

**From:** Architzel, Paul <Paul.Architzel@alston.com>  
**Sent:** Thursday, July 8, 2010 5:33 PM  
**To:** hardeightfutures <hardeightfutures@CFTC.gov>; secretary <secretary@CFTC.gov>  
**Cc:** 'Francis' <wiz@hard8trading.com>; Gensler, Gary <GGensler@CFTC.gov>; Dunn, Michael <mdunn@cftc.gov>; Chilton, Bart <BChilton@CFTC.gov>; Sommers, Jill <JSommers@CFTC.gov>; O'Malia, Scott <SO'Malia@CFTC.gov>; Berkovitz, Dan M <DBerkovitz@CFTC.gov>; Hammar, Julian <jhammar@CFTC.gov>; Yoshimura, Edwin J <Eyoshimura@CFTC.GOV>; Shilts, Richard A. <rshilts@CFTC.gov>; Leahy, Thomas M., Jr. <tleahy@CFTC.gov>; Stephen Lee <stephen@hard8trading.com>; Architzel, Paul <Paul.Architzel@alston.com>  
**Subject:** Comment on Petition for Rulemaking of Hard Eight Futures LLC  
**Attach:** 31997703\_1.pdf

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Dear Mr. Stawick:

We are filing the attached comment on behalf of our client, Hard Eight Futures LLC. We appreciate the Commission publishing our Petition for Rulemaking for public comment and we appreciate the Commission's consideration of our views on the matter. As we note in our comment letter, we believe that the requested relief will promote market integrity, enhance transparency, reduce possible systemic risk and encourage competition.

Please feel free to call me if you have any question about our submission.

Respectfully submitted,

Paul M. Architzel  
Alston & Bird LLP  
The Atlantic Building  
950 F Street, N.W.  
Washington, D.C. 20004-1404

Tel: 202 756-3492  
Fax: 202-654-4893  
Mobile: 301 785-0115  
email: paul.architzel@alston.com

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# ALSTON & BIRD LLP

The Atlantic Building  
950 F Street, NW  
Washington, DC 20004-1404

202-756-3300  
Fax: 202-756-3333  
www.alston.com

Paul M. Architzel

Direct Dial: 202-756-3492

E-mail: paul.architzel@alston.com

July 8, 2010

*VIA E-MAIL to hardeightfutures@cftc.gov*

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
1155 21st Street, N.W.  
Washington, D.C. 20581

Re: Hard Eight Futures Petition for Exemption from Section 2(a)(1)(C)(iv) of the Act and Appendix D to Part 30 of the Rules of the Commission

Dear Mr. Stawick:

We are submitting this comment on behalf of our client, Hard Eight Futures, L.L.C. (“Hard Eight”). Hard Eight appreciates the opportunity to respond to the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) request for comment on Hard Eight’s Petition permitting appropriate persons to trade non-narrow security indexes on foreign boards of trade.<sup>1</sup>

Currently, no prior qualifying action by the Commission or its staff is required in order for U.S. persons to enter into futures contracts traded on a foreign board of trade. Rather, U.S. customers are permitted to access the products offered by a foreign board of trade through a U.S. registered futures commission merchant (“FCM”) or introducing broker or through a foreign firm that has received an exemption from registration as a U.S. FCM under Commission Rule 30.10, 17 C.F.R. §30.10. In contrast, U.S. persons may not enter into futures contracts on a non-narrow security index traded on a foreign board of trade unless the foreign board of trade has applied for, and has been granted, a no-action letter by the Commission’s Office of the General Counsel (“OGC”).<sup>2</sup> Hard

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<sup>1</sup> “Petition of Hard Eight Futures, LLC for Exemptive Relief, Pursuant to Section 4(c) of the Commodity Exchange Act, from Section 2(a)(1)(C)(iv) of the Commodity Exchange Act and Appendix D to Part 30 of the Rules of the Commodity Futures Trading Commission,” 75 *Fed. Reg.* 34429 (June 17, 2010) (“Request for Comment”).

