission representative, a current list that (a) identifies and provides the main business addresses in the United States for those of its members and affiliates thereof that have DESs in the United States and indicates which of such members and affiliates thereof allow the use of AORSs by foreign futures and foreign options customers and (b) identifies and provides the main business addresses for those of its members

and affiliates thereof that allow the use of AORSs by foreign futures and foreign options customers, but who do not have DESs in the U.S.;

6. Prior to operating pursuant to the Commission order, the board of trade that received the order must file with the Commission, and maintain thereafter as long as it operates pursuant to the order, a valid and binding appointment of an agent for service of process in the United States, pursuant to which such agent is authorized to accept delivery and service of communications issued by or on behalf of the Commission, the Department of Justice, any member of the board of trade or affiliate of such member, or any foreign futures or foreign options customer. Service or delivery of any communication issued by or on behalf of any of the foregoing, pursuant to such appointment, shall constitute valid and effective service or delivery.

7. Prior to operating pursuant to the Commission order, the board of trade that received the order must file with the Commission a written representation, executed by someone with authority to bind the board of trade, stating that, as long as the board of trade operates pursuant to the 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 exemption order; and

8. The board of trade that received the order must provide the Commission with quarterly reports indicating with respect to each contract available to be traded from within the U.S. via DESs or AORSs (a) the total volume originating from DESs or AORSs located in the U.S. and (b) the total worldwide trade volume on the board of trade. If applicable, the board of trade also must provide reports upon request indicating the stocks held at any warehouse maintained by it in the U.S. for products that require physical delivery.

A significant issue raised in the concept release concerned the extent to which the Commission should look to the volume of a petitioner's contracts transacted by U.S. persons in determining whether such petitioner should be issued an exemption order under these proposed rules. The majority (although not all) of the commenters on this issue believed that the Commission should not use a volume test as the sole means to determine whether a board of trade should be eligible for a Commission order. Commenters varied, however, in their views as to the extent, if any, to which U.S. volume data should play a role in this determination. The Commission agrees with those commenters who suggested that adopting a particular percentage of volume within the U.S. beyond which a board of trade would be required to receive contract market designation could serve to inhibit the development

of new products that might appeal to U.S. users and could prove difficult to manage because volume potentially can vary greatly from one reporting period to the next. Thus, the Commission is not proposing any fixed percentage. However, the Commission believes that trade volume from within the U.S. is relevant in assessing whether a board of trade's contacts in the U.S. are so extensive that it should be required to be designated as a contract market and that a quarterly report that indicates a board of trade's volume of U.S. transactions in each contract and the total number of transactions worldwide in each contract would be beneficial to the Commission in obtaining a complete picture of the board of trade's U.S. activities. Accordingly, the Commission has determined to include in its proposal a periodic U.S. volume reporting requirement that would be included as a condition to each order issued under the proposed rules. The Commission believes that the volume data that would be required under the proposed rules, while relevant and helpful to the Commission, should not impose a significant burden. Specifically, as noted above, the proposed rules would require that a board of trade that received a Commission order provide a report to the Commission on a quarterly basis that indicates the total volume in each of its contracts that originates from automated trading systems in the U.S. (whether from DESs or AORSs) and the total volume of transactions in such contracts worldwide (including the U.S.). This information would be provided for each contract traded on DESs or AORSs from within the U.S.

Another issue raised in the concept release concerned a potential requirement for a biennial on-site review of the operations of members (and their affiliates) operating in the U.S. under a Commission order. The Commission has determined not to require a separate on-site review. As one commenter pointed out, any member or affiliate thereof that uses a DES to trade on behalf of U.S. customers pursuant to a Commission issued order would have to be registered as an FCM and would be subject to periodic audits by the Commission and its designated self-regulatory organization ("DSRO") (*i.e.*, U.S. contract market or NFA). The Commission does not believe that it is necessary to require an additional review under these rules. Rather, it anticipates that the DSRO's audit procedures would be extended to encompass a review of compliance with the Commission's new rules, and orders

<sup>33</sup> See, e.g., Rule 1.63(a)(6)(ii) (defining disciplinary offense for purposes of the Commission's rule concerning service on SRO governing boards by persons with disciplinary histories to include any violation of SRO rules that involves fraud, deceit or conversion or results in suspension or expulsion).

<sup>34</sup> Although the proposed rules would require that the Commission be notified if a board of trade operating under an exemption order intends to allow automated access to new products through DESs or AORSs located in the U.S., the proposed rules generally would not require any type of pre-approval process. However, as previously noted, the proposed rules would not alter a board of trade's obligations: (a) To receive a no-action position from the Commission prior to engaging in the offer or sale of any stock index futures or option contracts in the U.S. or (b) to have any foreign government debt obligation designated as an "exempt security" by the SEC before engaging in the offer or sale of any futures contract or option thereon in the U.S. section 2(a)(1)(B)(v) of the Act states generally that no person shall offer or enter into a contract of sale for future delivery of any security except an "exempt security" under Section 3 of the Securities Act of 1933 or section 3(a)(12) of the Securities Exchange Act of 1934.

issued thereunder, when adopted and issued.

The Commission wishes to make clear that the above list of conditions that will automatically apply under the proposal would not necessarily be exhaustive. For clarity's sake, each order likely would reiterate the conditions that are imposed automatically by the rules. However, as the rules state, the "default" or automatic conditions would apply even if not contained in an order, unless explicitly excluded therefrom. Additionally, a petitioner must include in its petition a written statement in which it consents to or agrees to comply with each of the conditions should the Commission issue the petitioner a Rule 30.11 exemption order.<sup>35</sup> Thus, consent or agreement to comply with the conditions also would be a prerequisite to the Commission's issuance of an order under these rules.

The Commission would be free to subject any order to other conditions that the Commission believes to be necessary or appropriate. In addition, under paragraph (f) of proposed Rule 30.11, the Commission would retain the authority to condition further, modify, suspend, terminate or otherwise restrict the terms of an order as they apply either to a specific person operating thereunder or to the order in its entirety. The Commission might determine to take such action, for example, if the Commission found that the board of trade that received the order, or an entity operating in the U.S. based on the order, materially violated a stated condition of the order, that the activities, operations and trading of the board of trade that received the order no longer justified the order, or that continuation of the order otherwise would be contrary to the Act, public policy or the public interest.

### 3. Rules Concerning Automated Order Routing Systems

#### a. AORS Definition

As noted above, the Commission is proposing to adopt a definition of the term "automated order routing system" in a new paragraph (tt) of Commission Rule 1.3, which contains the Commission's general definitions and thus would apply to U.S. designated contract markets in addition to boards of trade granted a Commission order under proposed Rule 30.11 and linked exchanges. The definition of an AORS is any system of computers, software or other devices that allows entry of orders through another party for transmission to a board of trade's computer or other

automated device where, without substantial human intervention, trade matching or execution takes place. "Entry of orders" for an AORS could be via a screen-based or other automated system. A customer who telephones an order to an employee of an FCM or Rule 30.10 firm would not be *entering* an order for purposes of these rules, and the AORS definition would not apply. The definition of AORS and the requirements relating thereto would apply to orders *for* and customer or foreign futures or options customer, although order entry itself could be made by the customer or by a person designated by the customer to enter orders on its behalf, e.g., a CTA.

As described more fully below, under Proposed Rule 1.71(a), if a customer or foreign futures or foreign options customer uses an AORS to transmit an order to an FCM or Rule 30.10 firm, such AORS must be a "qualified" AORS and satisfy certain minimum requirements specified in proposed rule 1.71(b). Further, under proposed rule 30.3(d), AORSs can only be used to access designated contract markets, boards of trade that have received an exemption under Proposed Rule 30.11 or linked exchanges.

The qualification requirements of Proposed Rule 1.71 do not apply to orders transmitted via an AORS if such orders are proprietary orders of the receiving firm, of if they are transmitted by a registered FCM to another firm for any proprietary account or customer omnibus account of the FCM. Systems transmitting such orders still fall within the definition of AORS, however, and therefore Proposed Rule 30.3(d) requires that such orders be directed to a contract market, a Rule 30.11 exempt board of trade or a linked exchange.

There are a number of possible permutations in how a particular order may be transmitted from a customer or an FCM for eventual execution on an automated board of trade, and it is important to examine each step of a particular transaction to determine what requirements apply. For example, if a customer telephoned an order to an employee of a U.S. FCM, who then entered the order into a system linked directly to an automated board of trade of which it was member, the second step of the transaction would involve the use of a DES, and under proposed Rule 30.3(c), the board of trade for which the order was placed must be a designated contract market, a Rule 30.11 exempt board of trade, or a linked exchange. If the same customer used a system that satisfied the definition of an AORS to send an order to an FCM (or Rule 30.10 firm) for transmission to an

automated board of trade, such AORS would have to be a qualified AORS and satisfy the requirements of Proposed rule 1.71(b). Under proposed Rule 30.3(d), the board of trade for which the order was placed would have to be a designated contract market, a Rule 30.11 exempt board of trade, or a linked exchange.

If a foreign futures options customer telephoned an order to an employee of an FCM and the FCM, using its customer omnibus account, were to take the order and transmit it electronically to another FCM, a Rule 30.10 firm or a firm otherwise exempt from registration as an FCM<sup>36</sup> for transmission into an automated board of trade, transmission of the order from the customer's FCM through the other firm for execution would constitute use of an AORS. Accordingly, under proposed Rule 30.3(d), the board of trade for which the order was placed must be a Rule 30.11 exempt board of trade or a linked exchange. The AORS used by the customer's FCM in this example would not have to be a qualified AORS that meets the credit check and other requirements of proposed Rule 1.71, however, because its use was by an FCM for a customer omnibus account.

Where a non-clearing member of a board of trade operating under a Rule 30.11 exemption order or of a linked exchange uses an automated device directly to access the board of trade's automated order matching engine and there is a post-trade give-up for clearing to an FCM or a Rule 30.10 firm, this would be treated as use of a DES rather than an AORS under the proposed rules. The requirements of proposed Rule 1.71 therefore would not apply.<sup>37</sup> However, an FCM or Rule 30.10 firm must bear in mind that, if the non-clearing member used an automated device to route an order through the FCM or Rule 30.10 firm prior to the order's transmission to the matching/execution engine of the board of trade, this would be treated as use of an AORS by the non-clearing member customer, and the AORS therefore would have to be a qualified AORS and to satisfy the requirements of proposed Rule 1.71, unless the non-clearing member is itself an FCM or has a proprietary relationship to the FCM receiving the order.

#### b. Requirements for Qualified AORSs

Proposed Rule 1.71 would set forth very basic standards that must be met by a qualified AORS. If these minimum requirements are satisfied, there would

<sup>35</sup> See proposed rule 30.11(b)(2)(xii).

<sup>36</sup> See *supra* note 20.

<sup>37</sup> The firm carrying the account generally would have to be a registered FCM or Rule 30.10 firm.

be no restriction upon the type of customer that could use the AORS, *e.g.*, no minimum net worth standards, and no restrictions upon the type of data that may be displayed to the customer. The AORS must be limited to exchange trading only, either on a designated contract market, an exchange linked to such a contract market or a board of trade that receives an exemption order in accordance with proposed Rule 30.11.<sup>38</sup>

A qualified AORS may only provide access for a customer or a foreign futures or foreign options customer to products that can lawfully be offered to or entered into by U.S. persons. Thus, for example, if there were a futures contract traded on a board of trade with a Rule 30.11 exemption order (or a linked exchange) involving a foreign stock index or a foreign government's sovereign debt instruments that had not received the requisite clearances, the futures contract could not lawfully be offered or sold to U.S. persons. The FCM (or Rule 30.10 firm, as applicable) should also exercise due diligence to verify that use of an AORS is permissible under, and undertaken in accordance with, the rules of the relevant contract market, board of trade that received a Rule 30.11 exemption order, or linked exchange.

