

**Chief Executive**

14 January 2011

Mr David A Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Dear Mr Stawick

**REGISTRATION OF FOREIGN BOARDS OF TRADE; RIN 3038-AD19<sup>1</sup>**

The London Metal Exchange Limited (“LME” or “Exchange”) is pleased to submit this comment letter in response to the November 19, 2010 Notice of Proposed Rulemaking (“NPR”) published by the Commodity Futures Trading Commission (“CFTC” or the “Commission”) regarding the registration of Foreign Boards of Trade (“FBOTs”). Very generally, the Proposed Rules would establish a registration and regulatory framework for foreign futures exchanges that provide direct electronic access to their electronic trade matching systems from terminals located in the US.

**I Introduction**

The LME was organized in London more than 130 years ago and is the world’s premier base metals market, offering futures and options contracts for aluminium, copper, tin, nickel, zinc, lead, aluminium alloy and NASAAC, steel billet, cobalt and molybdenum. The LME is regulated by the U.K. Financial Services Authority (“FSA”) as a recognized investment exchange and provides electronic access to its markets to members in a number of jurisdictions around the world. In March 2001, the LME obtained no-action relief from the CFTC authorizing it to provide LME members located in the United States with direct access to LMEselect, its electronic trading and order matching system.<sup>2</sup> Under the Proposed Rules, the LME would no longer be permitted to provide such access without registration with the Commission as an FBOT.

**II Summary**

The LME supports the Commission’s desire to establish a standardized regulatory framework for non-US futures exchanges (referred to by the Commission as

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<sup>1</sup> 75 Fed. Reg. 70974 (Nov. 19, 2010) (the “Proposed Rules”).

<sup>2</sup> CFTC Letter No. 01-11 (March 12, 2001).



“FBOTs”) who wish to provide US domiciled market participants with the efficiencies of direct electronic access to their futures and options markets. In particular, the LME agrees with the Commission’s implicit conclusion that an FBOT should be permitted to provide its members or other participants in the United States with direct access to its electronic trading and order matching systems without becoming subject to registration and regulation as a designated contract market (“DCM”) or designated trade execution facility (“DTEF”). We also fully endorse the Commission’s desire to prevent disruption to US markets that it regulates through cross-border circumvention.

As more fully explained below, however, the LME believes that the CFTC could achieve the objectives it has identified for the Proposed Rules with a comparability-based exemptive approach that would be significantly less burdensome for applicants and Commission staff and that would be more consistent with existing frameworks for the regulation of cross-border market access.

Specifically, the LME recommends that the Commission:

- make jurisdiction-by-jurisdiction comparability analyses with respect to exchange and clearinghouse regulation and delete these elements from the application materials; and
- adopt an exemptive rather than registration regime, consistent with international practice, and require contract designation (as in the case of US DCMs) only with respect to linked contracts (involving US-centric commodities).

The LME appreciates the opportunity to comment on various aspects of the Proposed Rules and has summarized its comments in the immediately following sections.

### **III Discussion**

#### **A Comparability**

##### *1 General*

Under the Proposed Rules, an FBOT that provides qualifying US persons with direct electronic access to its trading and order matching engine would be required to register with the CFTC. To qualify under the proposed framework, an applicant would be required to demonstrate that it is subject to regulation that is comparable to the regulation of DCMs in the US<sup>3</sup>. As part of the proposed framework, in addition to providing applicant-specific information, an applicant would be required to provide voluminous information regarding the home country regulatory framework under

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<sup>3</sup> We agree with the Commission’s observation that comparability should not be determined on the basis of a granular comparison of specific laws and regulations, but rather on the comparability of the regulatory protections that are afforded under the relevant regime(s). See Proposed Rules, at 70977.



which it operates. We believe that this approach would constitute an unnecessary burden on Commission and applicant resources.

Recognizing that a comparability evaluation involves an evaluation of the regulatory framework generally applicable to futures exchanges within a particular jurisdiction, we respectfully recommend that the Commission make this determination once, for a particular jurisdiction, and not require individual applicants to expend the human and financial resources to compile, describe and analyze the information necessary to support a conclusion that the Commission either will have made or is, in any event, capable of making with respect to all similarly situated registrants in the relevant jurisdiction. Reducing the information required to be submitted in connection with an application will necessarily reduce the staff resources necessary to review the submission. We therefore believe that this alternative will enable the CFTC to accomplish the same regulatory objectives while achieving significant resource efficiencies.

Every applicant should, of course, submit any information that is unique to its own circumstances.