<sup>2</sup> The OGC No-action procedure, which is discussed in greater detail below, is a substitute means for foreign boards of trade to comply with Section 2(a)(1)(C)(iv)’s prohibition on the general offer and sale of stock index contracts except as permitted under Section 2(a)(1)(C)(ii) of the Act. Section 2(a)(1)(C)(ii) of the Act in turn provides that the Commission may only designate a board of trade as a contract market for contracts on a security index that meet the requirements contained in that provision. *See e.g.* CFTC Letter

Eight's Petition seeks an exemption upon claim of notice to the Commission so that eligible contract participants<sup>3</sup> ("ECP") may trade on a foreign board of trade futures contracts on non-narrow indexes of foreign securities under the same conditions that apply to trading any other futures contract on a foreign board of trade. Granting Hard Eight's petition will also bring greater consistency and harmony in the manner in which futures contracts on foreign non-narrow security indexes, narrow security indexes and single securities are treated.<sup>4</sup>

Hard Eight's petition for exemption would require that persons wishing to trade a particular non-narrow security index on a foreign board of trade that is not subject to an OGC no-action letter notify the Commission of the person's intent to do so. The notice would require the claimant to demonstrate his or her qualification for the exemption and that the index is not narrow-based. This exemption would be available only with respect to contracts traded on foreign boards of trade the regulator of which has entered into a Memorandum of Understanding with respect to information sharing and cooperation with the Commission. The exemption would be effective with respect to that person and index unless the Commission notifies the person within ten business days that the claimant does not meet the requirements of the exclusion or the index does not qualify under section 1a(25) of the Commodity Exchange Act, 7 U.S.C. §1 et sea. ("Act"), as a non-narrow index and provides the person with an explanation of why it considers the person not to be qualified or the index not to be narrow-based, respectively. Under Hard Eight's Petition, the current OGC no-action requirement would continue to apply before the general public would be permitted to enter into such foreign stock index contracts.

Hard Eight, in its Petition, explained that the requested exemption is in the public interest. The current OGC No-action procedure was established in response to the 1982 amendments to the Act<sup>5</sup> and has operated without modification since that time. However, since that time there have been fundamental changes in the Act, in particular, the

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No. 99-25 (July 14, 1999) at <http://www.cftc.gov/tm/letters/99letters/tm/99-25.htm>. These provisions of the Act were formerly found at Sections 2(a)(1)(B)(v) and 2(a)(1)(B)(ii) respectively. Thus, the OGC no-action process relieves foreign boards of trade from the requirement that they become designated contract markets in order to offer stock indexes traded thereon to U.S. persons.

<sup>3</sup> The term "eligible contract participant" is defined in section 1a(12) of the Commodity Exchange Act.

<sup>4</sup> On June 30, 2010, the Securities and Exchange Commission ("SEC") issued an Order which permits qualified institutional buyers ("QIB") to access single security and narrow-based security index futures contracts traded on foreign boards of trade under certain conditions. No additional prior qualifying action by the SEC or its staff—such as issuance of an OGC no-action letter as required by the CFTC—is necessary for an eligible person to trade a narrow-based security index on a foreign board of trade. The Hard Eight Petition would result in CFTC procedures relating to the trading of foreign non-narrow security indexes being brought into greater alignment with the conditions that apply to the trading of narrow-based security indexes. See "Order Under Section 36 of the Securities Exchange Act of 1934 Granting an Exemption From Exchange Act Section 6(h)(1) for Certain Persons Effecting Transactions in Foreign Security Futures and Under Exchange Act Section 15(a)(2) and Section 36 Granting Exemptions From Exchange Act Section 15(a)(1) and Certain Other Requirements," 74 *Fed. Reg.* 32200 (July 7, 2009) ("SEC Order").

<sup>5</sup> See Futures Trading Act of 1982, Pub. Law 97-444, 96 Stat. 2294.

recognition that differences in regulatory treatment are appropriate between ECPs and less sophisticated traders. There have also been profound changes in the markets as well.

The exemption is conditioned upon a trader notifying the Commission prior to using the exemption, demonstrating that the index qualifies as a non-narrow index and that the regulator of the foreign board of trade has entered into a regulatory information-sharing agreement with the Commission. Accordingly, although the exemption would establish a more streamlined process, it is grounded in the most salient criteria that are currently used by OGC in making its determinations in issuing a no-action letter.

The Petition notes that the operation of the current OGC no-action process has the effect of preventing ECPs from trading such contracts in the more regulated exchange environment when they are permitted to enter into economically equivalent transactions in the less-regulated over-the-counter (“OTC”) market. Moreover, because transactions on foreign boards of trade generally are intermediated by U.S. registered entities or firms exempt from such registration under Commission rules, the exemption would not lessen the regulatory protections that are afforded to customers when trading on a foreign board of trade. Moreover, by making it possible for ECPs to execute such transactions in a cleared, exchange environment, the exemption would assist in preserving market integrity, enhancing transparency, reducing possible systemic risk and promoting competition.

