CFTC Letter No. 02-22
July 11, 2001
No-Action
Division of Trading and Markets

Re: "U"

Dear:

This is in response to your letter dated July 10, 2001, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by telephone conversations with Division staff. By your correspondence, you request, on behalf of "V", that the Division confirm that it will not recommend that the Commission commence any enforcement action against registered securities broker-dealers ("BDs") and registered representatives ("RRs") thereof in connection with their offer and sale of certain futures contracts designated "U based solely upon the failure of such BDs and RRs to comply with certain requirements under the Commission's rules applicable to futures commission merchants ("FCMs") and associated persons ("APs"), respectively.[1]

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

Description of the Instruments.

"U" or "Z" are cash-settled, electronically-traded futures contracts on broad-based, dynamic indices of stocks, bonds, currencies and other financial instruments.[2] Each "U instrument will have a stated maturity as set forth in the disclosure materials for the "U" on each specific index. "V" will elect to list each "U" instrument for trading pursuant to Section 5c(c) of the Commodity Exchange Act (the "Act")[3] and will comply with the requirements therein for any amendments to "V's" rules for "U".

Distinction between Institutional and Non-Institutional Customers.

Persons you refer to as "institutional customers" (that is, persons who are either: (a) "qualified institutional buyers" ("QIBs") as defined in Rule 144A[4] under the Securities Act of

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1 Commission rules referred to herein are found at 17 C.F.R. Ch. I (2001).

2 "U" and "Z" are service marks of "W".

3 7 U.S.C. § [7c(c)] (1994), as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"), Pub. L. No. 106-554, 114 Stat. 2763 (to be codified as amended in scattered sections of 7 U.S.C.).

4 17 C.F.R. § 230.144A (2001).

1933;[5] or (b) "V" members registered with the Commission as floor brokers or floor traders) would be required to conduct "U" transactions through a Commission-registered introducing broker ("IB") and/or an FCM.[6] From the institutional customer's perspective, the offer and sale of "U" will be essentially the same as with any other futures contract, in that the institutional customer will maintain a traditional futures account in its own name at an FCM, place orders with an AP of an IB or FCM or directly through "X", and comply with the "V's" standard performance bond and settlement variation requirements.[7] Accordingly, your request for a no-action letter does not cover the offer and sale of "U" to institutional customers.

You propose, however, that the offer and sale of "U" to persons who are not institutional customers would differ in certain material respects from the standard methods of operation in the futures industry. First, non-institutional customers would have the option of using registered BDs[8] and RRs[9] that would be "notice registered" with the National Futures Association ("NFA") as limited-purpose FCMs ("LP/FCMs") and limited-purpose APs ("RR/APs"), respectively, as described below. Non-institutional customers would also have the option of using securities accounts carried at entities that are dually-registered as BDs and as full-service FCMs

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[5] 15 U.S.C. § 77a *et seq*. (1994). The QIB definition includes: (1) an insurance company, a registered investment company, a small business investment company, a government employee benefit plan, an ERISA employee benefit plan, a pension plan trust, a business development company, a Section 501(c)(3) charitable organization and a registered investment adviser (in each case, acting for its own accounts or for the accounts of other QIBs, and owning and investing on a discretionary basis at least $100 million in securities of unaffiliated issuers); (2) an SEC-registered dealer acting for its own account or the accounts of other QIBs and owning and investing on a discretionary basis at least $10 million in securities of unaffiliated issuers; (3) an SEC-registered dealer acting in riskless principal transactions on behalf of QIBs; (4) a registered investment company acting for its own account or the accounts of other QIBs that is part of a family of investment companies that own in the aggregate at least $100 million in securities of unaffiliated issuers; (5) an entity owned entirely by QIBs, acting for its own account or the accounts of other QIBs; and (6) a foreign or domestic bank, savings and loan or equivalent institution acting for its own accounts or for the account of other QIBs, and owning and investing on a discretionary basis at least $100 million in securities of unaffiliated issuers and that has an audited net worth of at least $25 million.

[6] Any prospective "U" customer not meeting these standards would be treated as a non-institutional customer.

[7] The institutional customer will also be provided with the disclosure document that is furnished to non-institutional customers.

[8] BDs register with the Securities and Exchange Commission ("SEC").

[9] RRs register with NASD Regulation, Inc. ("NASDR").

("BD&FCMs" – collectively referred to along with LP/FCMs as "BD/FCMs").[10] Second, non-institutional customers would be subject to a 100 percent initial performance bond requirement in the case of long "U" positions and a 50 percent initial performance bond requirement in the case of short "U" positions.[11] Third, non-institutional customers trading through BD/FCMs generally would do so through their existing securities accounts at their BD/FCMs, who would maintain omnibus accounts for their customers' benefit at one or more clearing FCMs.[12]

Limited-Purpose FCMs and Limited-Purpose APs.

Under your proposal, a BD that is not currently subject to suspension by the SEC or by NASDR would be permitted to file an immediately effective notice with NFA to become formally registered as an FCM for the limited purpose of soliciting, accepting, and placing orders for the purchase and sale of "U" on behalf of non-institutional customers. Likewise, an RR that is not currently subject to suspension by the SEC or by NASDR would be permitted to authorize his or her sponsoring BD/FCM (which may be a BD&FCM) to file an immediately effective notice with NFA to become formally registered as an AP for the limited purpose of soliciting, accepting, and placing orders for the purchase and sale of "U" on behalf of non-institutional customers. In addition, a supervisor of RRs would be permitted to authorize his or her sponsoring BD/FCM to file an immediately effective notice with NFA to become formally registered as an AP for purposes of supervising the "U"-related activities of RR/APs already under his or her supervision in the context of the purchase and sale of securities.

The limited-purpose notice registration of LP/FCMs and RR/APs would enable them to conduct futures business only to the extent of "U" business with non-institutional customers. By contrast, fully-registered FCMs (whether stand-alone or part of a BD&FCM), IBs, and their APs would be able to engage in the full range of commodity interest transactions, including "U".[13] The Commission would retain all of its enforcement authority over the "U"-related activities of BDs and RRs (and their supervisors) that are registered in this manner as BD/FCMs and RR/APs, respectively.

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[10] A non-institutional customer who executes "U" transactions through a BD&FCM can choose to have the customer's account carried in a securities account or a futures account. Your defined term "BD&FCM," which we have adopted for purposes of this letter (including the incorporation of BD&FCM into the defined term "BD/FCM"), applies only where the BD&FCM executes and carries customer "U" positions in a securities account.

[11] You do not anticipate a significant non-institutional market for short "U" positions.

[12] If the BD and the clearing FCM are the same entity, the account is an "exchange control" account.

[13] If an account is carried in a BD&FCM customer futures account, "U" transactions must be executed and managed by a fully-registered AP.

Requirements for Non-Institutional "U" Customers.

Non-institutional customers, whether trading through a BD/FCM or through a fully-registered IB and/or FCM, would be required to deposit a significantly greater performance bond than would be the case with ordinary futures trading. Establishment of a long "U" position would require deposit of cash equal to 100 percent of the current "U" market value. The customer would not receive any settlement variation or be subject to any calls to deposit additional performance bond. Establishment of a short "U" position would require deposit of cash equal to 50 percent of the current "U" market value. If the settlement price of a short "U" position increased to a level such that the performance bond of the customer was less than 30% of such price, the customer would be required to restore the performance bond to 50% of the settlement price. If the settlement price of a short position decreased by a corresponding amount (i.e., such that the performance bond was equal to or greater than 70% of the settlement price), the customer would receive a settlement variation payment sufficient to return the performance bond to 50% of the settlement price.

Account Structure for Non-Institutional "U" Customers.

Non-institutional customers that purchased and sold "U" through a BD/FCM could have a different account structure than non-institutional customers that use traditional futures intermediaries.[14] Traditional IBs or FCMs would maintain standard IB or FCM customer accounts for their "U" customers and would continue to be subject to all of the applicable customer account-related requirements and obligations under the Act and Commission rules. In contrast, non-institutional customers of BD/FCMs could conduct "U" transactions through their existing securities accounts at the BD/FCMs, and each BD/FCM would maintain an omnibus account for the benefit of these customers at one or more clearing FCMs, which may or may not be affiliated with the BD/FCM (each, an "Omnibus Account").[15] BD/FCMs would transfer the required performance bond and, as applicable to short sales, maintenance restoration payments from each non-institutional "U" customer's securities account to the Omnibus Account no later than the opening of the following trading day. Accordingly, all futures-related customer funds would be held at the clearing FCM, which would be fully registered as such with the Commission. As with any other futures contract, the clearing FCM would transfer funds daily to the "V" and the "V" would transfer funds back to the clearing FCM, as the case may be, in compliance with "V's" performance bond and settlement variation rules. The clearing FCM would mark the positions in the Omnibus Account to market daily.

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[14] However, in the case of a BD&FCM, non-institutional customers may choose to have their account carried in a futures account.

[15] As noted previously, in the event that the BD and the clearing FCM are the same legal entity, an "exchange control" account would be used.

Interest Rate Pass-Through Feature

Each day after the determination of the daily settlement price, each clearing FCM carrying a long position would pay the "V", which would in turn pay each clearing FCM carrying a short position, an amount equal to the Federal Funds Effective Rate less a percentage rate specified for a particular "U" index. The "V" would determine all such interest rate pass-through amounts, which would be based upon the number of positions multiplied by the value of the contracts. Non-institutional customers holding long positions would not be assessed for this amount, but institutional customers holding long positions would be assessed. Non-institutional customers holding short positions would not receive interest rate pass-through payments, but institutional customers holding short positions would receive such payments.

Request for Relief

You state that in all respects "U" is a regulated futures product, and the Commission will have jurisdiction over persons who deal with customers, both institutional and non-institutional, in connection with the purchase and sale of "U". At the same time, you contend that certain obligations and requirements that are applicable to registered FCMs and APs are unnecessary and duplicative for BD/FCMs and RR/APs who are already registered with the SEC and NASDR. Non-institutional customers trading through a BD/FCM would generally be existing securities account customers that would have already executed the BD/FCM's securities account opening documentation.[16] Thus, you contend that no additional Commission-required documentation will need to be delivered to or signed by non-institutional customers prior to trading "U". Moreover, you believe that because of the 100% initial performance bond requirement for long non-institutional customers trading through BD/FCMs (50% for customers with short "U" positions), some of the disclosure issues normally associated with the requirement to make variation payments do not apply.

All customer funds related to "U" would be maintained by clearing FCMs fully subject to the Act and Commission Rules. (You further acknowledge that customer funds would be received by the BD/FCM in the first instance, for transfer to the clearing FCM, and would be returned to the customer by the BD/FCM after closeout of a transaction.) You assert that BD/FCMs would have no customer futures funds to segregate, and therefore, BD/FCMs should not have to maintain segregated accounts and should not be subject to the requirements normally applicable when customer funds are paid and collected.

In light of these positions, you request, effectively, that compliance with the existing securities law requirements applicable to BDs and RRs, as described in your correspondence**,**

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[16] This assumes that in most instances the customer's securities account was opened for the *bona fide* purpose of securities trading, and not for the purpose of trading "U".

substitute for otherwise applicable Commission-mandated registration, sales practice, minimum financial, treatment of customer funds, reporting, and books and records requirements. You further request that, on the condition that this substituted compliance is maintained, the Division agree not to recommend that the Commission commence enforcement action against BD/FCMs or RR/APs in connection with the offer and sale of "U" on behalf of non-institutional customers, based solely upon the failure to comply with certain provisions of the Act and Commission rules in these areas that are otherwise applicable to futures transactions.

Registration Requirements

In your correspondence, you state that BDs and RRs are subject to a comprehensive regulatory regime under the securities laws, administered by the SEC and various self-regulatory organizations. Each BD and RR must register and maintain its registration status under tests, criteria and standards similar to those found in the registration system governed by the futures laws. Given your depiction of the similar goals, requirements and procedures of the two registration systems, you argue that in order to avoid duplicative registration requirements and the compliance burden of applying two generally overlapping registration systems to a single registrant, BDs and RRs that intend to offer and trade "U" on behalf of non-institutional customers only should be subject to streamlined procedures to become registered with the NFA as LP/FCMs and RR/APs, respectively. Thus, you argue that among other related registration requirements, BD/FCMs and RR/APs should not be required to file Forms 7-R, 8-R or 3-R, submit fingerprints, attend mandatory ethics training, or pass the Series 3 or any other futures industry proficiency exam. Specifically, you propose that the Division should recognize that BD/FCMs and RR/APs, if notice registered with the NFA, will not be required to do more to satisfy the Commission's requirements of registration of FCMs and APs.

Under your proposal, in order to become formally registered as an FCM, solely for the limited purpose of soliciting, accepting, placing, and confirming orders for the purchase and sale of "U" on behalf of non-institutional customers, a BD would file with the NFA an immediately effective notice of intent to become a limited-purpose FCM and would certify both that it is registered as a BD with the SEC, and that it is not currently subject to any statutory disqualification applicable to BDs under Section 15(b) of the Securities Exchange Act of 1934 (the "Exchange Act").[17] You contend that this relief would be consistent with the recently enacted CFMA, which allows BDs to be registered as FCMs for specified purposes by filing a notice with the NFA. We also note that, in certain limited circumstances, specified persons who are in good standing with other financial regulators may intermediate futures transactions without registration under the Act.[18]

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[17] 15 U.S.C. § 78a et seq. (1994).

[18] *See* § 111(e) of the CFMA.

Similarly, RRs and their supervisors would register as APs, solely for the limited purpose of soliciting, accepting, and confirming orders for the purchase and sale of "U" on behalf of non-institutional customers, by having their sponsoring BD/FCM file with the NFA an immediately effective notice that would contain a list of persons who seek to register as limited-purpose APs.[19] Each BD/FCM would undertake promptly to inform the Commission and the NFA if the BD/FCM in fact became subject to a statutory disqualification, or if any RR/AP whom it sponsored became subject to a statutory disqualification. The Commission would have the authority to pursue a statutory disqualification action against a BD/FCM or RR/AP based on any conduct that occurred after notice registration. The Commission would retain the authority to restrict, suspend, or revoke registration in such a statutory disqualification proceeding and thereby to disqualify the notice registrant from engaging in "U" business.

Sales Practice Requirements

You represent that customers of BD/FCMs that purchased or sold "U" would generally be securities customers of the BD/FCMs. As discussed below in the section on minimum financial and reporting requirements, BD/FCMs would not maintain separate securities and futures accounts for each customer (each customer's "U"-related funds would be maintained in the Omnibus Account maintained by the clearing FCM). