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DIVISION OF
TRADING AND MARKETS

August 9, 1993

Ms. Eileen T. Flaherty
Associate General Counsel
Chicago Mercantile Exchange
30 South Wacker Drive
Chicago, Illinois 60606

Re: Passing the Book

Dear Ms. Flaherty:

This letter supersedes the discussion in section II of the Division of Trading and Markets ("Division") no-action letter of June 25, 1992. That letter responds to your letter of the same date in which you request on behalf of member firms of the Chicago Mercantile Exchange ("CME") and the Chicago Board of Trade ("CBOT") (hereinafter, referred to as the "Exchanges") and certain of their foreign affiliates, among other things, that the Division adopt a no-action position with respect to certain Commodity Futures Trading Commission ("Commission" or "CFTC") registration requirements that otherwise would apply to such firms were they to "pass the book" of their Globex customer orders to their foreign affiliates with Globex terminals. [1/] The changes set forth in this letter which reflect subsequent discussions between the Division and the Exchanges will apply prospectively and are not intended to adversely affect transactions undertaken in a manner consistent with the Division's June 25, 1992 letter or other relief granted thereunder.

In the June 25 letter and in subsequent conversations, you have made the following representations:

> The Globex Trading System is an after-hours automated order entry and matching system for futures and options on futures that will be

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1/ For purposes of this letter, the term "pass the book" or "passing the book" refers to the process by which orders for Exchange contracts received for or on behalf of customers of an Exchange member firm are transferred for entry into Globex terminals located in a non-U.S. office of a foreign affiliate of that Exchange member firm outside normal business hours in the U.S.

available in major financial centers throughout the world. It will operate approximately between the hours of (Chicago time) 2:30 p.m. and 6:00 a.m. Since these hours will overlap with the regular business hours in other time zones, foreign participation is anticipated. For this reason, certain CME and CBOT firms have indicated that they may staff their U.S. operations for part of the Globex Session and then would staff for the remainder of the Globex Session at a foreign affiliate of the Exchange member firm, as qualified pursuant to Exchange rules.

CME Rule 574 provides that affiliates of clearing members under common ownership with such members are eligible for Globex terminals. Similarly, the CBOT is permitting foreign affiliates of member firms to have access to its contracts through Globex if the foreign affiliate is controlled by its parent which also controls the CBOT member firm. For tax and other reasons, many members' foreign offices are established as separate legal entities. However, under Exchange rules, the Exchange member firm is responsible for Globex-related activities of Globex terminal operators located in offices of its affiliates, including activity on behalf of U.S. and non-U.S. customers. 2/

It is expected that the foreign affiliates will primarily service foreign customers that intend to trade through Globex. However, certain individuals in the foreign office would be designated to accept orders on behalf of the U.S. firm from U.S. customers. Given the hours of Globex, it is unlikely that U.S. customer business through these individuals would be significant. Nonetheless, certain Exchange member firms would like to have the flexibility to enable designated persons to accept such orders.

The Exchanges have requested clarification as to the U.S. regulatory requirements applicable to two types of activity undertaken on behalf of customers of the Exchange member firm by

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2/ CME Rule 901.M; CBOT Ruling 9A.04A.

individuals described for purposes of this letter as Designated Persons who are located in foreign affiliate offices. The first is the acceptance and entry of orders from customers of the Exchange member firm [3/] by individuals in the office of the affiliate, acting solely in a clerical capacity, exercising no discretion. Such individuals would act upon the instructions of customers and would merely accept customer orders for terminal entry. The Exchanges propose that, in such situations, the individuals need not themselves be registered persons, provided that they are supervised by a person at the foreign affiliate who is registered with the Commission as an associated person ("AP") of the Exchange member firm.

The second type of activity includes situations in which individuals at the foreign affiliate would handle the accounts of existing customers of the Exchange member firm, or accept or enter orders from such customers in other than a clerical capacity. The Exchanges propose that each individual who acts in such a capacity be registered as an AP of the Exchange member firm.

Because the foregoing arrangement raises issues with respect to domestic registration of the foreign affiliate and the Designated Persons handling customer orders, you have requested no-action relief on behalf of Exchange member firms and their qualified foreign affiliates and certain Designated Persons located at the foreign affiliates to permit such Designated Persons to engage in the two aforesaid activities for or on behalf of customers of the Exchange member firm. In particular you have requested no-action relief to:

> . . . permit certain individuals designated by the Exchange member firm as authorized to solicit, accept, or enter orders for [existing] . . . customers on behalf of the Exchange member firm without requiring the foreign affiliate to register with the CFTC . . . .