It is important to note that the current prohibition on trading futures contracts on non-narrow security indexes on foreign boards of trade acts as an incentive for ECPs to move their trading operations off-shore. U.S. trading firms compete in an international environment. Non-U.S. firms do not face similar trading restrictions and currently there is no process through which a U.S. trading firm is able to seek permission to trade such a futures contract. Granting Hard Eight’s Petition would address this situation by providing a means through which a U.S. ECP can gain permission to trade such a contract on a foreign board of trade and would thereby enable U.S. firms to compete with foreign firms more effectively.

Finally, the Petition should be favorably considered in light of the recent Order of the Securities and Exchange Commission permitting institutional investors to trade certain foreign narrow based security index (and single security) futures products. On July 7, 2009, the SEC issued an Order permitting Qualified Institutional Buyers (“QIB”) to trade foreign security futures products (narrow-based security indexes and futures on individual securities) traded on a foreign board of trade that meet certain conditions. In this regard, for qualifying foreign narrow-based indexes, 90% of the underlying securities in number and weighting must be issued by foreign private issuers where the primary trading market of each such security is outside of the U.S.; the futures contract must be traded on a foreign exchange or contract market; clearance and settlement must be

outside of the U.S. and the position may not be off-set through the facility of a U.S. exchange.<sup>6</sup>

With that background, we are pleased to respond to the specific questions posed by the Commission in its Request for Comment.

### **Question 1**

#### **Should an order granting the request for relief include any one or more of the conditions proposed by HEF in its Petition?**

The conditions proposed by Hard Eight are grounded in the current structure and requirements of Appendix D to Part 30 of the Commission's rules, the rules governing the OGC no-action procedures. First, and most importantly, the Petition provides that a participant notify the Commission of its intent to claim the exemption prior to trading in reliance on the exemption. The Commission has ten business days during which time it may notify the participant that the exemption may not be made effective and the reason for so finding. The notice is required to include a demonstration that the index meets the statutory definition of being a "narrow based index." Finally, the exemption would be conditioned upon the regulator of the foreign board of trade on which the index is traded having entered into an information sharing arrangement with the Commission.

These conditions are appropriate. By providing that the exemption is available only after the requestor has filed a notification with the Commission, the Commission will have an opportunity to validate the claim of exemption. Moreover, because the exemption is not self-effectuating, those trading in reliance on the exemption will be identified to the Commission making it possible for the Commission to communicate on an on-going basis as it deems appropriate.

The requirement that the claim of exemption include a demonstration that the index is not narrow-based is appropriate. Non-narrow security indexes are within the Commission's exclusive jurisdiction. If the contract is not narrow based, the trading mechanics for participants claiming the exemption will be the same as for any other futures contract traded on a foreign board of trade. If on the other hand, the index is, or becomes, narrow the petitioned-for exemption would not be applicable and the participant would look to the Order of the Securities and Exchange Commission<sup>7</sup> and CFTC requirements<sup>8</sup> to determine whether he or she is eligible to trade the security future product and the trading mechanics which would apply. In this regard, the criterion for

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<sup>6</sup> SEC Order at 32206.

<sup>7</sup> See note 4 *supra*.

<sup>8</sup> See, "Division of Clearing and Intermediary Oversight Advisory Concerning the Offer and Sale of Foreign Security Futures Products to Customers Located in the United States," <http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/fsfpadvisory.pdf> (June 8, 2010).

distinguishing between narrow-based and not-narrow based contracts is straightforward. The test is easily quantifiable and is readily determined by sophisticated participants, such as ECPs, based on objective factors.<sup>9</sup>

The requirement that the non-U.S. regulator have in place a Memorandum of Understanding is grounded in the requirement of Appendix D to Part 30, of the Commission's rules that the request for an OGC foreign stock index no-action letter include assurances that the foreign board of trade will share information with the Commission, either directly or indirectly.<sup>10</sup> Because the claim of exemption comes from the market participant and not the foreign board of trade, the existence of a Memorandum of Understanding between the regulators will ensure that if it becomes necessary for the Commission to obtain information with respect to trading in the foreign index, there is a path for such information to be provided.

These conditions are appropriate in light of the fact that the regulatory interest of the Commission in regulating the conduct of U.S. persons that trade on foreign boards of trade is limited. In this regard, the Futures Trading Act of 1982 clarified the Act's applicability with respect to foreign boards of trade in new Section 4(b).<sup>11</sup> As the House Committee on Agriculture explained, "Section 4(b) expressly empowers the Commission to protect the interests of United States residents against fraudulent or other harmful practices by a vendor of foreign futures who is located in the United States. . . ."<sup>12</sup>

We believe that the exemptive relief requested by Hard Eight's Petition should be understood in this context, especially in light of the fact that: 1) only sophisticated traders would be eligible for the exemptive relief, and 2) the exemptive relief would not apply where the foreign security index can be traded by directly accessing the foreign board of trade from within the U.S.

