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Hong Kong Futures Exchange Limited

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

18 January 2011

Mr. David Stawick
Secretary to the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
U.S.A.

Dear Mr. Stawick,

Proposed Rules on the Registration of Foreign Boards of Trade – (RIN 3038-AD19)

We refer to the email from Mr. Duane Andresen of your Division of Market Oversight dated 24 November 2010 inviting us to provide comments on the Notice of Proposed Rulemaking (75 Fed. Reg. 70973 (19 November 2010)) and the accompanying draft rules regarding the registration of foreign boards of trade.

We welcome the opportunity to comment on the proposals and enclose our response for your consideration.

Please do not hesitate to let us know if you have any questions. We would be pleased to discuss our comments and any issues arising from them with the Members of the Commission and the relevant Commission staff officials.

Yours sincerely,

Gerald Greiner
Chief Executive

Encl.

cc: Mr. Martin Wheatley – Chief Executive Officer, Securities and Futures Commission

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**Comments of Hong Kong Futures Exchange Limited on
Proposed Rules Governing the Registration of Foreign Boards of Trade**

18 January 2011

A. Background

1. Hong Kong Futures Exchange (“**HKFE**”) is one of the foreign exchanges that have been operating under a “direct access no-action relief” granted by the Commodity Futures Trading Commission (the “**CFTC**”). Pursuant to a no-action letter dated 9 June 2000 and a subsequent letter dated 30 July 2001, HKFE is permitted to make its electronic order matching system, Hong Kong Automated Trading System (“**HKATS**”), available to its Exchange Participants and certain non-Exchange Participants located in the U.S. without being subject to enforcement actions due to the failure to obtain designation as a “contract market” pursuant to Section 5 of the Commodity Exchange Act (the “**CEA**”) or the failure to effect registration as a “derivatives transaction execution facility” under Section 5a of the CEA (collectively, the “**Section 5/5a No-action Relief**”). This covers the trading of nine types of products offered by HKFE including the broad-based security index products, Hang Seng Index Futures Contracts, Hang Seng China Enterprises Index Futures Contracts and mini-futures contracts based on the Hang Seng Index and the Hang Seng China Enterprises Index (the “**Approved Index Products**”).
2. Separately, HKFE has also obtained CFTC no-action letters concerning the offer and sale in the U.S. of all the Approved Index Products, i.e. no-action relief from enforcement based on Section 2(a)(1)(C)(iv), 4(a) or 12(e) of the CEA if these products are offered or sold in the U.S. (the “**Offer and Sale No-action Relief**”).
3. At the end of November 2010, the CFTC invited HKFE to provide comments on the Notice of Proposed Rulemaking (75 Fed. Reg. 70973 (19 November 2010))(the “**Release**”) and the accompanying draft rules regarding the registration of foreign boards of trade (the “**Proposed Rules**”). It appears that the effect of the Proposed Rules is to do away with and replace the no-action relief previously granted to foreign exchanges and to subject all the exchanges (to be termed as “foreign boards of trade” or “**FBOTs**”) to a new registration regime.
4. This paper sets out HKFE’s key comments on the Proposed Rules and raises a number of fundamental questions which we hope could be clarified by the CFTC. HKFE hopes that our comments would assist the CFTC in its efforts in devising a registration regime that would not only further the regulatory objectives as explained in the Release, but also one that would be user-friendly and conducive to facilitating mutual reciprocity and reasonable accommodation of the interests of all markets worldwide.

B. Comments

1. Potentially full-blown registration process

Although the CFTC has represented that the registration requirements are similar to those of the existing no-action relief and foreign exchanges such as HKFE would only be subject a “limited” application process, upon review of the Proposed Rules, our overall impression is that the breadth and depth of information required under the registration regime is extensive and detailed and cannot be readily satisfied by relying on the no-action relief application filed by HKFE in 1999-2000. Specifically, the proposed registration criteria require a substantial volume of material that was not included in the original application and

that would need to be updated significantly as a result of the passage of time. On the whole, HKFE finds the registration requirements much more onerous than expected.

In the Release, the CFTC refers to the registration process by exchanges which have already been granted no-action relief as a “limited” process. In practice, HKFE does not think that the registration process can be regarded as “limited”. This is because the process envisaged by the CFTC would involve HKFE going through the following steps:

- review all the documents and information submitted in its 1999 application;
- identify the registration requirements which would be satisfied by the previously submitted information and documents;
- re-submit these information and documents to the CFTC again and certify that these information and documents remain “true and current”; and
- comply with all the other registration requirements stipulated in the Proposed Rules by submitting the necessary information and documents to support its application.

