

CFTC Letter No. 00-94**September 27, 2000****No-Action****Division of Trading & Markets**

Re: Rules 30.10 and 30.4 – No-Action Relief In Connection With Registration
as an Introducing Broker

Dear :

I. INTRODUCTION

This is in response to your letter dated February 18, 2000, supplemented by other correspondence up through September 14, 2000, to the Division of Trading and Markets submitted on behalf of “P”, a registered futures commission merchant (“FCM”), and its indirect parent, “Q”, including branch offices of “Q”, as supplemented by additional correspondence and telephone conversations with Division staff. Your letter, as supplemented, requests confirmation that “Q’s” London branch office (“R”) may qualify for an exemption from registration with the Commodity Futures Trading Commission (“Commission” or “CFTC”) in accordance with Commission Rule 30.10.¹ Further, the letter requests that the Division confirm that “Q’s” New York branch office (“S”) may register separately with the Commission as an introducing broker in accordance with Commission Rule 30.4. Finally, the letter requests that the Division confirm that it will not recommend any enforcement action against “P”, “S”, or “R” for aspects of the business arrangement that do not comport with certain Commission rules, as described below.

II. FACTS

Based upon the representations in your letter, as supplemented, we understand the facts to be as follows.

“Q” is a bank organized under French law, with branch offices in London and New York, among other locations. In accordance with the provisions of the Bank Holding Company Act, the Board of Governors of the Federal Reserve System (“FRB”) has authorized “S” to engage in certain activities, which are subject to the FRB’s regulation and oversight. “S” is licensed as a New York Branch Bank by the Superintendent of Banks of the State of New York.² “S” is a large branch with seven specialized areas (eight including the new “metals” area). It is categorized within “V”, which includes bank branches in twelve countries.³

“Q’s” wholly-owned subsidiary, “T”, also maintains a branch office in London (“U”). “U” is a ring-dealing member of the London Metal Exchange, Limited (“LME”). “U” solicits and accepts orders from U.S.

institutional customers for execution on the LME and other exchanges located outside the U.S. In accordance with the provisions of Commission Rule 30.10, “U” has qualified for an exemption from registration with the Commission. “P” is a wholly- owned subsidiary of “T”.

“R” and “S” engage in over-the-counter (“OTC”) derivatives and cash market transactions involving base metals on behalf of customers as well as for “Q’s” own proprietary account. Exchange transactions in related products are solicited and accepted through “U” or, indirectly, through “P”. In this regard, “P” currently operates a branch office on the premises of “S”. For reasons of business and operational efficiency, “Q” has determined to conduct its OTC derivative and cash market activities, as well as exchange transactions (i.e., futures and options activities) in related products, through a single entity. To this end, the base metals activities that had been handled by “U” will be conducted through “R”. “R”, in turn, will become a ring-dealing member of the LME and, in order to solicit or accept orders directly from foreign futures or foreign options customers,⁴ has applied for a “modified” exemption from registration with the Commission in accordance with Commission Rule 30.10.⁵

“S” will continue to engage in OTC derivatives and cash market transactions involving base metals. Further, “S” will solicit and accept orders from U.S. customers for execution in related transactions on non-U.S., as well as U.S., exchanges. All transactions on U.S. exchanges for U.S. customers will be introduced to “P” and cleared through it in fully-disclosed accounts. Transactions on non-U.S. exchanges will be introduced to “R”. In effect, therefore, “S” will be acting in the capacity of an introducing broker.

III. UNDERTAKINGS

In support of the request for a no-action position, the appropriate authorized officer of “S” has undertaken on behalf of “S” as follows:

(a) “S” will register under the Commodity Exchange Act (“Act”)⁶ as an introducing broker. It will register as associated persons:

1. all salespersons selling exchanged-traded products from the U.S.;
2. the supervisor of such salespersons (a Managing Director);
3. the supervisor of the Managing Director named above.

It will list as principals:

1. the Chief Executive Officer of “V”;
2. the supervisor identified in (a)2, above, who reports to the Chief Executive Officer;
3. the Chief Financial Officer of “V”;
4. the Chief Operating Officer of “V”.