## Question 2

**In granting no-action relief to a foreign board of trade seeking to offer and sell a futures contract on a foreign security index to U.S. persons, Commission staff generally rely on surveillance sharing agreements between the securities exchanges on which the securities comprising the index are traded, and the foreign board of trade. Also, before issuing such no-action relief, Commission staff often requests a representation or commitment from the foreign board of trade of its willingness and ability to share information with the Commission. . . . To ensure that there are**

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<sup>9</sup> Section 1a(25) of the Act sets forth the definition of "narrow-based security index." The numeric test of the statute is given further meaning by Commission rules 41.11 through 41.15, 17 C.F.R. §§41.11-41.15, which provide specific guidance on calculating whether an index is narrow-based and on changes in status from one type of index to the other.

<sup>10</sup> See 17 C.F.R. Part 30, Appendix D paragraph G(3).

<sup>11</sup> Pub. Law 97-444, 96 Stat 2294.

<sup>12</sup> H.R. Rep. No 97-565 at 85.

**similar protections in place in the circumstances posed by HEF's Petition, should an order granting the request for relief require that the foreign board of trade that lists the foreign security index futures contract to be traded by the ECP have: (i) submitted a pending request for no-action relief with respect to that futures contract; (ii) received a prior no action letter for another foreign security index futures contract; and/or (iii) received a foreign direct access no action letter?**

Hard Eight agrees that the ability and willingness of the foreign board of trade to share information with the Commission, directly or indirectly, could be demonstrated by the prior issuance by OGC of a security index no-action letter or by staff of the Division of Market Oversight of a direct-access no-action letter.

However, Hard Eight believes that such a condition would be overly restrictive. A foreign board of trade may not have previously requested an OGC or direct-access no-action letter for a variety of reasons. For example, the foreign board of trade may believe that there is not enough trading interest on the part of the general public in the U.S. to merit the time, attention and cost necessary to prosecute such a request. However, it may be precisely this type of market that is attractive to the sophisticated ECP trader. Indeed, it is likely that as a market becomes more attractive to U.S. ECPs, its appeal may become more generalized, at which point the foreign market would be more likely to commit the substantial resources necessary to gaining an OGC or a direct-access no-action letter.

Moreover, limiting the granting of the requested relief to instances where the foreign board of trade has a request for an OGC no-action letter pending would undercut much of the potential value of the requested relief. Although enabling ECPs to trade futures contracts on a foreign stock index during the sometime lengthy period that such no-action requests may be under consideration by OGC would be in the public interest, such a limitation would deny ECPs the more substantial benefit of trading such a contract in instances where no request has yet been submitted by the foreign board of trade.

The suggestion posed by the Commission of precluding ECPs from requesting relief unless the foreign board of trade has already been granted no-action relief or such a request is pending would potentially have a far-reaching anti-competitive effect. As noted above, a foreign board of trade may refrain from requesting no-action relief for a variety of reasons. One possible reason might be that the foreign market, by virtue of an outsourcing or other similar cooperation agreement, enters into a covenant that precludes it from seeking such OGC or direct-access no-action relief. If that were the case, the Commission's tying the *ECP's* ability to seek relief to the foreign board of trade's decision to first do so would reinforce and strengthen any such non-compete agreement by the exchanges, reducing competition. Section 15(b) of the Act requires that the Commission "endeavor to take the least anticompetitive means of achieving the objectives of the Act . . . in issuing any order or adopting any Commission rule . . .

including any exemption under section 4(c).”<sup>13</sup> Because there are other means of achieving the regulatory goal of ensuring that information sharing between the foreign board of trade and the Commission is possible, adopting such a limitation on the ECP’s ability to request exemptive relief would be highly suspect under Section 15(b) requirement of taking the least anticompetitive means of achieving the goals of the Act.