Section 4d of the Commodity Exchange Act ("Act") provides:

> It shall be unlawful for any person to engage as [an FCM] or introducing broker ["IB"] in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery, or involving any contract of sale for future delivery, on or subject to the rules of any contract market unless --

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3/ The term "Exchange member firm" refers to a CME or CBOT member firm that is located in the U.S. and registered as a futures commission merchant ("FCM").

> (1) such person shall have registered, under the Act, with the Commission as such [FCM] or introducing broker . . . .

Section 4k of the Act provides:

> (1) It shall be unlawful for any person to be associated with [an FCM] as a partner, officer, or employee, or to be associated with an introducing broker as a partner, officer, employee or agent . . . in any capacity that involves (i) the solicitation or acceptance of customers' orders (other than in a clerical capacity) or (ii) the supervision of any person or persons so engaged, unless such person is registered with the Commission under this Act as an [AP] of such [FCM] or of such introducing broker . . . . [4/]

The Exchanges believe that the relief requested would facilitate transmission of orders for CME and CBOT contracts by existing customers of Exchange members for servicing to a foreign affiliate during hours when the Exchange member firm is closed. In considering this request, the Division is mindful of the Commission's view that ordinarily an AP must be situated in either the main office or a designated branch office of a

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4/ In the context of Globex, those terminal operators located at licensed FCMs which enter non-discretionary customer orders (i.e., those merely translating customer instructions into keystrokes) currently are exempt from the Commission's AP registration requirements. See Memorandum of the Division to the Commission dated February 2, 1989, recommending approval of CME's Globex proposal ("CME Globex memorandum"), at pp. 20-22. See also, Memorandum of the Division to the Commission dated June 20, 1992, recommending approval of CBOT's Globex proposal ("CBOT Globex memorandum"), at pp. 15-17. This conclusion was premised in part on the Exchanges' assurances that such terminal operators would be supervised by Commission-registered APs. CME Globex memorandum at p. 21 and CBT Globex memorandum at p. 16. See also CFTC Interpretative Letter No. 82-2, Comm. Fut. L. Rep. (CCH) [1982-1984 Transfer Binder] ¶ 21,784 at 27,168 (June 9, 1982). But see 58 Fed. Reg. 19575 (April 15, 1993) in which the Commission deferred consideration of application of the floor trading registration requirement to persons using electronic trading systems.

registrant [5] in order to ensure adequate supervision, and to eliminate uncertainty as to the regulatory responsibilities, of all persons engaged in activities subject to regulation under the Act. [6]

The Commission's policies in this regard predated the advent of automated order entry and matching systems for trading regulated futures contracts and did not contemplate the existence of an automated trading system with the capacity to extend trading hours beyond the normal operating hours of registered firms. As a consequence, the application of the CFTC's registration requirement to offices in which the offshore terminals for such systems are located is a case of first impression. [7]

The Division believes that the limited order handling services contemplated by the Exchanges' June 25, 1992 letter (that is, after-hours use of a Globex order matching facility located outside the United States where any solicitation of trades would be limited to solicitation by a registered AP of existing customers of the Exchange member firm subject to extensive supervisory safeguards) do not raise the same regulatory concerns as would, for example, the operation of "full-service" offices to solicit and accept orders for execution

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5/ See S. Rep. No. 384, 97th Cong., 2d Sess. 40-41 (1982), and "Final Rules on Registration and Other Regulatory Requirements and Notice of Qualification for 'No-Action' Position Regarding Introducing Brokers," 48 Fed. Reg. 35248, 35252-35253 (August 3, 1983), reprinted in Comm. Fut. L. Rep. (CCH) [1982-1984 Transfer Binder] ¶ 21,792 at 27,198. See also CFTC Interpretative Letter No. 89-8, Comm. Fut. L. Rep. (CCH) [1987-1990 Transfer Binder] ¶ 24,495, at 36,148 (July 19, 1989).

6/ See also CFTC Interpretative Letter No. 84-26, Comm. Fut. L. Rep. (CCH) [1984-1986 Transfer Binder] ¶ 22,472, at 30,096 (December 6, 1984). But see CFTC Interpretative Letter No. 84-18 (CCH) [1984-1986 Transfer Binder] ¶ 22,388 (September 26, 1984) (Division no-action letter regarding non-proprietary branch office.)

7/ In adopting rules requiring sales agents of FCMs to register as IBs, the Commission stated that it would continue to monitor the effects of those rules and consider revisions as may be necessary. 48 Fed. Reg. 35248, 35278. Moreover, in Interpretative Letter No. 84-26, the Commission noted that it may be appropriate for the Commission's staff to grant specific relief from these requirements in certain cases. Interpretative Letter No. 84-26 at 30,099.

on contract markets from U.S. customers during normal day-time exchange operating hours.

Among other things, to qualify under Exchange rules for terminal access the foreign affiliate must be controlled by or be under common control with the Exchange member. You have indicated that the foreign affiliates soliciting, accepting and/or entering orders for existing customers of an Exchange member firm through Designated Persons would operate with regard to such customer business as agents of the Exchange member firm and, as such, for purposes of such customer business the Exchange member firm would be liable under the Act and Commission regulations for the acts of the foreign affiliate, including those of the Designated Persons at the foreign affiliate. 8/ In addition, you have represented that under Exchange rules approved by the Commission, the Exchange member firm would have supervisory responsibility for passing the book activities on Globex.

The Exchanges have set forth in their June 25, 1992 letter certain conditions to their request for no-action relief that they believe will ensure that the CFTC and the Exchanges will be able to satisfy their respective obligations under the Act in connection with activities related to passing the book. 9/ Those conditions are as follows:

> All Exchange member firms that intend to operate pursuant to the relief granted herein must identify themselves and their foreign affiliates, and all Designated Persons at such affiliates authorized to solicit, accept, or enter orders from customers on behalf of the member, in writing to the Exchanges, the National Futures Association ("NFA"), and the Commission.
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> All solicitations, acceptances or entries of orders for Exchange contracts on Globex by the foreign affiliate through its Designated Persons for or on behalf of customers of the Exchange member firm under the circumstances

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8/ In addition, the Exchange member firm would have the same regulatory responsibilities for Designated Personnel at the foreign affiliate who are registered as APs as it would for any other of its APs.

9/ The Exchanges' proposed conditions are substantially similar to those set forth by the Securities and Exchange Commission in granting no-action relief regarding the entering of orders into the NASDAQ International Service by foreign affiliates of member firms. SEC Release No. 34-29812, 56 Fed. Reg. 52082, 52088 (October 17, 1991).

described herein are acts of the Exchange member firm for which the foreign affiliate acts as agent, and the Exchange member firm is liable under the Act, the Commission's regulations and Exchange rules for all such acts. All Globex trading rules of the Exchanges continue to apply in connection with activities involving passing the book. In addition:

All customer accounts must be carried on the books of the Exchange member firm as customer accounts of that firm, including for purposes of computing net capital.

All written communication with customers must be by the Exchange member firm on its own stationery.

All monies, securities, and property of customer accounts must be maintained with the Exchange member firm.

The Exchanges will be responsible for advising Exchange member firms that they must maintain the appropriate level of supervision of Designated Persons engaging in the activities which are the subject of this letter and that failure to do so may result in the termination of this relief as to particular firms.

At least one of the Designated Persons at the foreign affiliate, regardless of whether discretionary or non-discretionary orders are accepted and entered, must be an AP and all Designated Persons at each such foreign affiliate must be subject to the supervision of a registered AP.

All Designated Persons who solicit customer orders or accept or enter such orders on a discretionary basis must be registered as APs of and sponsored by the Exchange member firm.

The Exchanges' disciplinary authority regarding activities that occur at the foreign affiliate will include authority over the Designated Persons and the Exchange member firm must have the right to terminate the authority of any Designated Person at the foreign affiliate to solicit, accept, or enter orders on behalf of customers.

Each Exchange member firm must obtain from any Designated Person not required to be registered under the circumstances described herein who accepts or enters customer orders at the foreign affiliate an acknowledgment that such person is subject to the Act, the Commission's regulations, and Exchange rules with respect to the activity that is the subject of this letter.

Each Exchange member firm must disclose the nature of the arrangement to its customers and provide specific instructions concerning the placement of orders pursuant to the arrangement.

Each Exchange member firm and its foreign affiliate must jointly and severally undertake in writing to ensure the Commission, upon request, prompt access, consistent with Commission Regulation 1.31 and applicable self-regulatory organization rules, to original books and records, wherever located, that relate to the soliciting, accepting, or entering of customer orders on behalf of such member at the foreign affiliate. 10/

The foreign affiliate must appoint an agent in the U.S. and consent to service of process in the U.S. with respect to

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10/ The Division notes that all data entered into the Globex terminal through this order transmittal process will be maintained at and available from the Exchange and the Exchange member firm.

The Division notes that the relief granted herein is premised on the ability of the CFTC and Exchanges to have access to relevant books and records maintained at the foreign affiliate. Such access is presumed adequate in jurisdictions where the CFTC has an arrangement with the relevant regulatory authority in that foreign jurisdiction to share information on a cooperative basis. If no such arrangement exists, the Division may require such additional assurances as may be deemed necessary on a case-by-case basis. Nothing in this letter or the arrangements made hereunder will prejudice the ability of the CFTC to obtain information, documents or testimony in connection with the operation of this no-action relief pursuant to any relevant memorandum of understanding or other arrangement for cooperation or any other available means whatsoever.

Finally, the Division notes that the Exchanges have represented that under relevant Exchange rules applicable to their members, they have the ability to request from their members access to the books and records of their members' foreign affiliates and that such members must undertake to obtain such books and records. See CME Rule 432.1 and CBOT Rule 545 and CBOT Ruling 9A.04A.

such affiliate's activities which are the subject of this letter. 11/

Each Exchange member firm must acknowledge in writing to the appropriate Exchange that the firm accepts the conditions set forth herein.

Essentially, the Exchanges represent that they will have the ability to monitor and investigate trading on Globex involving passing the book as described herein equivalent to their ability to do so in connection with orders placed directly at the Exchange member firm.

Based on these representations, and subject to the conditions set forth below, the Division believes that no-action relief from the requirement that sales or order acceptance activities may only take place within an FCM or from its branch offices (or from the offices of a registered IB) is appropriate under the circumstances herein. Accordingly, the Division will not recommend that the Commission take enforcement action against any Exchange member firm, its foreign affiliate or Designated Persons of such affiliate for failure to comply with the registration requirement in Section 4d of the Act in connection with the solicitation, acceptance or entry of orders for existing customers of the Exchange member firm for transactions in Exchange contracts on Globex through a foreign affiliate acting as agent of such Exchange member firm outside normal U.S. business hours. 12/

If for any reason the Division determines that either the Commission's or Exchanges' ability to monitor and investigate trading activity is impaired, or if either the Commission or the Exchanges are unable to obtain prompt access to books and records necessary to fulfill their respective regulatory obligations under the Act, or for any other reason the Commission or the Commission's staff determines in its discretion to be appropriate, the relief in this letter will be deemed withdrawn as to any particular Exchange member firm and its foreign

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11/ If the foreign affiliate has filed an agency agreement with the National Futures Association in accordance with Commission rule 30.5 for purposes of relief under Part 30 of the CFTC's rules, the firm may represent in writing that such agency appointment is valid in connection with this no-action relief.

12/ This relief does not alter the requirement that any foreign affiliate doing U.S. customer business on its own behalf must be registered with the Commission in the appropriate category or be exempt from registration.

affiliate upon written notice to the Exchange member firm and its affiliate, respectively, as appropriate. Relief may also be terminated as to all affiliates in a particular foreign jurisdiction by notice to the Exchange. In such event, provisions will be made for servicing existing positions through the Exchange member firm.

The relief described above is limited to orders entered into Globex. In addition, prior to implementing this no-action letter and the timeframes for satisfying the AP registration requirements set forth in Section III of the June 25, 1992 letter in any new jurisdiction not approved by the Division to date, the Exchanges must provide notice to the Division. Absent any objection from the Division within ten (10) days of receipt of such notice, the Exchanges may initiate procedures to implement this no-action relief as to that jurisdiction. Further, the Division will monitor the amount of activity engaged in pursuant to the above arrangement to determine whether the relief provided for remains appropriate.

The views expressed in this letter are based on the representations that you have made in your June 25, 1992 letter and are strictly limited to those representations. Any different, changed, or omitted facts or conditions might require the Division to reach a different conclusion and we therefore request that you notify us immediately if the facts change in any way from those as represented in your letter. The views expressed herein do not modify, limit or otherwise affect the Commission's jurisdiction for enforcement purposes over any person. The Division emphasizes that the relief granted in this letter does not excuse any person from compliance with any otherwise applicable requirements contained in the Act or the Commission's regulations, the rules of any U.S. self-regulatory organization or the laws, rules or orders of any jurisdiction in which affiliates' Globex terminals are located.

The views expressed in this letter are solely those of the Division and do not necessarily represent the views of the Commission or of any other division of the Commission.

Very truly yours,

Andrea M. Corcoran
Director