Finally, it will list “Q” as a non-natural person principal.

(b) “S” will enter into a guarantee agreement with “P”, thereby becoming a guaranteed introducing broker (“IBG”). “S”, as an IBG, will introduce its Commodity Exchange, Inc. (“Comex”) futures and options business to “P”, and LME futures and options business to “R”.

(c) “S” will adopt procedures to create a “fire wall” to separate the employees that will engage in futures-related transactions on behalf of customers, including foreign futures or foreign options customers, from the rest of the branch. Only individuals registered as associated persons will be authorized and permitted to solicit or accept orders from customers, including foreign futures or foreign options customers.

(d) In accordance with the provisions of Commission Rule 3.12(h)(1)(iii), “S” will take appropriate corporate action to vest final supervisory authority with respect to the futures-related activities of “S” in a registered associated person.

(e) In connection with its futures and options-related activities, “S” will solicit or accept orders only from institutional customers. For the purposes of this request, the term “institutional customer” will include those persons that qualify as “eligible swap participants” under Part 35 of the Commission’s rules. In addition, it will include any person whose investment decisions are made by a commodity trading advisor (“CTA”) subject to regulation under the Act with \$50 million under management, including any investment adviser registered as such with the Securities and Exchange Commission (“SEC”) that is exempt from regulation as a CTA under the Act or CFTC rules (or foreign persons performing similar roles or functions subject as such to foreign regulations).⁷ Further, such orders will be limited to futures and options transactions in which base metals are the underlying commodities.

In support of the request for a no-action position, the appropriate authorized officer of “P” has undertaken on behalf of “P” as follows:

“P” reaffirms that, as provided in the Guarantee Agreement it will execute with “S”, it accepts joint and several liability for all obligations of “S” under the Commodity Exchange Act (“Act”)⁸ and the rules promulgated thereunder with respect to the solicitations of, and transactions involving, all customer transactions of “S”. This includes the activities of “S” in connection with customer transactions that are introduced directly to “R”.

In support of the request for a no-action position, the appropriate authorized officer of “R” has undertaken on behalf of “R” as follows:

(a) In connection with its futures and options-related activities, “R” will solicit or accept orders only from institutional customers. For the purposes of this request, the term “institutional customer” will include those persons that qualify as “eligible swap participants” under Part 35 of the Commission’s rules. In addition, it will include any person whose investment decisions are made by a commodity trading advisor (“CTA”) subject to regulation under the Act with \$50 million under management, including any investment adviser registered as such with the Securities and Exchange Commission

(“SEC”) that is exempt from regulation as a CTA under the Act or CFTC rules (or foreign persons performing similar roles or functions subject as such to foreign regulations). Further, such orders will be limited to futures and options transactions in which base metals are the underlying commodities.

(b) No more than 15 percent of “R’s” annual net banking income will derive from futures-related activities on behalf of foreign futures or foreign options customers.

(c) “R” agrees to **provide upon request of the Commission, the NFA or the U.S. Department of Justice, access to its books and records for the purpose of ensuring compliance with these undertakings and consents to make such records available for inspection at a location in the U. S. within 72 hours after service of the request.**

IV. RULE 30.10 RELIEF

“R” has applied for confirmation of relief under the Commission’s Rule 30.10 Order to the SFA. That confirmation is being given by separate letter from the Commission and places “R” under the purview of the Commission’s U.K. Orders⁹, which exempt from Rule 30.4 registration requirements firms designated by the SFA.¹⁰

As a result of the Commission’s confirmation, “R” will also be subject to the Commission’s Limited Marketing Order, which permits firms that have received Rule 30.10 relief to engage in limited marketing conduct with respect to foreign futures or option contracts within the United States through their employees or other representatives.¹¹ The Limited Marketing Order restricts the marketing conduct of Rule 30.10 firms in the U.S. to “activities directed towards certain institutions and governmental entities whose description in terms of status and assets has been derived generally from the definition of [Qualified Eligible Person, or “QEP”] as that term is defined in Commission Rule 4.7(a)(1)(ii), 17 CFR 4.7(a)(1)(ii).”¹²