### Question 3

**The Commission is concerned that the condition for an MOU included in HEF’s Petition may not be workable in practice, given the wide spectrum of information sharing agreements to which the Commission is a party. . . . Should an order granting the relief requested in HEF’s Petition be conditioned on the existence of an MOU that is specifically tailored to obtain the information that the Commission needs to assess the efficacy of the foreign board of trade and its regulator, and to obtain surveillance information as it deems necessary? Should any such relief be limited to foreign security index futures contracts listed in jurisdictions that are signatories to the IOSCO Multilateral MOU?**

The Commission in determining whether the MOU should be specifically tailored to “assess the efficacy of the foreign board of trade and its regulator, and to obtain surveillance information as it deems necessary” should bear in mind that the exemption for ECPs should not be subject to the same requirements and in the same degree that would apply to an OGC no-action letter, which permits any person, including retail persons, to trade a futures contract on the index. Nor should it impose the same requirements as a direct access no-action letter, which permits more ready access to the foreign board of trade than that which would be permitted under the ECP exemption request.

The Commission should also bear in mind that no prior qualifying action by the Commission or its staff is required in order for U.S. persons to enter into futures contracts traded on a foreign board of trade in every commodity other than a non-narrow security index. In this regard, the SEC has not imposed any information sharing requirement as a condition for sophisticated U.S. persons to enter into or sell foreign narrow-based security index products.<sup>14</sup>

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<sup>13</sup> In this regard, although Appendix D to Part 30 assumes that the foreign board of trade is the entity that requests an OGC no-action letter. However, because *any U.S. person* is prohibited from trading a foreign non-narrow security index unless OGC issues a no-action letter, *any U.S. person* should be free to request an OGC no-action letter. For example, it would be perfectly appropriate and in the public interest for OGC to consider a no-action request from an association of FCMs or Part 30 firms that would be the intermediaries handling customer orders from U.S. persons. Hard Eight’s Petition can be seen as providing a substitute, streamlined process for an ECP, who is directly affected by the prohibition, of seeking permission to trade a specific futures contract on a foreign non-narrow security index.

<sup>14</sup> See “Order Under Section 36 of the Securities Exchange Act of 1934 Granting an Exemption from Exchange Act Section 6(h)(1) for Certain Persons Effecting Transactions in Foreign Security Futures and



Hard Eight believes that the primary regulatory interest of the Commission in connection with the execution by U.S. persons of off-shore transactions is customer protection. This is reflected in Section 4(b) of the Act empowering the Commission to protect the interests of United States residents against fraudulent or other harmful practices by a vendor of foreign futures who is located in the United States. . . .<sup>15</sup> Accordingly, the Commission should accept any information sharing arrangement which would be necessary to address any abuse of the relationship of the U.S. customer by his intermediary in the purchase or sale of such contracts.

#### Question 4

**As discussed above, a futures contract on a security index that moves from broad to narrow-based thereby becomes a security future that may no longer be traded by U.S. persons subject to the exclusive jurisdiction of the CFTC. To ensure full compliance with the requirements of the CEA and the federal securities laws, should an order granting the relief requested in HEF's Petition require an undertaking by the ECP to: (i) Continually monitor the underlying index to ensure that it remains broad-based; (ii) notify the Commission if the index becomes a narrow-based security index; and (iii) if the index continues to be narrow-based for more than 45 business days during 3 consecutive calendar months, to cease trading the futures contract and liquidate existing positions in an orderly manner over the next 3 calendar months (provided, however, that if the ECP and the futures contract are eligible for the exemptive relief granted by the SEC Order, the ECP may continue to trade that contract as a foreign security future)?**

It is possible that a foreign security index may move from broad to narrow-based. It is reasonable for the conditions of the exemption to require that those entities receiving the exemption monitor the foreign stock index and to notify the Commission of a change in the index's status from broad to narrow-based. Such monitoring of an index can be readily accomplished by sophisticated traders who would be eligible for the exemption. As the Commission rightly points out, the trader might be able to continue trading the contract as a security futures product consistent with the terms of the SEC Order. Otherwise, the trader would be required to phase out its positions as provided in Commission rules.

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Under Exchange Act Section 15(a)(2) and Section 36 Granting Exemptions From Exchange Act Section 15(a)(1) and Certain Other Requirements," 74 *Fed. Reg.* 32200(July 7, 2009).

<sup>15</sup> *Id.* at 85.