## 2 Clearinghouse

Under the proposed framework, an applicant would additionally be required to submit extensive information regarding the clearing of its contracts and its clearinghouse. For example, Appendix A of the Proposed Rules requires applicants to submit documentation relating to the FBOT and its clearing organization, including, *inter alia*, information regarding corporate structure, applicable home country regulatory regime, membership criteria, trading systems, terms of contracts made available for direct access, clearing and settlement procedures, internal rules and procedures, and information sharing agreements with US and foreign regulatory authorities.<sup>4</sup>

We note in this regard that, just as the Commission will *de facto* make a jurisdictional evaluation with respect to home country regulation of an FBOT, it should address the comparability of clearinghouse regulation in the same manner. While an FBOT should be required to identify its clearinghouse, no more should be required, from a comparability perspective, in the case of a clearinghouse that is located in a jurisdiction with respect to which the Commission has made a comparability determination (and, as recommended above in the case of FBOTs themselves, the Commission should make jurisdiction-by-jurisdiction comparability determinations with regard to foreign clearinghouses that are not registered as derivatives clearing organizations “DCOs” with the Commission).

As the Commission is aware, the LME’s contracts are cleared by LCH.Clearnet, which is registered with the CFTC as a DCO. In such cases, *a fortiori*, the LME and similarly situated FBOTs should not be required to supply the Commission with information regarding the clearinghouse that is already known to the Commission.

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<sup>4</sup> Proposed Rules, at 70995.



Notwithstanding the foregoing, we agree with the Commission that an FBOT should include in its application all applicant-specific rules and information governing or regarding the clearing of contracts that are made available to US persons through direct electronic access.

### 3 *Position Limits*

Under the Proposed Rules, an FBOT offering direct access to a linked contract would be required to adopt position limits no less stringent than those applicable under the rules of the linked market. The LME is sympathetic to the CFTC's desire to ensure that FBOTs are not utilized to circumvent anti-manipulation and related protections applicable to US listed contracts. However, we respectfully note that the Commission's proposal on this point is not consistent with its own observations regarding comparability in general. Foreign markets may well implement restrictions or obligations that could be more stringent or effective than position limits in addressing the regulatory objectives to be addressed by positions limits. Accordingly, we respectfully recommend that the CFTC enable FBOTs to adopt the position limits of a linked market as a safe harbor, but permit applicants to submit for approval any alternative approach that the Commission determines to be comparable in result.

### **B Exemption/Registration**

Under the Proposed Rules, the Commission's existing no-action approach to FBOTs would be replaced with a framework under which FBOTs wishing to provide direct electronic access to their markets would be required to register with the Commission. According to the Commission, the proposed registration framework will establish a more objective and uniform regime and, as a result, greater legal certainty for applicants than does the existing no-action approach.

The LME agrees both with the Commission's observations and objectives. However, while it is accurate that the proposed registration framework would accomplish the objectives cited by the Commission, it is equally clear that a Commission-adopted exemptive framework would accomplish precisely the same objectives. An exemptive framework would also be consistent with current international practice, including the Commission's own, regarding cross-border access. Accordingly, the LME encourages the Commission to develop a framework governing direct electronic access to FBOTs that provides an exemption from registration for FBOTs subject to comparable regulation. The CFTC already has an effective and instructive framework for such an approach in Part 30 of the CFTC Regulations under which exemptions for foreign brokers from foreign commission merchant ("FCM") registration are made available on an essentially jurisdictional basis.

The CFTC's proposal to require registration of FBOTs is particularly anomalous in the context of ongoing efforts by regulators in other jurisdictions to avoid duplicative regulation by adopting regulatory frameworks governing cross-border activity of financial entities and market participants based on comparability-based exemptive



frameworks. For example, the European Union (“EU”) has already adopted an EU-wide regulatory equivalency regime, the so-called “EU passport,” through the Investment Services Directive and, more recently, the Markets in Financial Instruments Directive (“MiFID”) which utilizes a principles-based approach to exempt EU financial market participants and intermediaries authorized and regulated in their home jurisdictions from duplicative and burdensome registration requirements in other EU jurisdictions. Many national jurisdictions currently provide exemptive relief that enables foreign market operators to provide local institutional investors with direct electronic access to their markets.

Consistent with this practice, the European Commission has proposed for comment and is in the process of considering revisions (among others) to MiFID that would allow it to negotiate mutual recognition frameworks with non-EU countries that would result in “exemptive relief for investment firms and market operators based in jurisdictions with equivalent regulatory regimes applicable to markets in financial instruments.”<sup>5</sup> In addition to the significant efficiency benefits inherent in an exemptive approach, the CFTC should also bear in mind considerations of international comity and the likelihood that foreign regulators may adopt reciprocal arrangements for electronic access to US boards of trade abroad, with concomitant inefficiencies and adverse consequences for US markets and market participants.

