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**SUPPLEMENTARY INFORMATION:** On August 2, 1995, an NPRM was published in the **Federal Register** proposing to amend 14 CFR part 71 to realign three Federal airways located in Colorado. No comments were received on the proposal.

The FAA has decided to withdraw the proposal at this time because the flight check revealed that the proposed airways would not meet FAA criteria for such routes.

#### List of Subjects in 14 CFR Part 71

Airspace, Incorporation by reference, Navigation (air).

#### Withdrawal of the Proposed Rule

In consideration of the foregoing, the Notice of Proposed Rulemaking, Airspace Docket No. 95-ANM-3, as published in the **Federal Register** on August 2, 1995 (60 FR 39280), is hereby withdrawn.

**Authority:** 49 U.S.C. 106(g), 40103, 40113, 40120; E.O. 10854, 24 FR 9565, 3 CFR, 1959-1963 Comp., p. 389.

Issued in Washington, DC, on July 15, 1998.

**Reginald C. Matthews,**

*Acting Program Director for Air Traffic Airspace Management.*

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## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Part 30

#### Concept Release on the Placement of a Foreign Board of Trade's Computer Terminals in the United States

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Request for comment.

**SUMMARY:** The Commodity Futures Trading Commission ("CFTC" or "Commission") is publishing this release to solicit the views of the public on how to address issues related to the placement by foreign boards of trade of computer terminals in the U.S. that would be used for the purpose of facilitating the trading of products available through those boards of trade. The Commission's staff has received requests for no-action positions and other inquiries regarding the Commission's regulatory treatment with respect to foreign board of trade computer terminals placed in the U.S. In general, these boards of trade, their members or their members' affiliates

have sought confirmation from the Commission's staff that the placement and usage of trading terminals in U.S. offices of foreign board of trade members and/or their affiliates would not require the foreign board of trade to be designated as a "contract market" under the Commodity Exchange Act ("Act"). In light of a significant increase in these types of requests, the Commission believes that it is appropriate to address the subject by way of the notice and comment rulemaking process. The Commission intends to propose rules and ultimately to adopt rules to govern the treatment of foreign terminals in the U.S. Toward this end, the Commission believes that it is appropriate first to issue this concept release to solicit public comment regarding issues raised with respect to foreign terminal placement and usage in the U.S.

**DATE:** Comments must be received on or before September 22, 1998.

**ADDRESSES:** Comments on the proposed rules should be sent to Jean A. Webb, Secretary of the Commission, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 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 "Foreign Board of Trade Terminals."

**FOR FURTHER INFORMATION CONTACT:** I. Michael Greenberger, Director, David M. Battan, Chief Counsel, Lawrence B. Patent, Associate Chief Counsel, or Lawrence T. Eckert, Attorney Advisor, Division of Trading and Markets, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 20581. Telephone (202) 418-5450.

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#### I. Background

In general, under Section 4(a) of the Act,<sup>1</sup> a futures contract may be traded lawfully in the U.S. only if it is traded on or subject to the rules of a board of trade that has been designated as a "contract market" under Section 5 of the Act,<sup>2</sup> unless the contract is traded on or subject to the rules of a board of trade, exchange or market located outside the U.S.<sup>3</sup> or is exempted from the Act. With respect to the regulation of transactions involving foreign futures,<sup>4</sup> Section 4(b) of the Act permits the Commission to regulate persons who offer or sell futures, but prohibits the Commission from adopting any rule or regulation that: (1) Would require Commission approval of any foreign board of trade contract, rule, regulation or action; or (2) governs any rule, contract term or action of a foreign board of trade.<sup>5</sup>

<sup>1</sup> 7 U.S.C. 6(a) (1994).

<sup>2</sup> 7 U.S.C. 7 (1994). Section 5 of the Act authorizes the Commission to designate any board of trade as a contract market provided that the board of trade complies with certain conditions and requirements set forth in the Act.

<sup>3</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, 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; [and]

(2) such contract is executed or consummated by or through a member of such contract market[.]

<sup>4</sup> The Commission has defined the terms "foreign futures" and "foreign options" in Rules 30.1 (a) and (b). Commission rules cited herein can be found at 17 CFR Ch. I (1998).

<sup>5</sup> Section 4(b) of the Act states in pertinent part:  
 The Commission may adopt rules and regulations proscribing fraud and requiring minimum financial standards, the disclosure of risk, the filing of

Significant developments in technology in recent years have now made automated trading methods an attractive addition or alternative to traditional open outcry for trading of commodity futures and option products on or subject to the rules of foreign and domestic boards of trade. Automated trading systems make it possible to execute trades on computer terminals within the U.S., no matter where the central computer is located, thus providing U.S. customers with a potential additional means of access to foreign products. Additionally, systems have been developed that enable customer orders to be submitted electronically to an FCM and then routed for execution on a foreign board of trade with little or no human intervention by a member of the foreign board of trade. These technological advances raise myriad issues concerning the use of these technologies. In this regard, a variety of issues has arisen concerning the degree to which a foreign board of trade's cross-border trading activities in the U.S. are subject to Commission regulation. Specifically, at what point does a foreign board of trade's presence within the U.S. become indistinguishable from that of a U.S. board of trade? Put another way, when should a board of trade be deemed to be a U.S. board of trade that is required to be designated as a contract market under Section 5 of the Act in order to offer its products lawfully within the U.S.? Should the Commission permit foreign boards of trade to place dedicated computer terminals in the U.S., or permit foreign boards of trade or their parties to provide persons in the U.S. with computer software that provides electronic access to a foreign board of trade, without the foreign board of trade first being designated as a U.S. contract market?<sup>6</sup> To the extent that "terminals" of foreign boards of trade

reports, the keeping of books and records, the safeguarding of customers' funds, and the registration with the Commission by any person located in the U.S., its territories or possessions, who engages in the offer or sale of any contract of sale of a commodity for future delivery that is made or to be made on or subject to the rules of a board of trade, exchange or market located outside the United States, its territories or possessions. . . . No rule or regulation may be adopted by the Commission under this subsection that (1) requires Commission approval of any contract, rule, regulation, or action of any foreign board of trade, exchange or market, or (2) governs in any way any rule or contract term or action of any foreign board of trade, exchange or market.

<sup>6</sup> A discussion concerning how to define "computer terminal" or some similar term is found at Section II.B.1. below, and makes clear that the Commission would intend this term (and this release) to cover not only dedicated proprietary terminals, but also certain other technologies that are used in a similar manner.

are allowed to be placed in the U.S. for trading without the foreign board of trade being designated as a contract market, what conditions should apply? And finally, with respect to the interface with foreign board of trade terminals, to what extent should customer use of automated order routing and execution systems be permitted and what safeguards, restrictions and conditions should apply to their use?

As described below, certain Commission staff have addressed some inquiries concerning electronic access to foreign boards of trade from within the U.S. by way of no-action letters. These staff letters do not constitute Commission action and do not establish any precedent. They merely convey the views of certain staff members that they will not urge the Commission to take enforcement action for violation of the Act or Commission regulations by the requestor of the letter if certain conditions are met. The Commission is free to act contrary to the views expressed by staff in such letters. The Commission now finds it appropriate to review the views set forth by certain Commission staff in these letters and to seek public comment on the proper approach for oversight going forward. The Commission desires to act as quickly as practicable in this regard and, accordingly, intends to adhere strictly to the 60-day comment period provided for in this release.

#### *A. Prior Views of Certain Commission Staff Concerning Terminal Placement in the U.S.*

##### **1. Prior Staff Views Related to Listing Products of Foreign Boards of Trade on Globex**

The first two letters issued by Commission staff that addressed issues concerning automated trading in the U.S. by foreign boards of trade involved trading through the Chicago Mercantile Exchange ("CME") Globex system ("Globex").<sup>7</sup> The first letter was a response to a request from the CME for an opinion regarding whether trading contracts of a foreign board of trade through Globex computer terminals in the U.S. required the foreign board of trade to obtain contract market designation pursuant to Section 5 of the Act ("CME Letter").<sup>8</sup> In the CME Letter, the Commission's Division of Trading and Markets ("Division") noted that,

<sup>7</sup> Globex is an automated order entry and matching system for futures and options on futures. See note 25, *infra*, and accompanying text.