## Question 5

### **Should an order granting the relief requested in HEF's Petition require that there be no solicitation of ECP orders, and/or that ECPs be required to trade only for their own account?**

We believe that requiring that there be no solicitation of ECP orders is unnecessarily restrictive. As noted in the Petition, futures contracts on a non-narrow security index should be treated no differently than trading on a foreign board of trade on any futures contract. The Commission in connection with its orders granting futures firms relief from registration as FCMs under Commission Rule 30.10 has granted Limited Marketing Conduct relief. The Commission has reasoned that certain contacts between a 30.10 firm and customers located in the U.S. who have a high degree of sophistication and financial resources would not be contrary to the public interest.<sup>16</sup> These Orders provide that a firm that has been granted Commission Rule 30.10 relief may engage in limited marketing to sophisticated U.S. persons as long as the firm does not establish a fixed location in the U.S. Hard Eight believes that, because the exemptive relief would only apply to sophisticated traders, this limited marketing approach should also be applied in the context of the Petition. In this regard, including non-narrow security indexes within a limited marketing approach is consistent in broad approach with the SEC's Order, which provides a conditional exemption from broker-dealer registration for a foreign broker engaged in limited contacts with eligible traders.<sup>17</sup>

Limiting trading under the exemptive order to an ECP trading for its own account also would be unduly restrictive. It should be noted that many ECPs that may wish to avail themselves of the exemption are not necessarily members of every foreign board of trade on which a qualifying index may trade. In such a case, the ECP trader would by necessity be required to trade as a customer through an intermediary. Thus, for example, Hard Eight, the Petitioner, may very well seek to trade a futures contract on a non-narrow security index through an FCM. It is in the public interest that U.S. registered FCMs be permitted to intermediate such transactions. Moreover, a registered commodity pool operator or commodity trading advisor should be able to trade such contracts on behalf of a commodity pool. Investors in commodity pools rely upon the professional expertise of those who manage such commodity pools and such entities should be able to trade under the requested exemption.

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<sup>16</sup> See e.g. "Limited Marketing Activities From a United States Location by Certain Firms and Their Employees or Other Representatives Exempted Under Commodity Futures Trading Commission Regulation 30.10," at: <http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/e8-15606.html>.

<sup>17</sup> See SEC Order at 32205 permitting associated persons of foreign brokers to engage in unchaperoned contacts with QIBS during visits to the United States for no more than 30 days in a year.

## Question 6

**As discussed above, HEF's Petition justifies its request for relief, in part, on the proposition that: (i) U.S. ECPs currently are able to trade contracts that replicate futures on foreign security indexes in the unregulated OTC markets; and (ii) it is in the public interest to enable them to do so in a more regulated and transparent exchange environment on a foreign board of trade. Yet, legislation currently pending before the Congress, if eventually enacted, could change this premise to some degree, as it would significantly enhance the transparency of OTC derivatives and require that certain swaps (subject to an "end-user exception") be traded on a contract market or a "swap execution facility" as provided for in that legislation. What are the implications of the OTC derivatives reform legislation pending in Congress, if any, on HEF's Petition?**

It is not clear that the OTC derivatives reform legislation may have any effect on Hard Eight's Petition. First, it is important to note that the Petition relates only to futures contracts on foreign security indexes. In this regard, such contracts may be traded primarily in the OTC market outside of the U.S. The OTC derivatives reform legislation, in broad brush, requires that OTC transactions that are accepted for clearing by a Derivatives Clearing Organization ("DCO") be submitted for clearing, absent an exemption, and transacted on a contract market or a swaps execution facility. If a DCO does not offer to accept a particular type of swap for clearing, those provisions do not apply.

Because these are foreign security indexes, it is not clear that a DCO would offer to accept such contracts for clearing, or even be expected to offer to accept such OTC contracts for clearing. This is true particularly if the primary locus of the market is outside of the U.S. Accordingly, depending upon the regulatory framework adopted abroad, it may be that the current anomaly continues, that sophisticated traders may be able to transact in the less regulated OTC environment but are precluded from trading the same contract on a foreign board of trade in the more protected exchange environment.

However, even if all of the requirements of the OTC derivatives reform legislation were to apply to these transactions, certain differences will remain between the exchange-traded and OTC trading environments. For example, the operation of a swaps execution facility is likely to be subject to fewer core principles than an exchange. As long as there is any difference in protections offered between the OTC trading environment and an exchange environment, it is in the public interest to remove unnecessary obstacles to trading in the more protected and regulated exchange environment.

### Question 7

**As discussed above, HEF's Petition proposes that an order granting its request for relief be conditioned upon all the securities in the index underlying the foreign futures contract being principally traded on, by, or through an exchange or market located outside the U.S. . . . What are the implications, if any, of the use of this standard in an order granting the relief requested in HEF's Petition in comparison to the "primary trading market" test that the SEC created for securities of foreign private issuers in a narrow-based security index as set forth in paragraph (1)(a)(ii) of the SEC Order? Should an order granting the relief requested in HEF's Petition treat securities in an index as being principally traded on, by, or through an exchange outside the United States if they meet the criteria for securities in a narrow-based security index contained in paragraph (1)(a)(ii) of the SEC Order?**

It is reasonable that the condition that the securities in the non-narrow index be traded principally outside of the U.S. be interpreted in harmony with the standard set forth by the SEC in its Order that the underlying securities be traded on a primary trading market that is not the U.S. This could be achieved either through interpretation or by the Commission adopting the language in the SEC Order.