For trading through an FCM, a qualified AORS would be required to provide all information required by Commission Rule 1.35(a-1)(1) concerning identification of customer orders, except that order-related times would have to be captured to the nearest second. The proposed requirement for timing to the nearest second is consistent with the Commission's previous advisory concerning recordkeeping requirements for electronic order-routing systems.<sup>39</sup>

The Commission believes that the use of AORSs may be beneficial for customers and FCMs in terms of convenience and efficiency. However, these systems are not infallible or without serious risk. The Commission is concerned that, due to the speed and the uninterrupted nature of an automated device, an error, if one should occur, could be very large in magnitude and impact and thus potentially could pose a significant risk to customers, to the

integrity of the FCM and to the marketplace in general if the AORS does not contain appropriate safeguards. Commission Rule 1.16 requires, among other things, that an FCM have in place appropriate internal accounting controls and procedures for safeguarding customer and firm assets.<sup>40</sup> However, that rule does not prescribe specific controls that must be in place. The Commission believe that it is appropriate to mandate that certain specific, minimum controls be present in any qualified AORS. These minimum safeguards do not supplant or replace an FCM's duties under Rules 1.16 and 166.3 and other applicable regulations, concerning proper internal controls and supervision of employees and accounts. Rather, they are minimum standards that should be implemented in addition to other appropriate controls employed by FCMs regarding AORSs.

Proposed Rule 1.71(b)(3) requires generally that an FCM or Rule 30.10 firm take reasonable steps to ensure that its system is and remains sound and secure and generally fit for its intended purpose. Proposed Rule 1.71(b)(5) provides that a qualified AORS must contain at a minimum checks that verify that any credit and trading or position limits for the account (as established by the FCM or Rule 30.10 firm) are not exceeded.<sup>41</sup> Such checking could be

<sup>40</sup> In particular, Rule 1.16(d)(1) requires that the scope of the FCM's annual audit, review of the accounting system and procedures for safeguarding customer and firm assets be "sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination in (i) the accounting system, (ii) the internal accounting controls, and (iii) the procedures for safeguarding customer and firm assets . . . will be discovered." A material inadequacy is defined generally in Rule 1.16(d)(2) to include, among others, "any conditions which contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to . . . (r)esult in material financial loss." See also, Commission Rule 166.3, which governs an FCM's general supervisory duty with respect to handling of accounts.

<sup>41</sup> This proposed rule is consistent with conditions currently placed on customers of the CME who may transmit Globex orders to FCMs via the Internet. By letter to the CME dated August 14, 1997, the Division, under authority delegated by the Commission in Rule 1.41(a)(3), informed the CME that its proposal to permit customers to transmit Globex orders to FCMs via the Internet did not require Commission approval under section 5a(a)(12) of the Act. Under CME's proposal, customers do not have direct access to Globex. Rather, the proposal permits CME clearing members to accept customer orders via the Internet. After receipt of a customer order, the order is transmitted to Globex via the clearing member's order routing system and CME's computer-to-computer interface ("CTCI"), which enables a clearing member to upload and download orders between the member's order routing system and Globex. A CME clearing member may use CME's CTCI only if (1) the member's order routing system contains automated credit controls or position limits or (2) customer orders received by a member through its order

performed manually or by the system itself on an automated basis. If these checks are automated, the FCM or Rule 30.10 firm must implement proper internal controls to ensure that limits appropriate to each customer or foreign futures or foreign options customer, as determined by personnel authorized to set such limits, are properly input into the AORS and updated as appropriate. The Commission is also proposing, in proposed Rule 1.71(b)(6) and (b)(7), that a qualified AORS must provide: (1) An FCM or Rule 30.10 firm, on a unilateral and immediate basis, with the capability to block use of an AORS if, for example, the firm determines that its security or the security of any contract market, linked exchange or board of trade operating pursuant to a Rule 30.11 exemption order may be adversely affected by use of the AORS and (2) reasonable precautions to ensure against unauthorized access, unauthorized trading and unauthorized disclosure of customer or foreign futures or foreign options customer orders<sup>42</sup> and to provide overall integrity and security of the AORS.

With respect to recordkeeping, the Commission is proposing that a qualified AORS must enable an FCM to download trade history on each order entered through the system on a daily basis and otherwise to maintain records related to such orders in accordance with Commission Rule 1.31.<sup>43</sup> To assure system integrity and appropriate trade data, any and all modifications to or cancellations of an order must be recorded. In addition, the Commission is proposing to require an FCM to maintain a record of accounts for which it will accept or transmit for execution orders that have been entered through an AORS. This record shall also include the name of any person designated by a customer or a foreign futures or foreign options customer to exercise control over the trading decisions for the account and shall be maintained in accordance with Commission Rule 1.31.<sup>44</sup> A Rule 30.10 firm should maintain records in accordance with the

routing system are subject to manual review and processing by a clearing member employee prior to being entered into a Globex terminal.

<sup>42</sup> See Commission Rule 155.3(b)(1).

<sup>43</sup> See proposed Rule 1.71(b)(8).

<sup>44</sup> Proposed Rule 1.71(c). The records of third-party account controllers, like all books and records required to be kept by the Act or rules thereunder, must be readily accessible during the first two years of the required five-year retention period under Rule 1.31. Commission staff have sometimes experienced difficulty in obtaining this information on existing accounts. Such information is required by Rule 1.37 and is generally maintained by FCMs, but sometimes the manner of maintenance improperly makes ready retrieval difficult.

<sup>38</sup> An AORS could also provide access to trading in cash markets, securities markets, or CEA-exempt hybrid markets, if such trading is consistent with all applicable laws and regulations. Trading of swaps via AORSs would not be permissible under the current Commission exemption for swaps, which prohibits the use of multilateral transaction execution facilities for swaps trading, see, *e.g.*, Rule 35.2(d), and thus would not be permissible under proposed Rule 1.71.

<sup>39</sup> 62 FR 7675, at 7677 (Feb. 20, 1997).

requirements of its home country regulator, which would then be available to Commission or NFA representatives under appropriate information sharing arrangements.

As discussed above, proposed Rule 1.71 is intended to establish minimum requirements with respect to the use and the soundness of an AORS. The Commission believes that these basic, common sense requirements likely would be adopted by any responsible FCM or Rule 30.10 firm, even in the absence of Commission action. Indeed, the Commission anticipates that AORSs may contain protections more elaborate than those required under the proposed rules. Depending on the nature of the system, compliance with existing Commission Rules 1.16 and 166.3 may require more stringent internal controls and protections to be in effect. The Commission requests comments as to whether any additional specific prudential standards should be included in the Commission's rules concerning the use of AORSs.

Certain commenters noted that rules pertaining to AORSs should apply universally. The Commission agrees with that position and is therefore proposing to add to Commission Rule 30.3 a new paragraph (e) to provide that, notwithstanding the terms of any prior Rule 30.10 order, it shall be unlawful for a Rule 30.10 firm to accept or transmit for execution an order from a foreign futures or foreign options customer through an AORS unless the system satisfies the requirements of proposed Rule 1.71(a), as appropriate for a Rule 30.10 firm. This provision would apply to existing Rule 30.10 firms irrespective of what may have been stated in an earlier Commission order under Rule 30.10.

With respect to the disclosure of risk that an FCM must provide to a customer or a foreign futures of foreign options customer using an AORS, the Commission notes that Rule 1.55, certain provisions of which are referred to above, provides in paragraph (g) thereof that any specific requirements set forth therein do "not relieve (an FCM) from any other disclosure obligation it may have under applicable law." Therefore, although the Commission is not proposing any specific risk disclosure language applicable to an AORS or a DES, just as it has not done so for contract market automated trading systems, the Commission believes that FCMs must disclose material risks about these systems. Designated contract markets have developed risk disclosure statements for their automated trading systems that FCMs provide to customers

using those systems, and comparable risk disclosures would be necessary and appropriate as to AORSs and DESs.

The Commission notes that there have been discussions between Commission staff and a joint industry-NFA committee concerning a generic electronic trading and order routing systems disclosure statement, which is proposed to replace the contract market-specific disclosure statements with the understanding that customers would always be entitled to further information about a particular system upon request or about particular material risks not otherwise covered by the generic disclosure statement. In determining whether a petitioner's regulatory structure is generally comparable to the U.S. structure with respect to customer protection and prohibition of fraud and abuse, the Commission would review the petitioner's risk disclosures pertaining to its automated trading systems in light of those prepared by designated contract markets for their systems and any generic disclosure statement ultimately developed in discussions between Commission staff and the industry-NFA committee discussed above. The Commission requests comment concerning any specific disclosure provisions that should be set forth in Commission rules.

The Commission also notes that proposed Rule 1.71 would not apply in a situation where the customer is outside the U.S. and trades on a Rule 30.11 exempt board of trade or foreign board of trade, but the trade is given up for clearance after execution to an FCM. The focus of Rule 1.71 is to assure that there is a sound automated system that will be secure and provide for credit and trading or position limit checks prior to execution, and the Commission does not believe that the above situation would allow pre-screening by the FCM. Of course, the Commission expects that an FCM will maintain appropriate internal controls and supervision with respect to any account that it clears in accordance with existing Rules 1.16 and 166.3.

The Commission is not proposing to apply the AORS definition or Rule 1.71 to order routing for open outcry execution. The Commission intends that these proposals would not alter its prior advisory referred to above or impact on efforts of contract markets using open outcry execution to enhance the automation of order flow.

#### 4. Interim Procedures

Several commenters have requested that the Commission grant interim relief to allow automated access from within the U.S. to boards of trade primarily

operated outside the U.S. in anticipation of the Commission's final rules. The Commission appreciates the importance of the issues involved in this rulemaking, but does not believe that it is appropriate to grant interim relief either before the Commission's adoption of final rules or pending the Commission's review of a board of trade's petition. Interested boards of trade should feel free, however, to begin a dialogue now with Commission staff to help expedite their preparation and submission of a petition following the Commission's adoption of final rules.

## IV. Related Matters

### A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601-611 (1994), requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The proposed rules discussed herein would affect boards of trade, their members or members' affiliates and FCMs. Many board of trade members and affiliates thereof will be FCMs. The commission previously has determined that, based upon the fiduciary nature of the FCM/customer relationships, as well as the requirement that FCMs meet minimum financial requirements, FCMs should be excluded from the definition of small entity.<sup>45</sup> With respect to potentially affected entities that are not FCMs, such entities must be board of trade members or their affiliates, which generally have financial requirements comparable to FCMs. On that basis, these entities should not be considered "small." Boards of trade likely to seek electronic access to their products from within the U.S. are similar in nature to designated contract markets, and the Commission has excluded contract markets from the definition of small entity.<sup>46</sup> Accordingly, on behalf of the Commission, the Chairperson certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities. Moreover, this proposal provides an alternative to the contract market designation process and to compliance with the law and rules related to contract markets and, in that respect, is less burdensome than that currently in place. Nevertheless, we invite comments regarding the applicability of the FRA to these proposed rules.

### B. Paperwork Reduction Act

When publishing proposed rules, the Paperwork Reduction Act of 1995 (Pub.

<sup>45</sup> FR 18618-18621 (April 30, 1982).

<sup>46</sup> *Id.*



L. 104–13 (May 13, 1995)) imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the Paperwork Reduction Act. In compliance with the Act, the Commission, through these rule proposals, solicits comments to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including the validity of the methodology and assumptions used; (2) evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information including the validity of the methodology and assumptions used; (3) enhance the quality, utility, and clarity of the information to be collected; and (4) minimize the burden of the collection of the information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

The Commission has submitted these proposed rules and their associated information collection requirements to the Office of Management and Budget. The burden associated with this entire collection (3038–0023), including these proposed rules, is as follows:

*Average Burden Hours Per Response:* 39.36003.

*Number of Respondents:* 73,640.

*Frequency of Response:* On occasion.

The burden associated with this specific proposed rule, is as follows:

*Average Burden Hours Per Response:* 21.25003.

*Number of Respondents:* 140.

*Frequency of Response:* On occasion and quarterly.

Persons wishing to comment on the estimated paperwork burden associated with these proposed rules should contact Desk Officer, Office of Management and Budget, Room 10202, NEOB, Washington, DC 20503 (202) 395–7340. Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street, NW., Washington, DC 20581, (202) 418–5160.

## List of Subjects

### 17 CFR Part 1

Commodity futures; Automated order routing system.

### 17 CFR Part 30

Commodity futures; Foreign futures and foreign options.

In consideration of the foregoing, and pursuant to the authority contained in

the Commodity Exchange Act, and in particular, sections 2(a)(91)(A), 4, 4c and 8a thereof, 7 U.S.C. 2, 6, 6c and 12a, the Commission hereby proposes to amend parts 1 and 30 of chapter I of title 17 of the code of Federal Regulations as follows:

## PART I—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 continues to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23 and 24.

2. Section 1.3 is proposed to be amended by adding paragraph (tt) to read as follows:

### § 1.3 Definitions.

\* \* \* \* \*

(tt) *Automated order routing system.*

This term means any system of computers, software or other devices that allows entry of orders through another party for transmission to a board of trade's computer or other automated device where, without substantial human intervention, trade matching or execution takes place.

3. Section 1.71 is proposed to be added to read as follows:

### § 1.71 Automated order routing system.

(a) It shall be unlawful for a firm registered or required to be registered as a futures commission merchant or a firm exempt from such registration under § 30.10 of this chapter to accept or transmit for execution an order from or on behalf of a customer (other than an owner or holder of a proprietary account as defined in § 1.3(y)) or a foreign futures or foreign options customer (as defined in § 30.1(c) of this chapter) that has been entered through an automated order routing system, whether the system is operated, maintained or provided to the customer or the foreign futures or foreign options customer by the futures commission merchant, a firm exempt from such registration under § 30.10 of this chapter or by another person, unless the automated order routing system is a qualified automated order routing system: *Provided, however* that the requirements of this section shall not apply to orders received by a firm registered or required to be registered as a futures commission merchant or a firm exempt from such registration under § 30.10 of this chapter from a registered futures commission merchant for that futures commission merchant's customer omnibus accounts or proprietary accounts.

(b) To be a qualified automated order routing system, such automated order routing system shall provide that:

(1) Access is limited to:

(i) Trading conducted on or subject to the rules of a designated contract market, through a registered futures commission merchant;

(ii) Trading conducted on or subject to the rules of a board of trade to which the Commission has issued an exemption order under section 4(c) of the Act following the board of trade's submission of a petition in accordance with § 30.11 of this chapter; or

(iii) Trading conducted on a board of trade the products of which are accessible as part of an automated trading system operated pursuant to specific rules regarding the particular linkage arrangement that have been submitted by a designated contract market to the Commission and are in effect pursuant to section 5a(a)(12)(A) of the Act and § 1.41 and which is otherwise primarily operating outside the United States.

(2) Access is limited to products that can be lawfully offered and sold in the United States;

(3) The futures commission merchant or firm exempt from such registration under § 30.10 of this chapter takes reasonable steps to ensure that the system is and remains sound and secure and fit for the purpose for which it is intended;

(4) For futures commission merchants, information required by § 1.35(a–1)(1) is recorded in accordance with that paragraph, except that order-related times must be captured to the nearest second;

(5) It is designed and operated consistent with the duty of the futures commission merchant or firm exempt from such registration under § 30.10 of this chapter to maintain proper internal controls and supervision over the handling of customer accounts. This must include, but is not limited to, credit and trading or position limit checks that are performed, either by a natural person or by the system itself, prior to the order's execution. If such credit and trading or position limit checks are automated, the futures commission merchant or firm exempt from such registration under § 30.10 of this chapter shall implement proper internal controls to ensure that limits appropriate to each customer or foreign futures or foreign options customer as determined by personnel of the futures commission merchant or the firm exempt from such registration under § 30.10 of this chapter authorized to set such limits are properly input into the

automated order routing system and updated as appropriate;

(6) The futures commission merchant or firm exempt from such registration under § 30.10 of this chapter has the capability on a unilateral and immediate basis to block any customer's or foreign futures or foreign options customers' use of an automated order routing system where necessary or appropriate to safeguard the futures commission merchant or firm exempt from registration under § 30.10, customer accounts or the stability or security of any designated contract market or any board of trade referred to in paragraphs (b)(1)(ii) and (iii) of this section; or for any other appropriate reason;

(7) There are reasonable safeguards to ensure against unauthorized access, unauthorized trading, and unauthorized disclosure of customer or foreign futures or foreign options customer orders and to provide overall integrity and security of the automated order routing system; and

(8) For a futures commission merchant, that the futures commission merchant has the capability to download trade history on each order entered through an automated order routing system on a daily basis and otherwise to maintain records related to such orders in accordance with § 1.31.

((c)(1) A futures commission merchant shall maintain in accordance with § 1.31 a record of those accounts of customers or foreign futures or foreign options customers for which the futures commission merchant will accept or transmit for execution orders that have been entered through an automated order routing system. This record shall also include the name of any person designated by the customer or foreign futures or foreign options customer to exercise control over the trading decisions for the account, which shall be readily accessible during the first two years of the required five-year retention period under § 1.31.

(2) A firm that is exempt from registration as a futures Medicare pursuant to an order granted by the Commission under § 30.10 of this chapter shall maintain in accordance with the recordkeeping requirements of its home country regulator a record of those accounts of foreign futures or foreign options customers for which the firm will accept or transmit for execution orders that have been entered through an automated order routing system. This record shall also include the name of any person designated by the foreign futures or foreign options customer to exercise control over the trading decisions for the account and shall be made available upon the

request of any Commission representative.

## PART 30—FOREIGN OPTIONS AND FOREIGN FUTURES TRANSACTIONS

4. The authority citation for part 30 continues to read as follows:

**Authority:** 7 U.S.C. 2, 4, 6, 6c, and 12a.

5. Section 30.3 is proposed to be amended by adding paragraphs (c)–(e) to read as follows:

### § 30.3 prohibited transactions.

\* \* \* \* \*

(c) Except as otherwise provided in § 30.11, it shall be unlawful to use or to provide to any person in the United States a direct execution system (as defined in § 30.11(a)(1)) for the purpose of facilitating the execution of transactions in foreign futures or foreign options unless the board of trade to which the direct execution system provides access has been designated as a contract market under section 5 of the Act.

(d) Except as otherwise provided in § 30.11, it shall be unlawful for any person to solicit or accept orders for, or to accept money, securities or property in connection with, the purchase or sale of foreign futures or foreign options by a foreign futures or options customer that are entered via an automated order routing system (as defined in § 30.11(a)(2)) unless the board of trade through which the transaction is to be executed has been designated as a contract market under section 5 of the Act.

(e) notwithstanding the terms of any prior Commission order issued under § 30.10, it shall be unlawful for a firm operating pursuant to a confirmation of a Commission order issued under § 30.10 to accept or transmit for execution an order from a foreign futures or foreign options customer through an automated order routing system unless the applicable requirements of § 1.71 of this chapter are satisfied.

### § 30.11 [Redesignated as § 30.12]

6. Section 30.11 is redesignated as § 30.12 and a new § 30.11 is added to read as follows:

### § 30.11 Access from the United States to automated trading systems of a board of trade whose primary locus of regulation and operations is otherwise outside the United States.

(a) Definitions: For purposes of this section:

(1) *Direct execution system* means any system of computers, software or other devices that allows entry of orders for products traded on a board of trade's

computer or other automated device where, without substantial human intervention, trade matching or execution takes place: *Provided, however*, that this term shall not include an automated order routing system as that term is defined in § 1.3(tt) of this chapter.

(2) *Automated order routing system* means automated order routing system as defined in § 1.3(tt) of this chapter.

(3) An *affiliate* of a member of a board of trade for purposes of this rule means any person that:

- (i) Owns 50% or more of a member;
- (ii) Is owned 50% or more by the member; or
- (iii) Is owned 50% or more by a third person that also owns 50% or more of the member.

(4) *Proprietary account* means proprietary account as defined in § 1.3(y) of this chapter.

(b)(1) Upon the submission of a petition for exemption by a board of trade in accordance with this section, the Commission may issue an exemption order to the board of trade if the Commission determines that:

(i) The petitioner is an established board of trade that wishes to place within the United States an automated trading system permitting access to trading its products but whose activities are otherwise primarily located in a particular foreign country that has taken responsibility for regulation of the petitioner;

(ii) The petitioner's home country has established a regulatory scheme that is generally comparable to that in the U.S. and provides basic protections for customers trading on markets and for the integrity of the markets themselves;

(iii) Except for certain incidental contacts with the U.S., the petitioner would be present in the U.S. only by virtue of being accessible from within the U.S. via its automated trading system;

(iv) The petitioner is willing to submit itself to the jurisdiction of the Commission and the U.S. courts in connection with its activities conducted under an exemptive order;

(v) The petitioner's automated trading system has been approved by the petitioner's home country regulator following a review of the system that applied the standards set forth in the 1990 International Organisation of Securities Commissions report on screen-based trading systems (as may be revised and updated from time-to-time) or substantially similar standards; and

(vi) Satisfactory information sharing arrangements are in effect between the Commission and the petitioner and the petitioner's regulatory authority.

(2) A petition of a board of trade made pursuant to this section should be filed with the Secretary of the Commission and must contain the following information, in English:

(i) The address of the petitioner's main business office and the name, address, telephone number, facsimile number and electronic mail address of a person to contact for additional information concerning the petition;

(ii) The petitioner's articles of association, constitution, or other similar organizational documents along with the date and place of its establishment;

(iii) A complete description of the contracts that initially will be traded through direct execution systems and/or automated order routing systems located in the United States;

(iv) The petitioner's current rules including all rules for members and users, which may be attached as an Appendix to the petition, and shall include a description of membership requirements and classes and distinctions between customer and proprietary trading;

(v) The address of the office responsible for monitoring compliance with the petitioner's rules and the supervisory arrangements for monitoring compliance with the rules insofar as the rules apply to activities conducted in the United States, as well as the name and address of the petitioner's home country regulator;

(vi) A description of the regulatory structure established in the petitioner's home country, including, without limitation, a description of the regulatory authority to which the petitioner is subject under the laws of such country, the status of the petitioner under those laws, and the applicable statutory and regulatory requirements established by law or by the regulatory authority that govern the operation of futures and options trading in the petitioner's home country, including, without limitation, applicable regulations or requirements concerning:

(A) Prohibition of fraud, abuse and market manipulation relating to trading on petitioner's markets;

(B) Recordkeeping and reporting by the petitioner or its members;

(C) Fitness standards for intermediaries operating on petitioner's markets, members, or others;

(D) Financial standards for the petitioner's members;

(E) Protection of customer funds, including procedures in the event of a clearing member's default, insolvency or bankruptcy;

(F) Trade practice standards;

(G) Rule review or general review of board of trade operations by its regulatory authority;

(H) Surveillance, compliance, and enforcement mechanisms employed by the board of trade and its regulatory authority to ensure compliance with their rules and regulations; and

(I) Regulatory oversight of clearing facilities; *Provided, however*, that if the petitioner or the regulatory authority that governs the petitioner has received an order of exemption, for trading on the petitioning board of trade, from the Commission under § 30.10 and the information required by paragraphs (b)(2) (ii), (iv) and (vi) of this section was provided to the Commission in the petition for such order and has not changed materially from the date of the Commission's order, the petitioner may, in lieu of furnishing the information otherwise required under paragraphs (b)(2) (ii), (iv) and (vi) of this section, make a statement to such effect which shall specify the date(s) the information was provided to the Commission and the name of the petitioner who received an order from the Commission under § 30.10;

(vii) Information sharing arrangements in effect between the board of trade and the regulatory authority in the petitioner's home country and the Commission, including information concerning any blocking statutes or data protection laws in effect in the petitioner's home country that might impair the Commission's ability to obtain information in accordance with such an arrangement;

(viii) A general description of the order matching/execution system and any direct execution system, software or devices operated by the board of trade, including, at a minimum, a general description of the architecture and security features of the systems, a statement as to the length of time such systems have been operating, a complete history of any significant system failures or interruptions, and 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 principles for screen-based trading set forth by the International Organisation of Securities Commissions; *Provided, however*, that if the information required by this paragraph has been provided to the Commission, or will be provided to the Commission contemporaneously with the board of trade's petition, by another

board of trade whose products trade through the same direct execution system or automated order routing system as the petitioner, the petitioner must so state and must identify the board of trade that has or will provide the Commission with the required information and need not itself provide the information required under this paragraph, but will remain responsible for the provision of such information by the other board of trade;

(ix) A description of all activities engaged in by the board of trade or its employees, agents or representatives in the United States, including, but not limited to, activities in connection with marketing, education or otherwise promoting the board of trade's business or products;

(x) The address of, and a description of activities engaged in by, any office of the board of trade located in the United States and the number of personnel employed or retained by the board of trade in the United States, including the number of personnel in each such office;

(xi) If the petitioner lists for trading any futures contracts that involve physical delivery of the underlying commodity and warehouses in connection with such delivery are located in the United States, its territories or possessions, the address of any such warehouses;

(xii) A written statement in which the petitioner consents to or agrees to comply with each of the conditions listed in paragraph (d) of this section; and

(xiii) Any further information that the Commission or its representatives request.

(c) To the extent that the products of multiple boards of trade are to be traded from the same direct execution system or automated order routing system, each board of trade whose products will be made available from such systems located in the United States must, either individually or jointly, submit a petition in accordance with this section:

*Provided, however*, that a board of trade's products may be offered through direct execution systems or automated order routing systems located in the United States and need not submit a petition to the Commission under this section or be designated as a contract market under section 5 of the Act if its products are accessible as part of an electronic trading system operated pursuant to specific rules regarding the particular linkage arrangement that have been submitted by a designated contract market to the Commission for review and are in effect under section 5a of the Act.

(d) The Commission may issue an order under section 4(c) of the Act and the provisions of this section subject to such terms and conditions as the Commission may find appropriate: *Provided, however*, that any order issued to a board of trade under this section will be subject to the following conditions at a minimum, unless otherwise specified in the order by the Commission:

(1) Only members of the board of trade and affiliates thereof will have access to direct execution systems, and the board of trade will not provide, and will take reasonable steps to prevent third parties from providing, direct execution systems to persons other than members and their affiliates;

(2) Unless otherwise exempt from registration, any member or affiliate thereof that solicits or accepts orders for, or accepts money, securities or property in connection with the purchase or sale of foreign futures or foreign options by a foreign futures or foreign options customer via an automated order routing system, or that transmits the order of a foreign futures or foreign options customer via a direct execution system, must be a registered futures commission merchant or a firm exempt from such registration pursuant to an order granted under § 30.10;

(3) The board of trade will submit the following information to the Commission on at least a quarterly basis:

(i) For each contract available to be traded through direct execution systems and automated order routing systems located in the United States, the total trade volume originating from such systems located in the United States; and

(ii) For each contract available to be traded through direct execution systems and automated order routing systems located in the United States, the board of trade's total worldwide trade volume, from any source;

(iii) A current list that:

(A) Identifies and provides the main business addresses in the United States for those of its members and affiliates thereof that have direct execution systems in the United States and indicates which of such members and affiliates thereof allow the use of automated order routing systems for foreign futures and foreign options customers; and

(B) Identifies and provides the main business addresses for those of its members and affiliates thereof that allow the use of automated order routing systems by foreign futures and foreign options customers, but who do not have direct execution systems in the

United States: *Provided, however*, that the board of trade will additionally provide a current list to a Commission representative at any time upon request;

(4) The board of trade will provide the Commission with written notice within 30 calendar days of:

(i) Any material change to any information provided in its petition to the commission for a section 4(c) exemption order under this section: *Provided, however*, that the board of trade will notify the Commission in writing;

(A) At least ten business days prior to offering any products not listed in its initial petition to be traded through direct execution systems or automated order routing systems located in the United States and;

(B) Within 24 hours of any significant system failure or interruption or a member's default, insolvency or bankruptcy;

(ii) A change in any laws or rules in the board of trade's home country relevant to futures or options, including rules of the board of trade itself, that may have a material impact on the order;

(iii) Any known violation of any obligations under the order committed by a member of the board of trade or an affiliate thereof operating in the United States under the order; and

(iv) Any disciplinary action taken against a member of the board of trade or an affiliate thereof operating in the United States under the order that involves any market manipulation, fraud, deceit or conversion or that results in suspension or expulsion and that involves the use of a direct execution system or an automated order system in the United States;

(5) Satisfactory information sharing arrangements must remain in effect between the board of trade and the board of trade's regulatory authority and the Commission;

(6) Prior to operating pursuant to the section 4(c) exemption order, the board of trade must file with the Commission, and maintain thereafter as long as the board of trade operates pursuant to the order, a valid and binding appointment of an agent for service of process in the United States, pursuant to which such agent is authorized to accept delivery and service of communications issued by or on behalf of the Commission, the Department of Justice, any board of trade member or affiliate of such member, or any foreign futures or foreign options customer. Service or delivery of any communication issued by or on behalf of any of the foregoing to the appointed agent shall constitute

valid and effective service or delivery; and

(7) Prior to operating pursuant to the section 4(c) exemption order, the board of trade must file with the Commission a written representation, executed by someone with authority to bind the board of trade, that, as long as the board of trade operates pursuant to the 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) exemption order;

(8) The Commission, in its discretion, may require other information of the board of trade to evaluate its continued eligibility for or compliance with conditions of a section 4(c) exemption order, or for any other reason. The Commission may require the board of trade 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.

(e) The Commission shall publish in the **Federal Register** a notice of availability of each petition received under paragraph (b) of this section for the purpose of providing notice to the public. Interested parties may request a copy of the petition or relevant parts thereof from the Secretary of the Commission: *Provided, however*, that the Commission may limit the public availability of any information received from the petitioner if the petitioner submits a written request to limit disclosure contemporaneously with the petition and the Commission determines that the information sought to be restricted constitutes a trade secret or that public disclosure of the information would result in material competitive harm to the petitioner.

(f) The Commission may, as it deems appropriate, condition, modify, suspend, terminate, or otherwise restrict the terms of an order issued under section 4(c) of the Act in accordance with this section if the Commission determines that a board of trade that has received a section 4(c) exemption order in accordance with this section is in material violation of any term or condition of the order, or this section that the continued effectiveness of the order would be contrary to public policy or the public interest, or that circumstances otherwise do not warrant continuation of the order as issued. The Commission may take such action with respect to the order in its entirety or with respect to a specific person or persons operating thereunder.

(g) Any trading conducted on or subject to the rules of a board of trade

that has received a section 4(c) exemption order in accordance with this section or a board of trade the products of which are accessible as part of an automated trading system operated pursuant to specific rules regarding the particular linkage arrangement that have been submitted by a designated contract market to the Commission and are in effect pursuant to section 5a(a)(12)(A) of the Act and § 1.41 of this chapter and which otherwise operates primarily outside the United States shall be deemed to involve the trading of foreign futures or foreign options, as appropriate, under the definitions of § 30.1(a) and (b) and under any provisions that refer to those definitions. A person located in the United States, its territories or possessions engaged in such trading shall be deemed to be a foreign futures or foreign options customer under § 30.1(c).

Issued in Washington, DC on March 16, 1999 by the Commission.

**Jean A. Webb,**

*Secretary of the Commission.*

Commissioner Barbara P. Holum joining in the concurring opinions of Commissioners Spears and Newsome.

Dated: March 16, 1999.

Commissioner Barbara P. Holum.

**Concurring Opinion of Commissioner David D. Spears—Proposed Rules Concerning Access to Automated Boards of Trade**

I have significant reservations about the complexity of the proposed rules. I believe the elaborate regulatory system this proposal envisions could impose unnecessary burdens on US FCMs and could be cited by foreign regulators as justification for imposing unnecessarily restrictive requirements on US exchanges. However, I also recognize that the Commission needs to act as quickly as possible to address issues relating to access to foreign boards of trade from within the US. Further delay in issuing proposed rules to allow for additional revisions or refinements in the proposal would be a disservice to those affected by the proposal. The investing public and the futures industry have every right to expect this agency to act expeditiously in bringing legal certainty to this area. Therefore, I have voted to issue the proposed rules in the form presented. However, I would urge commenters to review the proposal carefully with an eye toward suggesting revisions that would make the rules simpler without detracting from adequate customer protection or the fair

and even-handed treatment of all affected parties.

**Concurring Opinion of Commissioner James E. Newsome—Proposed Rules Concerning Automated Trading System Use in the United States**

I respectfully concur in the issuance of the proposed rules concerning automated trading system use in the United States. I agree that the proposal should be released for public comment, but I do not agree with the approach detailed therein, for the reasons stated below.

My concerns are twofold: first, I believe that the proposal is overly regulatory in approach, and secondly, I believe 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. I do not believe that the proposal appropriately mitigates the competitive concerns of our domestic exchangers, and, indeed, may well exacerbate the issue of inequitable regulatory treatment. Moreover, I believe that there are unnecessary additional burdens included in this proposal that would negatively affect the futures commission merchant community.

Given the widespread interest in this issue and the unfortunate delay in its release, I support moving forward expeditiously and giving the public another opportunity to comment on the proposal. However, I strongly urge interested parties to comment particularly on the issues I have mentioned, as well as alternative methods of addressing this issue, including, for example, the use of no-action procedures or the CEA's Part 30 Regulations.

Dated: March 15, 1999.

**James E. Newsome,**  
*Commissioner.*

[FR Doc. 99-6829 Filed 3-23-99; 8:45 am]

BILLING CODE 6351-01-M

**DEPARTMENT OF HEALTH AND HUMAN SERVICES**

**Food and Drug Administration**

**21 CFR Part 101**

**[Docket No. 99N-0554]**

**How to Use Health Claims and Nutrient Content Claims in Food Labeling; Public Meeting**

**AGENCY:** Food and Drug Administration, HHS.

**ACTION:** Announcement of public meeting.

**SUMMARY:** The Food and Drug Administration (FDA) is announcing a forthcoming public meeting concerning implementation of sections 303 and 304 of the Food and Drug Administration Modernization Act of 1997 (FDAMA). Those provisions provide for use, in food labeling, of health claims and nutrient content claims based on authoritative statements published by certain Federal scientific bodies or the National Academy of Sciences (NAS) or any of its subdivisions. We are holding the meeting to allow you to provide information and recommendations to assist us in identifying appropriate approaches for implementing sections 303 and 304 of FDAMA. We anticipate that the discussion will include presentations from people whom we invite to participate as well as from members of the public.

**DATES:** We will hold the meeting on May 11, 1999, 8 a.m. to 5 p.m. Please register by April 27, 1999. Written comments should be submitted by May 11, 1999.

**ADDRESSEES:** The meeting will be held at the Jefferson Auditorium, U.S. Department of Agriculture, South Bldg., 1400 Independence Ave. SW., Washington, DC.

You may submit written comments to the Dockets Management Branch (HFA-305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852. You may also send comments to the Dockets Management Branch at the following e-mail address: "FDADockets@bangate.fda.gov" or via the FDA Website "http://www.fda.gov".

**FOR FURTHER INFORMATION CONTACT:** Jeanne E. Latham, Center for Food Safety and Applied Nutrition (HFS-456), Food and Drug Administration, 200 C St. SW., Washington, DC 20204, 202-205-4697, or e-mail to "JLatham@bangate.fda.gov".

**SUPPLEMENTARY INFORMATION:**

**I. Background**

On November 21, 1997, the President signed FDAMA (Pub. L. 105-115) into law. FDAMA made amendments to the Federal Food, Drug, and Cosmetic Act (the act). In particular, sections 304 and 303 of FDAMA amended section 403(r)(2) and (r)(3) of the act by adding new paragraphs (r)(2)(G), (r)(2)(H), (r)(3)(C), and (r)(3)(D) to section 403 of the act (21 U.S.C. 343(r)(2)(G), (r)(2)(H), (r)(3)(C), and (r)(3)(D), respectively). These new paragraphs provide for the use in food labeling of nutrient content claims and health claims, respectively,