<sup>8</sup> See Letter from Andrea M. Corcoran, Director, Division of Trading and Markets, to Carl Royal, Vice President and General Counsel, CME (May 26, 1989).

consistent with Section 4(b) of the Act, the Commission has not issued rules governing the terms and conditions of contracts traded on foreign boards of trade or the rules or actions of foreign boards of trade. The Division provided its view that trading of contracts of foreign boards of trade through Globex terminals in the U.S. should not cause the Commission to deem any foreign board of trade for which products are listed through that system to be a domestic board of trade. The Division noted, however, that it would review the particulars of any proposal to trade the contracts of a foreign board of trade through Globex in light of the Commission's obligations under the Act to maintain the integrity of U.S. markets and to provide for the protection of U.S. customers.<sup>9</sup>

The Division issued a second letter on related issues to the *Marché à Terme International de France* ("MATIF") in response to MATIF's request that the Commission confirm that it would not assert jurisdiction over MATIF or MATIF contracts traded on Globex ("MATIF Letter").<sup>10</sup> In its response, the Division, among other things, reiterated its view that the mere trading of foreign board of trade products through Globex terminals in the U.S. should not cause any foreign board of trade for which products are listed through the Globex system to be deemed a domestic board of trade.<sup>11</sup>

<sup>9</sup> In a later no-action position, the Division also granted the CME and Chicago Board of Trade ("CBT") so-called "pass the book" relief, which allows CME and CBT member firms the flexibility to provide continuous access to Globex trading without the need for members to staff their offices 24 hours a day. The letter permits CME and CBT member firms to conduct Globex-related U.S. customer business through the offices of a foreign affiliate without requiring the foreign affiliate to register separately with the Commission as a futures commission merchant ("FCM"). Thus, CME contracts may be traded on Globex terminals located in non-U.S. offices of foreign affiliates of FCM-registered CME members, and U.S. customers may place orders for such contracts on Globex by contacting the FCMs' affiliates during hours that the CME floor is closed. The term "passing the book" is used to describe the process by which a customer order that is placed outside of regular U.S. business hours is transferred for entry into a Globex terminal located in a non-U.S. office of a foreign affiliate of an exchange member firm. CFTC Interpretative Letter No. 92-11, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,325 (June 25, 1992), *superseded in part by* CFTC Interpretative Letter No. 93-83, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,849 (Aug. 9, 1993).

<sup>10</sup> See Letter from Andrea M. Corcoran, Director, Division of Trading and Markets, to Gerard Pfauwadel, President, MATIF (May 7, 1990).

<sup>11</sup> The Commission later approved a formal cross-exchange access program between CME and MATIF. The Commission's approval of the CME/MATIF cross-exchange access program and other "trading link" programs is discussed in Section I.B. below.

## 2. Prior Staff Views Concerning the Placement of Foreign Board of Trade Terminals in the U.S.

The Deutsche Terminbörse ("DTB")<sup>12</sup> was the first foreign board of trade to seek and receive a staff no-action letter for U.S. placement of computer terminals for execution of trades on its market. The DTB sought a no-action position from Commission staff regarding placement of DTB computer terminals in the U.S. offices of its members for their principal trading purposes<sup>13</sup> and, where the DTB member is also an FCM registered under the Act, on behalf of U.S. customers as well, without obtaining designation as a contract market. After analyzing, among other things, the German regulatory structure and DTB's order processing network, clearing process and trading system integrity and architecture, the Division issued a no-action letter subject to the following conditions imposed upon DTB and their U.S.-located members who seek to place terminals in their offices.<sup>14</sup>

1. DTB terminals will be located only in the U.S. offices of DTB members;

<sup>12</sup> On June 18, 1998, DTB changed its name to Eurex Deutschland as a step toward a planned merger later this year with the Swiss Options and Financial Futures Exchange ("SOFFEX"). For the sake of historical accuracy and simplicity we will continue to refer to the DTB in this release.

The DTB is headquartered in Frankfurt, Germany, and is a fully automated international futures and option exchange on which all trades are executed and cleared electronically. Trading is conducted solely via computer terminals. The market participants' computers and terminals are linked to the DTB computer center by means of a wide-ranging telecommunications network. As noted above, DTB and SOFFEX plan to merge to create Eurex AG. Further, CBT, DTB and SOFFEX have signed a letter of intent to form an electronic trading link between CBT and Eurex with the eventual goal of providing users of Eurex and Project A (the CBT's adjunct electronic trading system, discussed in Section I.C. below) with access to both markets from a single screen.

<sup>13</sup> A "principal" trade under DTB rules is limited to a trade made by a DTB member for its own account. DTB's definition of "principal" is narrower than the definition of "proprietary" in Commission Rule 1.3(y). A proprietary trade under Commission rules would include not only trades of board of trade members for their own accounts, but also those made by certain members' affiliates and insiders for the their respective accounts.

<sup>14</sup> See CFTC Interpretative Letter No. 96-28, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,669 (Feb. 29, 1996). The Division's letter did not alter DTB's obligations to: (a) request a no-action position from the Commission prior to engaging in the offer or sale of any foreign stock index futures in the U.S.; or (b) have any foreign debt obligation first designated as an "exempt security" by the Securities and Exchange Commission ("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.

2. Only DTB members that also are U.S.-registered FCMs may trade for customers—non-FCM DTB members are limited to principal-only trading;

3. DTB members will (a) provide the Commission and the National Futures Association ("NFA") with access to their books and records and the premises where DTB terminals are installed, and (b) consent to U.S. jurisdiction with respect to compliance with relief provided in the no-action letter;

4. All DTB members that will operate pursuant to the relief granted will be identified to the Commission and NFA;

5. Upon request, DTB (a) will provide the Commission with information received from its members regarding the location of DTB terminals in the U.S. and (b) will update the information on a periodic basis;

6. DTB will continue to comply with the International Organization of Securities Commissions ("IOSCO") "Principles for Oversight of Screen-Based Trading Systems for Derivative Products";<sup>15</sup>

7. DTB will submit on at least a quarterly basis information reflecting the volume of trades from U.S.-based computer terminals compared to DTB's overall trading volume; and

8. DTB will provide the Division with prompt notice of all material changes to any DTB rules or German laws that may impact the provided relief.

In analyzing DTB's no-action request, the Division reiterated the positions set forth in the Globex letters discussed

<sup>15</sup> The Commission has adopted principles formulated by a working group of IOSCO for the regulatory review of automated trading systems. 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 in place 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 Policy Statement Concerning the Oversight of Screen-Based Trading Systems, 55 FR 48670 (Nov. 21, 1990), in which the Commission adopted the principles set forth in the IOSCO report entitled "Screen-Based Trading Systems for Derivative Products" (June 1990).

above. The Division concluded that no public interest would be affected adversely by DTB members having access to DTB terminals in the U.S. because (1) no customer trading would be permitted from U.S.-based terminals unless the DTB member firm is registered as an FCM and (2) the Commission's ability to inspect relevant books and records and the premises where DTB terminals are installed, in combination with information-sharing assurances received from the German Federal Securities Supervisory Office ("BAWe"),<sup>16</sup> provided an adequate basis for supervision of such trading. The Division noted that the DTB and/or the relevant German state or federal regulatory authorities have rules, systems, and compliance mechanisms in place that address, among other things, the processing of orders, including prioritization and execution (*i.e.*, DTB's order execution algorithm), and the timely availability of information necessary to conduct adequate surveillance of the DTB system for supervisory and enforce purposes.<sup>17</sup> Further, DTB members located in the U.S. are permitted to enter trades for, and access trading screens of, only those contracts permissible for trading by U.S. persons.<sup>18</sup> Finally, the Division also emphasized the importance of DTB's agreement to provide information to the Commission concerning the location of terminals in the U.S. and the volume of trades originating from the U.S.