### Question 8

**As discussed above, the SEC Order generally limits the category of U.S. persons that may trade foreign security futures to QIBs (who own and invest \$100 million or more). This is a narrower class of investors than ECPs. The group of persons that satisfy the ECP definition but may not be QIBs includes registered investment companies, commodity pools, pension plans, corporations and high net worth individuals. . . . If the relief requested in HEF's Petition is granted, an ECP that is a QIB and trades a foreign futures contract on a foreign security index that moves from broad to narrow-based can continue to trade that contract as a foreign security future, provided the contract otherwise meets the requirements of the SEC Order. An ECP that is not a QIB, however, would have to exit its position in the foreign futures contract within the applicable grace period or be in violation of the Exchange Act. Given this difference in legal status, should an order issued by the Commission granting the relief requested in HEF's Petition be limited to QIBs?**

Hard Eight believes that limiting the requested relief to QIBs would be contrary to the public interest for a number of reasons. First, futures on non-narrow security indexes merit consideration on their own terms. In this regard, futures on non-narrow security indexes do not raise the same regulatory issues raised by futures contracts on narrow based or single security futures products. Narrow-based indexes might act as a proxy for a contract on a single security and may therefore raise issues of trading on material non-public information relating to the underlying. Non-narrow indexes do not raise that issue

and are also less likely to raise issues of market manipulation. It is therefore unnecessary to apply the more restrictive eligibility standard of the SEC's Order to the Petitioned-for exemption.

Secondly, the ECP definition of section 1a(12) of the Commodity Exchange Act is well understood in the context of futures regulation. It would create regulatory confusion to incorporate into the exemption an eligibility standard—QIB—that is not found anywhere else in the futures regulatory framework.

Thirdly, the issue of the transition of a futures contract on a non-narrow security index to a narrow-based security index is well established in Commission rules. Commission Rule 41.14, 17 C.F.R. §41.14, has been in effect for almost ten years. This transition rule appears to have caused little in the way of market disruption. Because the public is familiar with the application of the transition rules with respect to domestic U.S. narrow based and non-narrow security indexes, there should be little or no confusion in extending the concept to foreign security indexes.

Finally, even if the Commission were to adopt the QIB eligibility standard, it would not necessarily lead to a seamless transition from a broad-based to narrow-based security index. Where an index transitions from non-narrow to narrow-based, a QIB, although eligible to continue trading the futures contract on what is now a narrow-based security index, might nevertheless have to adjust his or her brokerage arrangements to comply with the SEC's Order. Accordingly, the Commission should not adopt the QIB eligibility standard. Rather it should retain the eligibility category of ECP, a category which is well-grounded in the Commodity Exchange Act. ECPs are sophisticated traders and will be able to understand that they may qualify to trade futures contracts on non-narrow indexes but not on narrow-based indexes.

**With respect to access to foreign security futures by U.S. persons, are the conditions contained in the SEC Order consistent with Section 2(a)(1)(F)(ii) of the CEA? Should ECPs that are not QIBs be permitted to trade foreign security futures? What conditions, if any, should be imposed on such trading by ECPs that are QIBs, and ECPs that are not QIBs? How should an order permitting ECPs to trade foreign security futures take into account, as mandated by Section 2(a)(1)(E) of the CEA, “the nature and size of the markets that the securities underlying the security futures product reflects?”**

Hard Eight appreciates that the Commission has raised these issues. Hard Eight believes that after the Commission adopts the requested exemption, further harmonization between the requirements of the two Commissions would benefit traders and be in the public interest. However, a first step is for the Commission to grant the Petition and to proceed with an exemption for non-narrow contracts.