The Limited Marketing Order provides that, although Rule 30.10 relief is intended to be available only to firms that do not operate in the U.S., marketing activity that does not exceed 30 business days in any calendar year does not constitute a *de facto* fixed U.S. presence that would disqualify a firm from eligibility for Rule 30.10 relief.¹³ The Commission stated, however, that:

The Commission’s policy is intended only to permit marketing activities in the United States for limited periods by Rule 30.10 exempted firms and their employees or other representatives. Clearly, any person who establishes a fixed location for the solicitation or acceptance of business in the United States, or whose marketing activities involve long or repeated periods within the United States that can be characterized as a *de facto* fixed presence, will be required to register with the Commission.¹⁴

In order to avoid the need for “Q”, “S”, or “R” to register as an FCM under the Act, “S” must be treated as an “affiliate” of “Q” rather than a “branch” for purposes of registration. There is

precedent for this. In three prior situations, the Division has treated a bank branch in one country as a separate legal entity from the bank's branches in another country. In all three cases, the Division determined that, notwithstanding the presence of bank branches in the U.S., the Division would not recommend enforcement action against a non-U.S. bank for failure to register either as an FCM or as an IB.¹⁵ In none of those cases, however, did the U.S. branches engage in activity subject to Commission regulation, except for proprietary trading.

"S" has undertaken that there will be a "fire wall" between the employees who will be soliciting and accepting orders for commodity interest transactions, and those employees not so engaged. The purpose of this is to create an environment similar to an "affiliate" for those employees working on IB activities in the bank branch.

The "affiliate" form is suggested by the Limited Marketing Order to which "R" is subject:

This order addresses marketing and other sales activities by firms with Rule 30.10 relief and their employees or other representatives from United States locations and does not encompass any other activities subject to regulation under the Act. To the extent that a Rule 30.10 firm has an affiliate (which is separately incorporated or otherwise has a separate legal existence) in the United States which is registered with the Commission (e.g., an IB), the Commission wishes to make clear that such registrant's conduct will not be attributed to the Rule 30.10 firm for purposes of the limitation on duration and frequency of activities in the United States imposed by this Order.¹⁶

In CFTC Staff Letter 93-65, Division staff concluded that a foreign firm would be eligible for Rule 30.10 relief notwithstanding the existence in the United States of an affiliate if certain procedural requirements were met.¹⁷ These requirements include the registration of a U.S. affiliate as an IB. CFTC Staff Letter 93-65 also notes: "These procedures apply only with respect to affiliates and subsidiaries of an applicant for Rule 30.10 relief. Applicants which have an unincorporated division or branch office in the United States will continue to be required to obtain separate no-action relief from the Division."¹⁸

There is precedent for treating bank branches as "affiliates" for certain purposes. Although the Commission orders granting general Rule 30.10 exemptive relief from FCM registration have applied only with respect to persons located outside of the United States, the Division has permitted foreign futures and options brokers with U.S. bank branches to obtain a Rule 30.10 exemption under certain conditions. In CFTC Staff Letter 89-5,¹⁹ the Division stated that it would not recommend enforcement action if a division or branch of a foreign bank is *de facto* treated as a separate entity by the Office of the Comptroller of the Currency ("OCC") and has no involvement with U.S. foreign futures and options customers. Under those circumstances, the branch could be treated by the bank as though it were a subsidiary or affiliate,²⁰ and the foreign firm would be eligible for an exemption under Rule 30.10. The Division has required foreign firms with U.S. bank branches that are seeking confirmation of Rule 30.10 relief to make certain representations (e.g., that the U.S. branch does not

solicit or otherwise have contact with U.S. customers for transactions governed by Commission rules) on the assumption that the bank branch is not registered. In so doing, the Division noted that the bank branch “is viewed as a separate legal entity in many respects under the federal bank regulatory scheme.”²¹

In connection with their futures-related activities, “S” and “R” intend to solicit or accept orders only from institutional customers. For the purposes of their request, the term “institutional customer” includes those persons that qualify as “eligible swap participants” under Part 35 of the Commission’s rules. In addition, it includes any person whose investment decisions are made by a CTA subject to regulation under the Act with \$50 million under management, including any investment adviser registered as such with the SEC that is exempt from regulation as a CTA under the Act or CFTC rules (or foreign persons performing similar roles or functions subject as such to foreign regulations).²² Further, such orders will be limited to futures and options transactions in which base metals are the underlying commodities.

Although the proposed targeted customer as defined in the request is different than that contemplated in the Limited Marketing Order, this is balanced by the fact that the bank branch will in fact be registered as an IB, which should enhance customer protection.

In keeping with the spirit of the Limited Marketing Order to which it is subject, “R” has proposed a “cap” on its business generated by solicitation of U.S. customers by the bank branch, of no more than 15 percent of “R’s” annual net banking income.

V. IB ACTIVITIES

“S” has agreed to enter into a guarantee agreement with “P”, thereby becoming an IBG. “S”, as an IBG, will introduce Comex futures and options customers to “P”, and LME futures and options customers to “R”. The regulatory capital of “P”, the guarantor, is \$\$\$, \$\$ in excess of its minimum requirement.²³ “P” reaffirms that, as provided in the Guarantee Agreement it will execute with “S”, it accepts joint and several liability for all obligations of “S” under the Act and the regulations promulgated thereunder with respect to the solicitations of, and transactions involving, all customer transactions of “S”.

Commission Rule 1.57(a)(1) prohibits an IBG from introducing customers to any FCM other than its guarantor. Rule 1.57(a)(1) was amended to add this language in 1992.²⁴ One objective of the amendment was to ensure that guarantee agreements between FCMs and IBGs serve their intended objective of protecting the customer of the IBG. However, there is precedent for taking a no-action position on this aspect of Rule 1.57(a)(1), where the IBG is in the same corporate group as the FCMs to whom it will be introducing customers, and all three subsidiaries are managed by a corporate parent. In CFTC Staff Letter 92-18,²⁵ Division staff concluded that no-action on a similar arrangement between three subsidiaries of a well-capitalized firm (referenced as the “W Group”)

would not be contrary the 'customer protection' objective of the rule.

This opinion is based principally upon the close relationship which exists between the companies comprising the "W Group" with respect to both ownership and management and the substantial capital held by A. In particular, we note that: (1) each entity in the "W Group" is, either directly or indirectly, a wholly-owned subsidiary of Y; (2) each entity in the "W Group" is under the management of D; and (3) A has a substantial cushion over its required regulatory capital.

The Division has reviewed the undertakings of "S", "P", and "R", and believes that such undertakings will be sufficient to ensure that the regulatory purposes of the Commission's rules and orders thereunder are addressed. Specifically, in these circumstances, the registration of "S" as an introducing broker, and the signing of a guarantee agreement with "P", enhances both customer protection and financial stability.

VI. CONCLUSION

Based upon the foregoing, subject to compliance with the terms and conditions of this letter, the Division will not recommend that the Commission initiate enforcement action in connection with the business arrangements described above as follows:

- (1) Against "Q", "R" and "S" based solely upon their failure to register as an FCM under Section 4d (1) of the Act and Commission Rule 3.10; or
- (2) Against "P", "S" or "R" under Commission Rule 1.57(a)(1) based solely upon the failure of "S" to introduce all of its customer accounts to "P".

The positions adopted herein are based on the information provided to us and relate only to the provisions of the Act and Commission rules set forth in paragraphs (1) and (2) immediately above. "Q", "R", "S" and "P" remain subject to all other provisions of the Act and Commission Rules, including all anti-fraud provisions. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In that connection, please inform us immediately of any material changes in the operations of the aforementioned entities relevant to the discussion herein.

Please be advised also that the no-action positions set forth above are solely those of the Division of Trading and Markets and do not necessarily represent the views of the Commission or those of any other unit of its staff.

Very
truly
yours,

John C.
Lawton

Acting
Director

1 Commission rules referred to herein may be found at 17 C.F.R. Ch. I (2000).

2 See n. 19, infra, for more information about regulation of “S” as a New York Branch Bank.

3 “AA”, “BB”, “CC”, “DD”, “EE”, “FF”, “GG”, “HH”, “II”, “JJ”, “KK”, and “LL”.

4 See Commission Rule 30.1(c), which defines a “foreign futures or foreign options customer” as a person located in the U.S. trading futures or options contracts on or subject to the rules of any foreign board of trade. See also Commission Rules 30.1(a), 30.1(b) and 1.3(ss).

5 “U” will continue to conduct a customer business in commodities other than base metals and, in that connection, will maintain its exemption from registration under Commission Rule 30.10. “R”, as a branch of a French bank, has applied for “modified” relief based on dual regulation by the British Securities and Futures Authority (“SFA”) and French regulators (Commission Bancaire) under both the SFA 30.10 Order and the Commission’s Mutual Recognition Memorandum of Understanding (“MRMOU” – the functional equivalent of Rule 30.10 relief) with the Commission des Operations de Bourse (“COB”) in France. SFA will supervise “R” with respect to all regulatory issues outlined in the SFA 30.10 Order except for minimum capital requirements, which the Commission Bancaire will supervise. See n. 9, infra, for a summary of the history of the SFA Rule 30.10 orders.

6 7 U.S.C. §1 et seq. (1994).

7 This standard is taken from Rule 30.12(a)(2)(v), which permits certain foreign firms acting in the capacity of FCMs and IBs to accept and execute foreign futures and foreign options orders directly from U.S. customers via various media without having to register with the Commission. The final rule was published at 65 Fed. Reg. 47275 (August 2, 2000), and became effective on September 1, 2000.

8 7 U.S.C. §1 et seq. (1994).

9 In 1989, the Commission issued a series of Rule 30.10 orders authorizing firms designated by the U.K. Securities and Investments Board (“SIB”) and certain U.K. “Self-Regulating Organisations” (“SROs”) to conduct brokerage activities for U.S. customers on any non-U.S. exchange designated under U.K. law. See 54 Fed. Reg. 21599, 21600 (May 19, 1989) (SIB), 54 Fed. Reg. 21604, 21605 (May 19, 1989) (Association of Futures Brokers and Dealers (“AFBD”)), 54 FR 21609, 21610 (May 19, 1989) (The Securities Association (“TSA”)), and 54 Fed. Reg. 21614, 21615 (May 19, 1989) (Investment Management Regulatory Organisation (“IMRO”)). The AFBD and TSA subsequently merged to form the Securities and Futures Association, which became the successor

organization for Rule 30.10 purposes. See 56 Fed. Reg. 14017 (April 5, 1991). The SIB recently became the Financial Services Authority ("FSA").

10 In 1989 and 1993, the European Union ("EU") issued the Second Banking Directive and the Investment Services Directive, respectively. Pursuant to these Directives, investment firms, banks, and other institutions that are authorized to engage in certain types of investment business in one EU member state may conduct such business in other EU member states without organizing in those states. The relief under the "European Passport" is available only to branches, not subsidiaries, of EU firms. Under the European Directives, however, the appropriate authorities in the jurisdiction in which a branch operates will monitor the branch for compliance with conduct of business rules, whereas the appropriate authorities in the branch's country of origin will monitor the branch for compliance with client money and minimum capital rules. This division of regulatory responsibility, however, may be modified by an agreement between the branch and its two regulators. "R" has requested, and the Commission Bancaire and SFA agreed, that SFA will continue monitoring "R" for compliance with SFA's money rules. Each regulator has given information-sharing representations to the Commission. In confirming Part 30.10 relief in these circumstances, the Commission will be following the precedent established by its Part 30.10 confirmations to Macquarie Bank Limited (Dec. 15, 1998), "X" (May 13, 1999), Skandinaviska Enskilda Banken (Dec. 9, 1999), and Carr Futures SNC-U.K. (Dec. 9, 1999).

11 57 Fed. Reg. 49644 (November 3, 1992).

12 Id. A subsequent Commission order expanded the universe of potential customers to which solicitation may be made by Rule 30.10 firms in the U.S. to include "accredited investors" as that term is defined in the SEC's Regulation D issued pursuant to the Securities Act of 1933. 59 Fed. Reg. 42156 (August 17, 1994). Recently, the Commission's "QEP" definition has been changed to "Qualified Eligible Person" to eliminate the earlier distinction between two subgroups, "qualified eligible participants" and "qualified eligible clients." Under the revision, those in both categories are termed "Qualified Eligible Person," as are some additional persons described in the new rule. See Final Rule, Exemption from Certain Part 4 Requirements for Commodity Pool Operators With Respect to Offerings to Qualified Eligible Persons and For Commodity Trading Advisors With Respect to Advising Qualified Eligible Persons, 65 Fed. Reg. 47848 (August 4, 2000).

13 57 Fed. Reg. at 49646.

14 Id.

15 CFTC Staff Letter 93-113, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,930 (October 29, 1993); CFTC Staff Letter 92-19, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,516 (October 9, 1992); CFTC Staff Letter 89-5, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,471 (December 8, 1988).

16 57 Fed. Reg. 49644, at 49646, n. 10.

17 CFTC Staff Letter 93-65, [1992-1994 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 25,784 (July 16, 1993). As part of the Rule 30.10 application to the Commission, such applicant must: (a) identify the name and location of any affiliate or subsidiary in the United States which acts in a related capacity (i.e., a bank, broker-dealer or dealer in a cash commodity); (b) represent that the applicant will not accept any futures-related business from any of its affiliates or subsidiaries in the United States (other than a proprietary account of the affiliate or subsidiary), unless such entities are registered in the appropriate capacity; and (c) represent that it has informed its bank, broker-dealer and dealer in cash commodity affiliates or subsidiaries in writing that they may not introduce to, or solicit futures business on behalf of, the applicant, *unless such entities are registered in the appropriate capacity*. (Emphasis added.)

18 Id. at n. 5.

19 CFTC Staff Letter 89-5, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,271 (December 5, 1988). “S” is licensed by the Superintendent of Banks of the State of New York under the New York Banking Law, with the prior approval of the Federal Reserve Board. The Branch is examined by the New York State Banking Department and is subject to banking laws and regulations applicable to a foreign bank that operates a New York Branch. At the request of Division staff, staff of both the New York State Banking Department and the Federal Reserve Board have advised Division staff on an informal basis that they have no objection to the branch bank registering as an IB.

20 In CFTC Staff Letter 88-3, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,085 (January 15, 1988), the Division distinguished between a foreign firm having U.S. divisions (which are “legally part of the firm itself”), and a foreign firm with a U.S. subsidiary or affiliate (which “is a separate legal entity.”) The letter stated that while a foreign firm with a U.S. branch or division would *not* be eligible for Rule 30.10 relief, a foreign firm with a U.S. subsidiary or affiliate would be eligible for a Rule 30.10 exemption. Id. The Division modified that position in CFTC Staff Letter 89-5 by recognizing that foreign bank branches and divisions are often operated separately and in a manner analogous to a subsidiary. CFTC Staff Letter 89-5 at 36,071.

21 CFTC Staff Letter 89-5, id. at n.18.

22 See n. 7, supra.

23 Per February 29, 2000 quarterly report as posted on the March 31, 2000 “Selected Financial Data for FCMs” aspect of the CFTC website (<http://www.cftc.gov/tm/fcmdata.003>).

24 57 Fed. Reg. 23136 (June 2, 1992). The amendment effectively codifies the Division’s position set forth in CFTC Staff Letter 88-4 [1987-1990 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 24,098 (January 26, 1988).

25 CFTC Staff Letter 92-18, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,515

(October 8, 1992).