The no-action position taken in the DTB letter was based upon, among other things, the premise that the DTB is a "bona fide foreign board of trade" whose main business activities take place in Germany. By conditioning its letter on the DTB providing the Division with quarterly updates of DTB's U.S.-originated trading volume, the Division intended to leave open the possibility that at some point DTB's activities in the U.S. might rise to a level that would necessitate greater Commission regulation.

The initial DTB no-action letter was modified in a no-action letter to the DTB dated, May 9, 1997, in which the Division agreed not to recommend Commission enforcement action if DTB terminals

<sup>16</sup> The BAWe carries out oversight of the German securities and futures markets pursuant to the German Securities Trading law and is the central authority in Germany for cooperation with the Commission in questions of futures trading oversight and in matters that are subject to the oversight of the German Federal States.

<sup>17</sup> In this regard, DTB terminals located in the U.S. have a systems capability to "time stamp" the execution of customer orders so that an electronic "audit trail" is maintained.

<sup>18</sup> See note 14, *supra*.

were placed in DTB member firm booths at the CME, subject to compliance with the terms and conditions of the original DTB letter.<sup>19</sup> Under the May 1997 letter, no enforcement action would be recommended if DTB terminals are placed only at booths of firms that are both CME and DTB members; only DTB contracts authorized or permissible for trading by U.S. persons are eligible to be traded from the terminals; no CME contracts are traded via the terminals; and CME has no involvement in clearance or settlement of the contracts. Currently, there are no terminals in DTB member firm booths at the CME.

Pursuant to the DTB no-action letters, if a DTB member located in the U.S. wishes to install a DTB terminal in its office, the DTB itself must make a written filing to the NFA on behalf of that member. The DTB makes this filing after a DTB member applies to the DTB to place a DTB terminal in the U.S. The filing identifies the member that intends to operate a DTB terminal in the U.S. and includes: (1) A Declaration signed by the member whereby the member declares that it acknowledges (a) the terms and conditions of the division's no-action letter and that it will comply therewith and (b) its obligation to inform DTB in writing of any changes regarding its DTB membership or the placement of DTB terminals in the U.S.; and (2) an Acknowledgment of Jurisdiction signed by the member whereby the member acknowledges that (a) for purposes of the DTB no-action letter it is subject to the Act and the Commission's regulations thereunder, (b) it will provide upon request prompt access to original books and records and the premises where DTB terminals are installed in the U.S., and (c) the person signing the Acknowledgment on behalf of the member is duly authorized to do so. Under the terms of the Division's no-action letter, the DTB member may begin trading on its U.S.-based DTB terminal five business days after the DTB member is identified to the NFA unless NFA or the Division informs DTB otherwise. The DTB does not inform the member of the approval of its application until the five-day period has passed.

### *B. Commission Approval of the Trading of Products of Foreign Boards of Trade in the U.S. Pursuant to Trading Link Programs*

As noted above, the Division issued the MATIF Letter which, among other things, enunciated the Division's view

<sup>19</sup>See Letter from Andrea M. Corcoran, Director, Division of Trading and Markets, to Volker Potthoff, Senior Vice President and Dr. Ekkehard Jaskulla, Deutsche Borse AG (May 9, 1997).

that the trading of MATIF products through Globex terminals in the U.S. should not cause MATIF to be deemed a domestic board of trade. After the issuance of the MATIF Letter, the Commission approved a formal cross-exchange access program between CME and MATIF previously submitted by CME, which allows CME and MATIF members to enter orders through Globex terminals located in the U.S. and France, respectively, to buy and sell each other's products.<sup>20</sup> Under the program, the rules of the exchange whose products are traded apply to the members of the other exchange when they trade those products. Accordingly, CME members trading MATIF contracts through Globex terminals located in the U.S. are subject to MATIF's Globex trading rules, while MATIF members trading CME contracts through Globex terminals located in France are subject to CME's Globex trading rules.

In approving the CME-MATIF proposal, the Commission evaluated MATIF's Globex trading rules, CME and MATIF rules regarding member eligibility to participate in the cross-exchange program, how each exchange would monitor its members in trading the other exchange's contracts, and the market surveillance and financial and sales practice rules that would apply in each instance.<sup>21</sup> The Commission noted and relied on the fact that MATIF'S Globex trading rules governing trading of MATIF contracts are generally the same as the CME's Globex trading rules. Accordingly, all market participants trading MATIF contracts through Globex are subject to the same trading rules whether they are CME members or MATIF members.

Pursuant to its regulatory authority, the Commission also approved last year a reciprocal trading link between the CBT and the London International Financial Futures and Options Exchange ("LIFFE").<sup>22</sup> The parties to this linkage have determined not to operate the linkage at this time, but the

<sup>20</sup>The Commission took this action pursuant to the regulatory authority provided under Section 5a(12), now Section 5a(a)(12)(A), of the Act. See Letter from Jean A. Webb, Secretary of the Commission, to Eileen T. Flaherty, Associate General Counsel, CME (Sep. 25, 1992).

<sup>21</sup>The responsibility for enforcing each exchange's Globex trading rules is shared between the two exchanges. Surveillance for compliance with these rules by those trading over the Globex terminals is the responsibility of the exchange whose contracts are traded. Each exchange continues to carry out its own market surveillance activities for all its contracts traded on a terminal, and each exchange's members continue to be subject to their respective exchange's financial and sales practice requirements.

<sup>22</sup>See Letter and Order from Jean A. Webb, Secretary of the Commission, to Paul J. Draths (May 6, 1997).

Commission's evaluation of the proposal remains illustrative of the Commission's standards and requirements for link arrangements which allow products of foreign boards of trade to be traded in the U.S. Under the CBT-LIFFE trading link, each exchange can list the other's major financial futures and option contracts for trading on its floor by open outcry during regular trading hours. In evaluating this trading link, the Commission compared the trading rules and member eligibility rules of LIFFE with those of the CBT and analyzed the manner in which surveillance and investigations related to contracts traded over the link could be implemented effectively at each board of trade. The Commission approved this trading link under the condition, *inter alia*, that LIFFE-designated contracts traded on CBT be subject to CBT rules.

The Commission also has approved other trading arrangements commonly referred to as trading links whereby products of U.S. designated contract markets can be traded through automated trading system terminals located in foreign jurisdictions.<sup>23</sup> These arrangements do not, however, allow the trading of the foreign exchanges' products in the U.S.<sup>24</sup>

### *C. Foreign Regulators' Treatment of U.S. Terminals in Their Jurisdictions*

Several U.S. futures exchanges have developed automated trading systems for exchange members and their customers to trade in certain of the exchanges' futures and options contracts after regular trading hours. The CME's Globex system, for example, is an electronic trade execution system developed by the CME and Reuters for trading CME contracts, generally outside regular business hours.<sup>25</sup> Globex brings

<sup>23</sup>In 1995, the New York Mercantile Exchange ("NYMEX") established a linked access arrangement with the Sydney Futures Exchange ("SFE") and linked SFE terminals located in Sydney to the NYMEX ACCESS trading system. In 1997, a linked access arrangement between NYMEX and the Hong Kong Futures Exchange ("HKFE") permitted HKFE members to trade NYMEX contracts on NYMEX ACCESS terminals located in Hong Kong.

<sup>24</sup>These arrangements are referred to in Section I.C., below, which discusses foreign regulators' treatment of U.S. terminals placed in their jurisdictions. See note 27, *infra*.

<sup>25</sup>Although the Globex system originally was intended as an after-hours system for trading products otherwise traded on the floor of the CME, the CME now trades E-mini Standard and Poor's 500 contracts both on Globex and on the floor of the CME, depending upon the size of the order, during regular trading hours. The CME recently announced that it intends to launch a new electronic trading system, "GLOBEX2," in September 1998 in a joint venture with MATIF. GLOBEX2 will use a new system architecture that will replace that currently used by the Globex system.

buy and sell orders together by linking individual terminals to a central computer where orders are processed. NYMEX and the CBT also have developed automated trading systems, known as NYMEX ACCESS and Project A, respectively.<sup>26</sup>

CME, NYMEX A and CBT each have computer terminals located in certain foreign countries on which trading for foreign firms and customers is conducted.<sup>27</sup> CME Globex terminals are located abroad in the offices of both CME members and offshore affiliates of those members. Similarly, NYMEX ACCESS terminals are located in offices of NYMEX members and affiliates thereof. The CBT Project A terminals in the U.K. are located in branch offices of CBT members and in the offices of affiliates of CBT members. CBT, NYMEX and CME permit users of their terminals in foreign countries to trade for both proprietary and customer accounts.

Foreign jurisdictions vary in their approaches to reviewing requests by U.S. boards of trade to place computer terminals in their countries. A non-U.K. board of trade that wishes to place computer terminals in the U.K., for example, must first become a "recognised overseas investment exchange" ("ROIE") under Section 40 of the Financial Services Act ("FSA").<sup>28</sup> Under the FSA, an application by a non-

U.K. board of trade for treatment as an ROIE is reviewed to ensure, among other things, that: (1) Investors in the U.K. are afforded protections at least equivalent to those provided by the FSA for customers trading on or subject to the rules of U.K. boards of trade; (2) the applicant is willing to cooperate by sharing information with U.K. regulators; and (3) adequate arrangements exist for information sharing between the applicant's regulator and U.K. regulators. The FSA also provides that, in determining whether it is appropriate to "make a recognition order," a relevant consideration is the extent to which persons in the U.K. and the country of the applicant have access to each other's financial markets.

The procedures for approval of U.S. board of trade terminal placement appear somewhat less formal in other foreign countries, although each jurisdiction appears to require some form of review by the jurisdiction's regulatory authorities prior to allowing a U.S. board of trade to place computer terminals in its country. Australia and Hong Kong, for example, appear to require foreign boards of trade to be approved through an exemption process.<sup>29</sup> In France, the placement of terminals must be recognized by the Ministry of Finance. Prior to installing terminals, the Commission des Opérations de Bourse ("COB") must be informed of the dates that screens will be installed and the location of their intended installation. Additionally, a foreign firm operating a terminal must comply with French rules governing disclosure and solicitation of the public. In Japan, approval by the Ministry of Finance is necessary before trading may take place through "foreign screen-based systems."<sup>30</sup>

#### *D. Order Routing and Execution of U.S. Customers Order on a Foreign Board of Trade*

In developing the Commission's policy with respect to the treatment of

foreign board of trade computer terminals in the U.S., it is helpful to review the basic methods by which a U.S. customer traditionally placed orders for products offered on a foreign board of trade where computer terminals of that exchange were not located within the U.S.

U.S. customers traditionally have transacted business on a foreign board of trade by way of: (1) Communicating through a U.S.-registered FCM or IB; or (2) communicating with a foreign firm that has received an exemption from registration under Part 30 of the Commission rules.<sup>31</sup> U.S. customers traditionally have placed orders via the telephone. In the case of a communication from a U.S. customer to a U.S.-registered FCM or IB, the FCM or IB generally would relay the customer's order for execution to a foreign member of the foreign board of trade by telephone or other means (e.g. facsimile transmission). The trade would be carried on the books of the foreign firm on an omnibus basis.<sup>32</sup> If the U.S. customer communicated directly with a foreign firm with a Part 30 exemption, the foreign firm simply would execute the customer's trade either electronically or on the floor of an exchange, as appropriate. With advances in available technology, many intermediaries are implementing automated order routing systems that allow customers electronically to submit their orders and that are intended to pass these orders to a board of trade with minimal, if any, human intervention. Issues concerning such automated systems are discussed in Section II. C. 2., below.

#### **II Request for Comment**

The Commission solicits comment from the public on the broad range of issues related to providing electronic access to a foreign board of trade from within the United States. The Commission notes that any action taken

<sup>26</sup> Certain CBT contracts initially were listed for trading on Globex. However, CBT later withdrew from participation in the Globex system to develop its own automated trading system, Project A.

<sup>27</sup> As of the beginning of 1998, the CME had placed Globex terminals in the U.K., Hong Kong, Japan, France and Bermuda, NYMEX ACCESS terminals were located in Australia, Hong Kong and the U.K., and CBT's Project A terminals were located in the U.K.

In certain cases, a board of trade in the foreign jurisdiction in which U.S. terminals are located has formal business agreements or arrangements with the U.S. exchange that has placed terminals in that country. For example, agreements exist between NYMEX and the SFE and the HKFE, respectively, which permit SFE and HKFE members to trade products on NYMEX ACCESS. Likewise, there is an agreement in effect between the CME and MATIF that permits, under certain circumstances, each exchange to trade the contracts of the other through Globex. As discussed above, the Commission has approved the necessary CME and NYMEX rule changes enabling these agreements and has permitted the trading arrangements proposed by these exchanges, subject to certain conditions. See Letters from Jean A. Webb, Secretary of the Commission, to Ronald S. Oppenheimer, Esq., Executive Vice President and General Counsel, NYMEX (June 5, 1997); Letter from Jean A. Webb, Secretary of the Commission, to Ronald S. Oppenheimer, Esq., Executive Vice President and General Counsel, NYMEX (Sep. 1, 1995); Letter from Jean A. Webb, Secretary of the Commission, to Eileen T. Flaherty, Associate General Counsel, CME (Sep. 25, 1992).

<sup>28</sup> CME, NYMEX and CBT were designated as ROIEs prior to placing computer terminals in the U.K.

<sup>29</sup> On August 30, 1995, the Australian Federal Attorney General signed a Declaration exempting NYMEX ACCESS from regulation under the Australian Corporations Law, subject to certain conditions pertaining primarily to information sharing between the SFE and NYMEX and disciplinary procedures for breaches of NYMEX ACCESS trading rules. With respect to the placement of Globex and NYMEX ACCESS terminals in Hong Kong, the Hong Kong Securities and Futures Commission requested that it be kept informed with respect to operations of terminals with Hong Kong dealers and requested information-sharing arrangements with the CME and NYMEX.

<sup>30</sup> The Japanese Ministry of Finance informed the CME of its approval with respect to the placement of Globex terminals in Japan by letter to the CME on February 8, 1993.

<sup>31</sup> In general, under the Commission's Part 30 rules, foreign brokerage firms may be exempted from the registration requirements of the Act provided that the Commission determines that the firm is subject to comparable rules and regulations in its home country. 17 CFR part 30.

<sup>32</sup> If contact with U.S. customers is limited to carrying the customer omnibus account of the U.S. FCM for execution on the foreign exchange, the foreign firm would not be required to register with the Commission as an FCM or receive an exemption under Part 30. See CFTC Interpretative Letter No. 87-7 [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,972 (Nov. 17, 1987).

in this area must ensure the Commission's ability to carry out its obligations under the Act to maintain the integrity of the U.S. markets and to provide protection to U.S. customers. At the same time, the Commission believes that its regulatory approach should not inhibit cross-border trading by imposing unnecessary regulatory burdens.

As a means of raising relevant issues and facilitating a discussion thereon, this concept release provides a framework that may form the basis for a later rulemaking. For example, Division staff has explored the possibility of a new rule that might be included among the Commission's Part 30 rules (concerning foreign futures and options transactions) and could implement a two-step procedure similar in some respects to that currently in effect under Rule 30.10 with respect to foreign firms that wish to obtain an exemption from compliance with the Commission's part 30 regulations.<sup>33</sup>

Under the potential procedure envisioned by the Division, a foreign board to trade initially would petition the Commission for an order to place its computer terminals in the U.S. without being designated as a U.S. contract market. If the Commission issued the requested order, a member of the board of trade or an affiliate of a member would then be permitted to request confirmation of relief under the order to allow the member or affiliate to place and to operate a foreign board of trade computer terminal in the U.S., subject to appropriate conditions contained in the order. The remainder of the concept release describes this potential approach more fully and raises a variety of issues

<sup>33</sup> Commission Rule 30.10 is an exemptive provision that allows the Commission to exempt foreign firms from the application of certain CFTC rules and regulations (e.g., those governing registration and financial requirements) based upon substituted compliance by a firm with comparable regulatory requirements imposed by the firm's home-country regulator. 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 order 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 U.S.; (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 arrangements. 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 U.S. See orders of October 28, 1992 and August 4, 1994. 57 FR 49644 (Nov. 3, 1992) and 59 FR 42156 (Aug. 17, 1994), respectively.

concerning foreign board of trade terminal placement and use in the U.S. generally. The following discussion assumes that a foreign board of trade wishes to place computer terminal in the U.S. without being designated as a contract market. Any foreign board of trade, of course, may apply for designation as a U.S. contract market and, upon the Commission's approval of such designation, may offer its products in the U.S. subject to rules for U.S. contract markets.

#### *A. A Possible Approach for Foreign Terminal Placement and Use in the U.S.*

##### 1. Petition Procedure

As noted above, under the possible approach envisioned by Division staff, a foreign board of trade would be required to petition for an order that would allow the foreign board of trade to place its computer terminals in the U.S.<sup>34</sup> In evaluating DTB's request for a no-action position to allow it to place computer terminals in the U.S., the Division reviewed, among other things the following information provided by the DTB: (1) An overview of the DTB, including the regulatory structure applicable to the operation of the DTB and transactions thereon; (2) a description of the order processing network utilized by the DTB; (3) a description of the DTB's clearing process; (4) a description of the system integrity and architecture of the DTB system, including security arrangements and procedures regarding system failures; and (5) a description of the contracts which initially were to be traded on the DTB through computer terminals located in the U.S. and a discussion of the rules and regulations governing such contracts.<sup>35</sup> The Commission's petition procedure could set forth a specific list of items, similar to the information reviewed as part of the DTB's no-action request. The Commission could review all of the information received from each petitioner and, based upon the totality of the information received, make a

<sup>34</sup> Given the type and scope of information concerning the foreign board of trade and its operations that likely would be required to be provided to the Commission in a petition, it would be most appropriate for the foreign board of trade itself to submit such a petition. However, the Commission requests comment as to whether it would be feasible and appropriate to allow the petition to be submitted on behalf of the foreign board of trade by a member of the foreign board of trade or an affiliate thereof or by the foreign board of trade's foreign regulatory authority.

<sup>35</sup> Requirements with respect to the offer and sale of foreign stock index futures and futures and option contracts on foreign debt obligations would still be applicable if the Commission were to adopt the procedure outlined herein. See also, note 14, *supra*.

determination as to whether an order of exemption should be issued. Under such an approach no particular piece of information would necessarily be dispositive. The Commission could publish petitions in the **Federal Register** for public comment.<sup>36</sup> The Commission requests comment as to whether specific tests should be used to evaluate each required item of information rather than reviewing all of the information based upon a "totality of the circumstances." If so, what tests are appropriate for each category of information discussed below?

Six general categories of information might be requested.<sup>37</sup> (1) General information concerning the petitioner foreign board of trade 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 petitioner's technological system and standards; (4) financial and accounting information pertaining to the petitioner; (5) information concerning the ability of U.S. boards of trade to place and operate computer terminals in the petitioner's home country; and (6) information concerning the petitioner's intended U.S. activities and presence. More specifically, the first category of information discussed above (general information concerning the petitioner and its products) could include information such as the petitioner's main business address, its address in the U.S. for service of process, a copy of the petitioner's organizational documents and a list of the contracts that the petitioner desires to trade in the U.S. through its terminals.

The next category of information concerning the regulatory requirements of the petitioner and its home regulatory authority might include: (1) A copy of the petitioner's rules; (2) a list of the persons responsible, and the supervisory arrangements in place, for monitoring compliance with respect to those rules of the petitioner that apply to activities conducted in the U.S.; and (3) a comprehensive discussion of the regulatory structure in the petitioner's home country. This last point might include information on the following: (a) the regulatory authorities to which the petitioner is subject in its home

<sup>36</sup> The Commission could, upon the request of a petitioner, limit the public availability of information if it determined that such information constituted a trade secret or that public disclosure would result in material competitive harm to the petitioner.

<sup>37</sup> Information requested would be required to be translated into English where appropriate.

country and the petitioner's status under the laws of the country; (b) applicable requirements established by law or by regulatory and self-regulatory authorities in the petitioner's home country regarding the protection of customer funds (including in the event of insolvency), recordkeeping, reporting, timing of transactions, allocation of orders, ability to obtain the identity of customers, including rules concerning entry of account numbers, and trade practice standards, including any rules concerning prearranged trading, noncompetitive trading, "frontrunning," trading ahead of customers, wash sales and bucketing of transactions; (c) procedures employed by the regulatory and self-regulatory authorities in the petitioner's home country to ensure compliance with their rules, including a history of market failures and defaults in the petitioner's home country; (d) information sharing arrangements 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 which might impair the Commission's ability to obtain information under such an arrangement; and (e) a discussion of any disciplinary action taken against the petitioner by its home country regulatory authorities. For petitioners that have received an exemption under Commission Rule 30.10 or petitioners from a jurisdiction where another entity has received such an exemption, providing the information discussed above concerning the petitioner's home country regulatory requirements would likely prove duplicative in some respects. The Commission requests comment generally on means by which the Commission could prevent unnecessary duplication of information.

Information concerning technological systems and standards of the petitioner might include a discussion of the order processing system, its system integrity and architecture and its clearing and settlement process. A discussion of the order processing system might include, among other things, a complete discussion of the order execution algorithm for each contract traded (to the extent the algorithm differs by contract). The discussion of the system integrity and architecture might include, for example, the location of computer servers (if appropriate), information concerning the processing time for executed transactions, security arrangements and procedures regarding system failures that govern U.S.-placed computer terminals, including a

discussion of liability for market interruptions, and a discussion as to whether these features and procedures differ (and, if so, how they differ) from those used in the petitioner's home country or on petitioner's computer terminals located in other countries, if any.

General financial information and trading volume data might include 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). The Commission requests comment generally as to what types of trading volume information are maintained by foreign boards of trade and how volume is calculated. More specifically, the Commission requests comment as to whether foreign boards of trade maintain information such that it would be feasible to provide the Commission with information concerning, for each contract traded and in the aggregate, the percentage of trading volume that originates from U.S. registered FCMs, the percentage of trading volume that originates from U.S. customers, and the percentage of trading volume that originates from each other jurisdiction where trading activity occurs.

Each petitioner might be required to provide a statement from its home country regulator as to any requirements or restrictions placed by authorities in its home country on U.S. boards of trade with respect to the placement and operation of computer terminals or the sale of products in such country. If any such requirements or restrictions exist, the statement might include a description of the restrictions or regulations, be accompanied by copies of any relevant statutes or other relevant legal materials, and include a description of the application process, if any, required for a U.S. board of trade and their members or affiliates of members to place its computer terminals and/or to sell products in the petitioner's home country.

Information concerning the petitioner's U.S. activities might include, for example, information concerning the location of any office, delivery points or employees of the foreign board of trade within the U.S. and any marketing, educational or other activities in the U.S. in which the foreign board of trade engages. The Commission requests comment regarding the appropriateness of each of these items of information and encourages commenters to address what additional information might prove

valuable for the Commission to consider in evaluating a petition from a foreign board of trade to place its terminals in the U.S.