### Question 9

**Lying at the core of the complex interplay between HEF's Petition on the one hand, and the CEA and the federal securities laws on the other hand, is the application of the statutory definition of a "narrow-based security index" to foreign security indexes. To the extent that a foreign security index falls squarely on the broad-based side of the line, distinctions between ECPs that are QIBs and those that are not, and the prospect of an ECP that is relying on the relief requested by HEF violating the securities laws, may be of less concern. Congress has recognized that "[t]he detailed statutory test of a narrow-based security index was tailored to fit the U.S. equity markets, which are by far the largest, deepest and most liquid securities markets in the world." In the CFMA in 2000, Congress directed that the CFTC and the SEC, within one year, jointly adopt rules or regulations that set forth requirements for broad based foreign security indexes traded on a foreign board of trade. And shortly thereafter, the CFTC and SEC promised to consider amending the rules regarding security index futures trading on or subject to the rules of a foreign board of trade. Should the CFTC and the SEC establish criteria to exclude appropriate foreign security indexes from the definition of a "narrow-based security index?" If so, on what basis? How should it be determined whether a foreign security index is appropriately treated as a broad-based security index so that foreign futures on such an index would trade subject to the exclusive jurisdiction of the CFTC, or as a narrow based security index so that foreign futures on such an index would trade as foreign security futures? The Commission encourages commenters to submit any quantitative data and analysis to support any proposed distinctions between broad and narrow based foreign security indexes.**

Hard Eight urges the Commission as a first step to act on its Petition using the statutory test differentiating narrow and non-narrow indexes. Although Congress recognized that a more nuanced test might be appropriate in the context of non-U.S. markets, Hard Eight does not believe that the Commission should delay acting on its Petition while the Commissions consider jointly amending their rules on this issue.

### Question 10

**Is the exemption requested in HEF's Petition consistent with the requirements for relief set forth in Section 4(c) of the CEA?**

**• Would granting the exemption requested in HEF's Petition be consistent with the public interest and purposes of the CEA?**

As explained in Hard Eight's Petition, the requested relief would remove barriers to ECPs entering into futures contracts on non-narrow security index futures on foreign boards of trade. As explained in the Petition, this will provide ECPs with the choice to be able to carry out such transactions in a more, rather than less, regulated environment. Under the relief, ECPs would be able to access non-narrow security futures products

under the conditions which apply to all other commodities under the Act. Thus, the relief sought is clearly in the public interest.

Moreover, the relief sought would not have a material adverse effect on the Commission or any contract market in carrying out its regulatory or self-regulatory duties. The main effect would be to permit trading of futures on foreign non-narrow security indexes on par with all other commodities traded on a foreign board of trade. Thus, there is no adverse effect from the requested relief. If anything, the requested relief will place more transactions within an exchange-traded framework, one of the fundamental goals and objectives of the Act.

**• Would granting the relief requested in HEF's Petition have any material adverse effects upon derivatives clearing organizations, exchanges, or other Commission registrants from a competitive or other perspective?**

Granting Hard Eight's Petition would not have a material adverse effect on any DCO, contract market or other Commission registrant. The security indexes in question are composed of indexes that are traded on foreign boards of trade and granting the requested relief would not hamper a U.S. market from seeking to list a similar contract if it so chose. Accordingly, there is no adverse competitive or self-regulatory effect upon U.S. futures exchanges or derivatives clearing organizations arising from the requested relief.

However, it is clear that a significant competitive disadvantage to U.S. trading firms currently exists and will persist until Hard Eight's Petition is granted. Trading firms operate in a global environment. Commission policies that limit access by U.S. trading firms to futures contracts on non-narrow foreign security indexes disadvantages them in their competition with international trading firms which face no similar restrictions. This impediment to U.S. firms' competitiveness acts as an incentive to move operations outside of the U.S. In light of the fact that these firms are among the most sophisticated and innovative traders in the world, this is clearly contrary to the public interest. Until Hard Eight's Petition is granted, U.S. trading firms will continue to operate under a significant competitive disadvantage.

\* \* \* \* \*

Hard Eight appreciates the Commission publishing for public comment its Petition for Rulemaking. Hard Eight believes that its Petition addresses a significant competitive disadvantage faced by U.S. ECPs without compromising the regulatory

protections that benefit participants on regulated futures markets. Hard Eight believes that the exemption in its Petition, by making it possible for ECPs to execute futures contracts on non-narrow foreign security indexes in a cleared, exchange environment, will promote market integrity, enhance transparency, reduce possible systemic risk and encourage competition.

Respectfully submitted,



Paul M. Architzel

cc: Francis Wisniewski  
Chairman Gensler  
Commissioner Dunn  
Commissioner Chilton  
Commissioner Sommers  
Commissioner O'Malia  
Daniel Berkovitz, General Counsel  
Julian Hammar, OGC  
Edwin Yoshimura, OGC  
Richard Shilts, Director DMO  
Thomas Leahy, DMO