Effectively, therefore, HKFE still has to identify all the “gap” information and documents and submit them to the CFTC for the purpose of meeting the registration standards. Given the substantial period of time that has passed since HKFE applied for no-action relief and the comprehensive and expanded nature of the registration criteria, the requirement for “limited” registration will not, in our view, be significantly less onerous or burdensome than if HKFE were to go through a new or full-fledged registration. HKFE believes the work involved in submitting a “limited” application under the proposed regime would be substantially more than the 50 hours estimated by the CFTC.

Accordingly, HKFE strongly recommends that the CFTC grandfather FBOTs which have been granted a Section 5/5a No-action Relief and accept them as registered entities under the new registration system (see 2 below). At a minimum, the CFTC should establish a registration process for existing FBOTs with no-action relief that is, in fact, “limited” and calls for additional information only in those areas where it believes that it has a demonstrable need.

2. Grandfathering

It is not obvious from the Proposed Rules that applications for registration by FBOTs which have already been granted a Section 5/5a no-action relief would be viewed more favourably or less stringently than from entities which have not been granted any no-action relief before. As far as HKFE is aware, there is, at present, no concrete proposal to provide any “grandfathering” to these exchanges.

HKFE has operated under the Section 5/5a No-action Relief for over 10 years. The CFTC has substantial experience in dealing with us and to our knowledge, there has not been any compliance problems or difficulties. Given this experience, it seems that putting FBOTs such as HKFE through another burdensome, time-consuming and expensive application process appears unnecessary and an inefficient use of the CFTC’s resources. As the CFTC has already accepted HKFE as an exchange that has satisfied requirements for the no-action relief and CFTC has publicly stated that there is no substantive policy or standard difference between the criteria they have adopted in the existing regime and those to be

adopted under the new system, it is our view that exchanges such as HKFE should not be subject to a full-blown substantive rule-by-rule review under the new registration system. The CFTC should be able to take comfort from its own no-action relief and take a broad-brush policy view on the suitability of a foreign exchange in relation to the new registration system.

3. Regulation of foreign exchange market transactions should defer to home country regulation

HKFE notes the regulatory objectives of the Proposed Rules. However, the CFTC has already determined that FBOTs currently allowed to operate in the U.S. are subject to comprehensive and comparable regulation in their home jurisdictions under the no-action relief regime. Moreover, international markets have evolved in the past few years particularly in light of the lessons drawn from the global financial crisis. The degree and rigour of supervision and regulation that FBOTs are subject to in their home country jurisdictions (such as the regulatory scrutiny that HKFE is subject to under the oversight of the Securities and Futures Commission (the “SFC”) in Hong Kong), as well as the level of regulation on exchange participants and the protection afforded to their customers and public investors alike, have been extended, developed and refined.

Therefore, HKFE believes that except where the CFTC has fundamental concerns over a jurisdiction’s regulations, regulatory objectives or practices or its regulator on the basis of, for example, comparability or transparency, a substantive or a rule-by-rule review by the CFTC (as a foreign regulator to FBOTs) for the purpose of registration of FBOTs may not be necessary or appropriate. Instead, we suggest that the CFTC could defer any particular regulatory issues to the regulator and the regulatory regime of the FBOT’s home country jurisdiction unless it has reasons to believe on an exception basis that an FBOT like HKFE is not meeting the standards required by the CFTC.

4. Mutual reciprocity

It seems to us that the adoption of the Proposed Rules would be a departure from the CFTC’s long-standing policy of mutual recognition and comity. This has the potential of putting the U.S. out of step with the regulatory approach taken in other jurisdictions and could lead to the diminution rather than the expansion of global connectivity.

HKFE understands that certain U.S. contract markets have obtained regulatory approvals in overseas jurisdictions and will continue to seek authorization to locate their trading terminals abroad. In fact, for example, in Hong Kong, a number of order entry and trading terminal systems of various U.S. contract markets have been granted access by the SFC under a very simple authorisation process that relies, for the most part, on the U.S. home market regulation and cooperation between the regulators. Please see the SFC’s Guidelines for the Regulation of Automated Trading Services:

<http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileServlet?docno=H198>

HKFE supports this reciprocity standard, especially if it is applied uniformly among international regulators. HKFE encourages the CFTC to preserve a regulatory system that is based on mutual recognition, since such a system benefits exchanges and market participants in all countries, including the U.S. Creating unnecessary obstacles to cross-

border trading will affect all markets and market participants and limit the use of risk mitigating instruments traded in global markets. Thus, for example, while HKFE could not expect to enter the U.S. with its trading services if Hong Kong authorities were to wall out the U.S. contract markets, foreign markets like HKFE can take comfort that protectionist action within the U.S. would also be discouraged because it could provoke similar treatment of U.S. contract markets seeking foreign expansion. Mutual reciprocity should stimulate reasonable accommodation of the interests of all markets worldwide.

C. Questions/Issues

1. Effect of the Proposed Rules

While the existing no-action relief letters expressly state that HKFE or an FBOT would be relieved from prosecution for failing to comply with Sections 5 or 5a of the CEA, the Proposed Rules have not expressly mentioned this specifically.

At present, Section 48.6(a) of the Proposed Rules provides that an FBOT operating pursuant to an existing no-action relief must register with the CFTC in order to continue to provide “direct access” to its electronic trading and order matching system from the U.S. Section 48.3(a) further states that it shall be unlawful for an FBOT to permit “direct access” to its electronic trading and order matching system from within the U.S. unless and until the CFTC has issued a valid and current Order of Registration to the FBOT pursuant to the new Part 48. However, there is no express provision in the Proposed Rules stating that registration under Part 48 would relieve an FBOT from compliance with Section 5 or 5a of the CEA. HKFE assumes that this is the intention and would be grateful if the CFTC could let us know if this understanding is not correct.

2. Impact of the Proposed Rules on the Offer and Sale No-action Relief

HKFE understands that the intention of the Proposed Rules is to do away with the Section 5/5a No-action Relief. It is not entirely clear, however, whether the Offer and Sale No-action Relief would be affected by the Proposed Rules or the withdrawal of the Section 5/5a No-action Relief as a result of the introduction of the Proposed Rules.

HKFE assumes that it can regard the no-action relief in relation to the offer and sale of the Approved Index Products independently of and not affected by the introduction of the FBOT registration system or the withdrawal of the Section 5/5a No-action Relief, hence, a new application for the Offer and Sale No-action Relief is not necessary or ancillary to an application for FBOT registration under the Proposed Rules. Please advise if this assumption is not correct. We would also be grateful if the CFTC could indicate whether there is any intention to limit or withdraw the Offer and Sale No-action Relief whether as part of the proposals to introduce the FBOT registration system or as part of a wider scheme (if any) to regulate FBOTs.

3. Meaning of “direct access”

Section 48.2 of the Proposed Rules defines “direct access” to mean “an explicit grant of authority by a foreign board of trade to an identified member or other participant located in the U.S. to enter trades directly into the trade matching system of the foreign board of trade”.

We understand that this definition appears in the Dodd-Frank Act.

It would be helpful if the CFTC could clarify the meaning of “explicit grant of authority” and, if possible, provide examples of the kind of conduct or actions on the part of an FBOT that would be regarded as “an explicit grant of authority”. It would also be helpful if the CFTC could clarify in the Proposed Rules its previous position taken in connection with the prior no-action process that an automatic order routing connection from the U.S. to an FBOT would not be considered as “direct access”.

4. Meaning of “foreign board of trade”

Under the Proposed Rules, “foreign board of trade”, the subject of the regulations, is defined to mean “any board of trade, exchange or market located outside the United States”, incorporated or not, where “foreign agreements, contracts or transactions are entered into”.

We would be grateful if the CFTC could advise whether the definition would cover alternative trading platforms such as non-U.S. based dark pools.

If the intention of the Proposed Rules is not to cover non-U.S. based dark pools or is designed with such threshold requirements as to effectively only affect traditional exchanges in overseas jurisdictions (as not all FBOTs (as defined) are eligible for registration under the Proposed Rules), HKFE queries whether an uneven playing field may be created in favour of these dark pools if access to them are available from the U.S.

HKFE wishes to thank the CFTC for the opportunity to comment on the Proposed Rules and hopes that the above would positively contribute towards the discussion on the regulation of FBOTs in relation to direct access.

Hong Kong Futures Exchange Limited

18 January 2011