## 2. Conditions of an Order

Under Commission Rule 30.10, the Commission may, upon request, grant a petition of a foreign firm for an exemption from certain Part 30 requirements "subject to such terms and conditions as the Commission may find appropriate." In developing a rule concerning foreign board of trade terminal placement in the U.S., the Commission could reserve for itself similar flexibility to issue orders to a foreign board of trade subject to appropriate terms and conditions. Moreover, the rule could set forth certain conditions that the Commission would include, at a minimum, in each order allowing U.S. terminal placement by a foreign board of trade. The Division staff has urged that many of these conditions should be similar to those imposed upon the DTB in the Division's no-action letter, discussed above. The Commission requests comment on the following list of conditions that might be included in a Commission order:

1. Computer terminals must be located only in the offices of members of the foreign board of trade and their affiliates or in a member's or affiliate's firm booth on the floor of a U.S. board of trade;
2. Any member or affiliate thereof that executes trades under an order must be registered as an FCM unless it trades solely for its proprietary account;<sup>38</sup>
3. The foreign board of trade must notify the Commission in writing immediately of any material changes in the information provided in its petition to the Commission, in its rules, or in the laws or rules of its home country;
4. The foreign board of trade must notify the Commission immediately of any Known violations of the order, the Act, the Commission's regulations, or any other futures regulatory scheme by the board of trade or by a member of affiliate operating under a Commission order;
5. The foreign board of trade, in order to ensure compliance with the terms of the Commission's order, must conduct an on-site review of the activities of each member or affiliate operating under the order at least every two years or upon notice of a possible violation of the order.<sup>39</sup>

<sup>38</sup> "Proprietary account" as used herein has the same meaning as that contained in Commission Rule 1.3(y).

<sup>39</sup> Comment is requested on whether to permit the foreign board of trade to arrange for NFA or a U.S.



6. Satisfactory information sharing arrangements must be in effect among the appropriate regulatory authorities and the Commission;<sup>40</sup> and

7. The foreign board of trade must provide the Commission with quarterly reports indicating: (a) With respect to each contract traded through U.S. computer terminals, (i) the total trade volume, and (ii) the trade volume broken down by customer and proprietary trades; (b) with respect to each contract traded through computer terminals in other jurisdictions, the total trade volume by jurisdiction and in the aggregate; and (c) with respect to all contracts traded on the board of trade (whether traded in the U.S. or elsewhere), the total trading volume for the period and by contract.<sup>41</sup> If applicable, the foreign board of trade also would be required to provide quarterly reports indicating the stocks held as of the end of the quarter at any warehouse maintained by in the U.S. for products that require physical delivery;

In addition to the conditions discussed above, the Commission could retain the authority to condition, modify, suspend, terminate or otherwise restrict an order that it issues, as applied to a specific person operating thereunder or with respect to the order in its entirety. The Commission could then take action, for example, if the Commission determined that the foreign board of trade that received and order, or an entity operating in the U.S. based on the order, ceased to comply with a stated condition of the order or that continuation of the order would be contrary to public policy or the public interest.

### 3. Request for Confirmation of Relief from Members and Their Affiliates

Under the possible approach the Division envisions, following the

self-regulatory organization to conduct the required on-site review. The Commission also requests comment as to whether the on-site review is appropriate and, if so, whether it should be conducted more or less frequently than biennially.

<sup>40</sup>The Commission requests comment concerning whether its rules should specify particular elements that would be required to be included in a "satisfactory" information sharing arrangement and, if so, what elements are appropriate. Additionally, the Commission requests comment as to who should be a party to such an arrangement. Should the arrangement be only between the Commission and the relevant home country regulator, or should the foreign board of trade itself be a party to the arrangement?

<sup>41</sup>The Commission requests comment as to what information foreign boards of trade currently maintain concerning trading volume on a jurisdiction by jurisdiction basis and, in particular, whether foreign boards of trade currently maintain information in a manner that would enable them to provide the Commission with quarterly reports indicating the percentage of its total volume that originated from each foreign jurisdiction, whether from terminals or otherwise.

issuance of an order, an entity that desired to operate a computer terminal in the U.S. under the order would request confirmation of its ability to do so by filing a confirmation request with NFA. Such a procedure would be similar to the current procedure followed by DTB on behalf of its members that wish to install DTB terminals in the U.S. under the DTB's no-action letter.

Such a written confirmation request would be signed by a duly authorized representative of the foreign board of trade member or affiliate, and the member or affiliate would do the following: (1) Certify that it is a member or an affiliate of a member in good standing of a foreign board of trade that has received a Commission order; (2) certify that it will take reasonable precautions to safeguard access to computer terminals operated by it under the order; (3) agree to comply with all applicable conditions of the order; (4) provide the NFA with the address where computer terminals are to be kept and the number of terminals to be placed in each location;<sup>42</sup> (5) acknowledge that is subject to the jurisdiction of the Commission and the U.S. with respect to its activities related to the order; (6) agree to keep books and records in accordance with the Act and the Commission's regulations, if the member or affiliate is registered as an FCM, or in accordance with Rule 1.3 if not registered;<sup>43</sup> (7) agree to provide the Commission with prompt access to the premises where computer terminals are located;<sup>44</sup> (8) indicate what type of business it intends to operate in the U.S. and whether it will be trading for its proprietary account, for customer accounts or both (and if the person intends to engage in customer business, certify that it is or will be registered as

<sup>42</sup> Such information would be required to be updated when a change occurs. The Commission requests comment as to whether ten business days is a reasonable time period in which to update such information.

<sup>43</sup> In the case of an unregistered entity engaged only in proprietary trading, the entity could keep either its original books and records or a complete copy of its books and records in its U.S. office. However, if copies were kept rather than originals, the member or affiliate thereof would be required to: (1) state why it is necessary or beneficial to keep the originals outside the U.S.; (2) provide the address where they are kept; (3) agree to provide the books and records in the U.S. within 72 hours of a request of a Commission or NFA representative; and (4) certify that no foreign laws would prevent the Commission's inspection of the books and records.

<sup>44</sup> If the member or affiliate is a registered FCM that utilizes an automated order routing system for transmitting trades submitted electronically from customers, the FCM could be required to keep a list of the names and addresses of each customer who utilizes this system and make such list available to the Commission or a Commission representative upon request.

an FCM and acknowledge that it is subject to all applicable Commission regulations); (9) provide a description of any litigation, enforcement actions, disciplinary proceedings or other civil, criminal or administrative proceedings, within the prior five years, involving the requester or any principal of the requester (as the term "principal" is defined in Commission Rule 3.1(a), in which there was an allegation of fraud, customer abuse, or violation of applicable regulatory or board of trade requirements; (10) agree to provide NFA and the Commission with immediate written notice of any material changes in its structure, status or operations that might impact the entity's activities under the order; (11) agree to provide additional information as necessary; and (12) make any other certifications that may be required by the order. The Commission requests comment as to the appropriateness of these potential requirements. Are any of these requirements unduly burdensome? Are there any additional certifications, undertakings, or acknowledgments that the Commission should consider including?

Such a confirmation request could become effective automatically ten business days after its receipt by NFA unless the requester was notified otherwise. If contacted, the requester would have to receive written notification from the Commission or NFA prior to placing any terminals in the U.S.

### B. Definitional Issues

As discussed above, the Division envisions a regulatory approach that would provide a means for a foreign board of trade to petition the Commission to place computer terminals in the U.S. for use by its members and their affiliates. Initially, several definitional issues are raised by such an approach. For example: (a) how should the term "computer terminal" be defined? (b) where in the U.S. may computer terminals be placed; and (c) who is an "affiliate" of a foreign board of trade member? These issues are discussed individually below, and the Commission requests comment on them.

#### 1. Definition of Computer Terminal

The Commission believes that the term "computer terminal," or some similar term should be defined broadly under any rule adopted regarding foreign board of trade terminal placement in the U.S. to anticipate, to the extent practicable, the evolution of electronic trading systems. By defining such a term broadly to anticipate



changes in technology, the Commission would hope to ensure that a person could not circumvent any rules adopted by the Commission simply by contending that a particular device is not a computer terminal even though the device performs essentially the same operation. Historically, the term "computer terminal" was thought to be a dedicated proprietary computer system that provided access to a board of trade (e.g., a DTB computer terminal). This perception is rapidly changing, however, as new technologies enter the marketplace. The Commission anticipates that "computer terminal" or some similar term would be defined for purposes of proposed rules in such a way as to contemplate such changes, and would include not only proprietary computer systems, but also any other device that currently is being used or may be used in the future to provide access to a foreign board of trade in the same manner and providing the same functionality as a proprietary system. Such devices might take the form of specialized computer software, a telephonic system, or Internet access to a foreign board of trade through a personal computer, telephone or similar device which is provided in a manner that makes Internet use the functional equivalent of a proprietary terminal. The Commission requests comment as to whether a mechanism that enables a customer order to be submitted electronically to an FCM and subsequently to a foreign board of trade without the necessity for human intervention at the FCM should be considered a "computer terminal" under Commission rules.<sup>45</sup>

As new technology evolves, new types of access to foreign markets likely will develop. The Internet, which has seen tremendous growth in recent years, provides one likely source for such development.<sup>46</sup> The Commission solicits comment on what types of "computer" or other technological systems currently are in use or anticipated that could provide access to a foreign board of trade. To what extent is Internet access to foreign futures and options currently available? Is direct Internet access (i.e., not conducted through an intermediary) currently available to any foreign board of trade? To what extent is the Internet currently being used for the placement of orders

for futures and option products with U.S. or foreign FCMs? How should the Commission define "computer terminal" so as to be sufficiently inclusive?

## 2. Where May Computer Terminals Be Located in the U.S.?

The Division's approach would permit members of a foreign board of trade and members' affiliates to place computer terminals in their U.S. offices or in their firm booths on the floor of a U.S. board of trade. The Division does not currently contemplate that proposed rules would permit the installation of a foreign computer terminal that provides a customer a direct link to a foreign board of trade's floor or computer system without first flowing through a registered FCM that is a member or affiliate thereof of the foreign board of trade. Neither does the Division contemplate that the proposed rules would permit any customer to utilize a foreign board of trade's computer terminal maintained by a member of the foreign board of trade or its affiliate to achieve such direct access. The Commission requests comment as to these positions of the Division and as to what safeguards might be required to prevent improper access to a foreign board of trade's computer terminals in the U.S.

## 3. Definition of an "Affiliate" of a Foreign Board of Trade Member

The Division's approach would allow affiliates of members of a foreign board of trade to operate foreign board of trade computer terminals pursuant to a Commission Order. This position raises the issue of who is a *bona fide* affiliate of a member. Arguably, only those person who have a substantial ownership connection to a member should be permitted to have access to a foreign board of trade's U.S.-located terminals, this preventing customers from circumventing Commission rules by becoming an "affiliate" in name only. An affiliated of a foreign board of trade member for those purposes could be defined as: (1) A person that owns 50 percent or more of a member (i.e., a foreign board of trade member's parent company with an ownership interest in the member of 50 percent or more); (2) a person owned 50 percent or more by a member (i.e., a foreign board of trade member's 50 percent or more owned subsidiary); (3) a person that is owned 50 percent or more by a third person that also owns 50 percent or more of a member (i.e., a member's sister company where both the member and the sister company are owned 50 percent or more by a third person); or

(4) any person that otherwise has control, is controlled by or is owned 50 percent or more by a third person that has control of a member. The Commission requests comments as to the appropriateness of this definition. Should the Commission permit affiliates of foreign board of trade members to operate computer terminals in the U.S. absent the foreign board of trade's designation as a U.S. contract market? Is a 50 percent threshold too high or too low?

The Commission is also concerned that foreign board of trade do not create categories of membership without creating meaningful distinctions between a member of a foreign board of trade and a customer thereof. The Commission requests comment as to whether the Commission should consider imposing any requirements that would enable the Commission to ensure that a member of a foreign board of trade is a *bona fide* member. If so, what types of requirements are appropriate?

## C. Other Issues Concerning Foreign Board of Trade Terminal Placements in the U.S.

### 1. *Bona Fide* Foreign Board of Trade

The Division in the DTB letter took the position that only a *bona fide* foreign board of trade should be entitled to place and operate computer terminals in the U.S. without being designated as a contract market. At some level of U.S. activity, a board of trade can no longer claim to be a board of trade located outside the U.S. and would be required to be designated as contract market. The Division's approach describe above would establish a number of requirements that are aimed specifically at providing the Commission with initial and ongoing information concerning a foreign board of trade's U.S. presence. For example, as noted above, the Commission could receive in a petition from a foreign board of trade information concerning: (1) Any physical presence the board of trade has in the U.S.; and (2) any marketing, education or other activities that are conducted by a foreign board of trade in the U.S. or that otherwise are directed toward U.S. customers. This information could be required to be updated in the event of a material change. The Commission also could receive in a foreign board of trade's petition certain information concerning the foreign board of trade's recent trade volume originating from the U.S. and the current quantity of stocks, if any, held in any U.S.-located warehouses. Such information could be required to

<sup>45</sup> See also, discussion of automated order routing and execution issues in section II.C.2, below.

<sup>46</sup> In this regard, FutureCom, a U.S. exchange owned by the Texas Beef Trading Co., Ltd., has applied to the Commission for contract market designation. If its application is approved, FutureCom would be the first U.S. Internet-based futures and option exchange.

be provided quarterly. Information about a foreign board of trade's activities and presence in the U.S. is relevant in determining whether a board of trade should be required to be designated as a U.S. contract market. Likewise, the percentage of a foreign board of trade's volume that originates from the U.S. also is relevant in determining such questions. The Commission solicits public comment as to whether it should define in its rules the level of U.S. activity requiring contract market designation. If so, how should the level be defined? Additionally, the Commission requests comment as to any U.S. activities, other than those discussed above, that might be relevant to a determination as to whether a board of trade that desires to place its computer terminals in the U.S. is a *bona fide* foreign board of trade.

The Division's potential approach describes above also assumes that any foreign board of trade that would petition the Commission for an order under such procedures would be a *bona fide* board of trade that is subject to an established rulemaking structure. This view is in keeping with Congressional intent with respect to what is meant by the term "foreign board of trade" under the Act. In this regard, the legislative history concerning the 1982 amendments to the Act suggests that, when Congress amended the Act in 1982, it intended that the exclusion of futures contracts traded on "a board of trade, exchange or market located outside the United States" form the off-exchange ban in Section 4(a) of the Act, as well as the limitation on the Commission's regulatory authority in Section 4(b), apply only to "bona fide foreign futures contracts" traded in a regulated exchange environment.<sup>47</sup> Consistent with Congressional intent, the Commission made clear when promulgating part 30 that the part 30 rules do not permit the offer and sale in the U.S. of foreign futures or options that are not executed *on or subject to the rules of a* foreign board of trade.

## 2. Order Execution and Order Routing Issues

Technological capabilities now exist that would enable a customer, who is not a member of a foreign board of trade, to send orders to the foreign board of trade through an automated order routing system that is linked to the board of trade through a member. Through such a system, customers could place orders on the foreign board

of trade with little, if any, human intervention by the member. Execution of the customer's order could be accomplished either through the foreign board of trade's system interface or on the floor of an exchange.

To date, the Commission has not opined on the appropriateness of an FCM's use of an automated order routing system that would allow customer orders that have been submitted electronically to the FCM to be transmitted into a foreign board of trade computer system for placing orders on the foreign board of trade.<sup>48</sup> As discussed above, the Division's approach does not contemplate that the Commission's rules would permit customers to have access to "computer terminals" such that they would have the functionality of a proprietary terminal and could place a trade directly on a foreign board of trade without the use of an intermediary. The Commission requests comment on whether its rules should permit the use of some type of automated process to be employed by FCMs to allow customer orders that have been submitted electronically to the FCM to be transmitted into a foreign board of trade computer system. If so, what features would the system have to include or lack so that it would not be deemed a computer terminal under Commission rules? For example, should any automated order transmission system allowing a customer to transmit orders to its FCM require an employee of the FCM to review and to accept such orders and to take some affirmative, non-automated action to transmit such order to the foreign board of trade, or should fully automated intermediation be permitted, in which a fully computerized process would substitute for acceptance and transmission of orders by FCM employees? Should any such system limit a customer's view of

<sup>48</sup> By letter to the CME dated August 14, 1997, the Division, under authority delegated by the Commission in Rule 1.41a(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 clearing members 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 the member through its order routing system are subject to manual review and processing by a clearing member employee prior to being entered into a Globex terminal.

information to only a portion of that otherwise available to a member of a foreign board of trade that has a computer terminal? If so, what types of information should be permissible to be viewed by the customer on such a system and what information should be inaccessible? Should automated systems be required to provide, at a minimum, credit and position limit checks? The Commission requests comment as to other safeguards that should be required if automated verification, acceptance and transmission of customer orders to a foreign board of trade's computer system is permitted.

If the Commission were to permit an FCM to use a fully automated process to transmit electronically submitted customer orders to a foreign board of trade, should the FCM's use of this process be permitted only pursuant to the requirements of a Commission order to the foreign board of trade? That is, should customer access through an automated order routing system be provided: (1) only to a foreign board of trade that had received an order from the Commission to place computer terminals in the U.S. without being designated as a contract market; and (2) only through an FCM that is a member or affiliate of a member of such foreign board of trade and that had undergone the appropriate confirmation process to operate computer terminals under the foreign board of trade's order? Or should fully automated order routing systems allowed to provide access to all foreign boards of trade even if they have not received permission to place terminals in the U.S.? How should foreign firms that operate pursuant to an exemption under Commission Rule 30.10 be treated?

## 3. Linkages Between Boards of Trade

As electronic trading systems continue to evolve, some boards of trade are finding it advantageous to enter into partnerships with other boards of trade to make their products more widely available.<sup>49</sup> These partnerships raise issues regarding how a Commission rule should accommodate situations where the products of one board of trade are being made available through another board of trade's computer terminals located in the U.S. or where two or more boards of trade share the same electronic trading platform. The Division's approach, described above, would apply not only with respect to a single foreign board of trade, but also in circumstances where the products of multiple foreign boards of trade are traded from a single system. In such a

<sup>47</sup> See S. Rep. 384, 97th Cong., 2d Sess. 45-47, 84-85 (1982); H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. 84-85 (1982).

<sup>49</sup> See, e.g., note 12, *supra*.

case, each foreign board of trade whose products would be made available through U.S.-located computer terminals would be required to comply with any requirements adopted by the Commission in its order. For example, if two or more foreign boards of trade share the same computer terminal platform and each wished to place computer terminals in the U.S. for the use of its members (or members' affiliates), each would be required to receive an order from the Commission and comply with the requirements in that order under the approach described above. The Division's approach would also arguably apply to a foreign board of trade which trades through terminals shared with a U.S. exchange that has been designated as a U.S. contract market.<sup>50</sup> The Commission requests comment as to whether different requirements should apply to a foreign board of trade's products which are traded on the computer terminals of a U.S. contract market. If so, how should such requirements differ and why?

### III. Conclusion

The Commission believes that it is appropriate to develop rules concerning placement of foreign board of trade terminals in the U.S. in light of the growing interest among foreign boards of trade to do so. The Commission hopes to develop an approach to address these issues that will provide certainty to foreign exchanges that wish to place their computer terminals in the U.S. for trading purposes and will be consistent with the Commission's obligations under the Act to maintain the integrity and competitiveness of the U.S. markets and to provide protection to U.S. customers. To this end, the Commission requests public comment on the issues and the Division's approach, as discussed above.

Issued in Washington, D.C. on July 17, 1998 by the Commission.

**Jean A. Webb,**

*Secretary of the Commission.*

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## DEPARTMENT OF HEALTH AND HUMAN SERVICES

### Food and Drug Administration

#### 21 CFR Part 808

[Docket No. 97N-0222]

#### Medical Devices; Preemption of State Product Liability Claims

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

**ACTION:** Withdrawal of proposed rule.

**SUMMARY:** The Food and Drug Administration (FDA) is announcing that it is withdrawing a proposed rule that published in the **Federal Register** of December 12, 1997 (62 FR 65384), relating to medical device preemption of State product liability claims. FDA is making this withdrawal because of concerns that have been raised regarding the interplay between the FDA Modernization Act of 1997 (FDAMA) and the proposed rule.

**DATES:** The proposed rule is withdrawn July 24, 1998.

**ADDRESSES:** Copies of the draft proposed rule and its comments may be obtained from the Dockets Management Branch (HFA-305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852.

**FOR FURTHER INFORMATION CONTACT:** Joseph M. Sheehan, Center for Devices and Radiological Health (HFZ-215), Food and Drug Administration, 2094 Gaither Rd., Rockville, MD 20850, 301-827-2974.

**SUPPLEMENTARY INFORMATION:** Section 521 of the Federal Food, Drug, and Cosmetic Act (the act) (21 U.S.C. 360k) contains an express preemption provision applicable to medical devices regulated by FDA. The Supreme Court addressed whether section 521 of the act preempts State common law tort claims arising from allegedly defective medical devices. (See *Medtronic, Inc. v. Lohr* (Lohr), 116 S.Ct. 2240 (1996).) The Court concluded that section 521 of the act did not supplant the State law duties for devices marketed pursuant to a premarket clearance issued under section 510(k) of the act (21 U.S.C. 360(k)). Since *Lohr* was decided, the lower courts have interpreted section 521 of the act inconsistently and have reached conflicting conclusions with respect to whether section 521 of the act preempts State law claims for injuries allegedly resulting from medical devices that have received premarket approval under section 515 of the act (21 U.S.C. 360e), or have received an investigational device exemption under

section 520(g) of the act (21 U.S.C. 360j(g)).

In light of the confusion among the lower courts in interpreting section 521 of the act since *Lohr*, and in accordance with the Supreme Court's recognition that FDA's interpretation of the preemptive effect of section 521 of the act is entitled to substantial weight, the agency issued the proposed rule in the **Federal Register** of December 12, 1997 (62 FR 65384), addressing the circumstances under which section 521 of the act preempts State common law tort claims based on injury from allegedly defective medical devices. The proposal is consistent with the position that the agency has historically taken on issues related to device preemption. The comment period on this proposed rule was open until February 10, 1998. The agency received 41 comments from a variety of associations, law firms, and individuals representing industry and consumer interests.

FDA has decided to withdraw the rulemaking to amend its regulations regarding preemption of State and local requirements applicable to medical devices. FDA is taking this action because, even though the proposed rule was issued after the enactment of FDAMA, it was conceptualized and written prior to enactment.

Concerns have been raised by industry and congressional representatives that the agency did not share its thinking on its interpretation of section 521 of the act during FDAMA deliberations, even though an early draft of the proposed rule was shared during the spring of 1997 with attorneys for Public Citizen Litigation Group, who represented *Lohr* in the *Lohr* case. The remedy under FDA's regulations for disclosure of a draft regulation is ordinarily to issue a notice in the **Federal Register** making the draft publicly available. See 21 CFR 10.80(b)(2). Such a contemporaneous notice was not, however, provided in this case.

Because of the great policy significance of these preemption issues, the concern that Congress was not aware of the agency's thinking during FDAMA deliberations, and the potential interplay between the FDAMA device provisions and device preemption, the agency believes that it is imperative for all interested parties to have confidence that the agency is addressing their concerns in an impartial manner. Therefore, the agency is taking the unusual step of withdrawing the proposed rule.

The early draft of the proposed rule that was disclosed, the comments on it, and the correspondence raising

<sup>50</sup>The Commission anticipates that a foreign board of trade that currently is trading its products through computer terminals in the U.S. would be required to comply with any new rules eventually adopted by the Commission, but would be provided a transition period in which to come into compliance.