Notwithstanding the foregoing, the LME appreciates the unique issues that are presented, and the challenges the Commission can face, when a foreign market makes linked contracts available through direct electronic access from the US. To address these concerns, we respectfully recommend that the Commission apply to linked contracts a contract designation process, akin to that applied by the Commission when a DCM submits a new contract for listing.<sup>6</sup> This designation process would subject an FBOT to contract review and compliance obligations, as contemplated by the Commission under the Proposed Rules (subject to the clarification noted above regarding the permissibility of a comparability approach to position limits).

We believe the foregoing approach would be entirely consistent with Congressional intent and the flexibility afforded the Commission under section 738 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). Section 738 authorizes, but does not require, the CFTC to adopt rules and regulations requiring registration with the CFTC for an FBOT that provides its members or other participants in the United States with direct access to its electronic trading and order

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<sup>5</sup> Public Consultation: Review of the Markets in Financial Instruments Directive (MiFID) at Section 8.3 (Dec. 8, 2010), available at [http://ec.europa.eu/internal\\_market/consultations/docs/2010/mifid/consultation\\_paper\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf). The EC also noted that it considers it necessary to establish an EU-wide regime for access by non-EU market participants to EU financial markets “in order to create a real level playing field for all financial services actors in the EU territory.” *Id.*

<sup>6</sup> We note that, to date, linked contracts have tended to involve commodities uniquely deliverable in the US (e.g., WTI light sweet crude oil). It is not as clear to the LME that the same US regulatory interests would arise in circumstances where the underlying commodity is not a US-centric commodity.



matching systems. Other provisions, such as Section 752 of Dodd-Frank, further admonish the Commission to consult and cooperate with international regulators. In light of these provisions, we believe the CFTC should adopt a regulatory approach that minimizes the resource burdens imposed on its staff and on other market operators and participants and that respects important considerations of international comity. The LME, therefore, encourages the CFTC to adopt a comparability-based exemptive approach that defers, to the extent practicable, to home country regulation of FBOTs and imposes only those incremental informational and documentation requirements necessary to fulfill its statutory mandate, with designation and heightened regulation of linked contracts.

### **C Definition of “Linked Contract”**

The LME respectfully requests confirmation by the Commission regarding the scope of the definition of “linked contract.” The Proposed Rules define a linked contract as a “futures or option or swaps contract made available for direct access from the United States by a registered foreign board of trade that settles against any price (including the daily or final settlement price) of one or more contracts listed for trading on a registered entity as defined in section 1a(40) of the [Commodity Exchange] Act.”<sup>7</sup> We read this definition to capture explicit, contractual terms that provide for the use of the linked market’s settlement price and we do not understand this definition to capture any contracts of the type traded on the LME, all of which settle against prices generated by the LME. We would appreciate confirmation by the Commission of our reading of this definition.

### **D Definition of “Direct Access”**

We also request that the Commission provide further guidance as to the scope of the “direct access” definition and the degree to which this covers access to application programming interfaces developed by members to interface with exchange systems (“APIs”). The Proposed Rules define “direct access” as “an explicit grant of authority by a foreign board of trade to an identified member or other participant located in the United States to enter trades directly into the trade matching system of the foreign board of trade.”<sup>8</sup> While the proposed definition does not provide clear guidance on this issue, the LME generally understands “direct access” to mean access to the graphical user interface (“GUI”) of an FBOT, and not indirect access via an API. This approach would be consistent with the approach generally adopted by other regulators. It is critical that FBOTs understand clearly the circumstances under which they would be regarded as providing direct access in light of the significant regulatory responsibilities placed on them with respect to these participants (eg, compliance with restrictions on the categories of persons who are permitted to have such access).

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<sup>7</sup> Proposed Rules, at 70988.

<sup>8</sup> Id.





## **E Scope of Contracts Eligible for Direct Access**

We ask that the Commission consider expanding the scope of the contracts eligible for direct access under the Proposed Rules. The LME understands and accepts the CFTC's proposed restriction prohibiting direct access to a contract that would be unlawful for a DCM to list for trading in the US. However, the NPR appears to go beyond this prohibition and to restrict direct access to futures, commodity options and swaps. The LME sees no reason why the scope of contracts available for trading through direct access should be circumscribed in such a limited manner, and to prohibit direct access, for example, to spot and forward contracts, as well as other contracts that may be lawfully made available for trading in the US (subject, of course, to compliance with any non-CFTC rules or regulations that may be applicable to such contracts). Accordingly, we respectfully request the Commission to reconsider the scope of contracts and products eligible for direct access under the Proposed Rules so as not to prohibit access to any contract that may be lawfully made available for trading in the US, subject to compliance with applicable legal requirements.

As the Commission is aware, LME contracts generate new settlement dates for trading on each trading day, including contracts that settle within the regular settlement cycle for spot contracts, as well as contracts intended to be physically settled by the contracting parties. We respectfully request the Commission's confirmation that any limitation it may contemplate with respect to the contracts that may be offered through direct access would not include any such contracts listed by the LME.

## **F Timeframe for Existing No-Action FBOT Registration**

The LME encourages the Commission to extend the timeframe under which FBOTs operating pursuant to existing no-action relief can continue to offer direct access after the effective date of the Proposed Rules without having submitted a completed FBOT application. The proposed 120-day period is much too short given the scope of the information and documents that even FBOTs eligible for the "limited" registration process are required to submit. For example, these FBOTs must include all of the information and documentation required of initial applicants. Furthermore, to the extent an FBOT wishes to rely upon previously submitted information or documents in its application, it must "resubmit the information or documentation, identify the specific requirements for registration...satisfied by the resubmitted information, and certify that the information remains current and true."<sup>9</sup> In this regard, we respectfully request that the Commission reconsider the requirement that FBOTs resubmit materials and information previously submitted in connection with a granted application for no-action relief.

There does not appear to be any compelling reason for the imposition of such a short timeframe for FBOTs operating pursuant to no-action relief to complete their

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<sup>9</sup> Id., at 70989



registration applications. Indeed, the Commission has an existing framework that accomplishes much - if not substantively all - of the proposed framework, albeit on a no-action basis. Given the time-consuming nature of what amounts, in practical terms, to a full registration application and the serious market disruptions that could result from an FBOT's inability to complete a "limited" application within the proposed 120-day period, the LME respectfully requests that the CFTC consider adopting a 180-day time period.

## **G US-Based Trading Volume**

Under the Proposed Rules, a registered FBOT must, on a quarterly basis and also any time at the request of the Commission, provide the Commission with information for each contract made available for trade in the United States regarding its total trade volume originating from electronic trading devices in the United States as well as worldwide.<sup>10</sup> In the NPR, the CFTC seeks comment regarding whether a specified percentage of US origin volume should disqualify a foreign board of trade for treatment as an FBOT under the Proposed Rules. The LME does not believe that the volume of US executed trades alone is relevant to an FBOT's status as a *bona fide* foreign board of trade. So long as the core operations of the FBOT such as market governance, administration, operation of the central electronic processing systems and surveillance are conducted outside of the United States - as has been required under the no-action process and would continue to be required under the Proposed Rules - and the FBOT has both an operating history and is regulated abroad, the level of US trading volume should not be a relevant factor in evaluating whether or not an FBOT is "foreign," is entitled to an exemption from DCM or DTEF registration, or is eligible for FBOT status under the Proposed Rules (as the same may be amended by the Commission prior to adoption).

Indeed, the Commission's adoption of a comparability standard effectively polices against the organization of FBOTs in such light touch jurisdictions to evade effective regulation and mitigates the adverse consequences of any such strategy. Moreover, in the case of a *bona fide* foreign board of trade that has existed for a number of years in a foreign jurisdiction subject to comprehensive regulatory oversight, emphasis on US-originated volume seems wholly inappropriate.

## **H Submission of US-Domiciled Entities to Service of Process**

Under the Proposed Rules, certain US domiciled persons would be required to submit to service of process in the United States and to designate an agent for that purpose. More specifically, each current or prospective member of an FBOT or other participant that is granted direct access to the FBOT's electronic trading and order matching systems from the United States pursuant to the FBOT's registration and is not itself registered with the Commission as an FCM, a commodity trading advisor ("CTA") or a commodity pool operator ("CPO") would be required to: (1) file a written representation with the Commission submitting to its jurisdiction; (2) file a

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<sup>10</sup> Id., at 70993.





valid and binding appointment with the FBOT of a United States agent for service of process; and (3) maintain a written representation with the FBOT that it will provide the Commission and other US authorities with prompt access to its original books and records as well as to the premises where its trading system is available in the United States.

The Commission has, in the past, imposed such requirements on non-US domiciled persons, such as foreign brokers, accessing US DCMs for trading purposes. In that context, the requirement is understandable in light of potential limitations on *in personam* jurisdiction in the US. Such jurisdictional issues, however, are no more raised in the case of US persons trading from the US on a foreign market than in the case of US persons trading from the US on US markets. We therefore do not understand the need or motivation for this proposed requirement.

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The LME appreciates the opportunity to comment on the Proposed Rules regarding registration of FBOTs. We would be pleased to discuss any of the comments or recommendations in this letter with the Commission or its staff in greater detail.

Yours sincerely

**Martin Abbott**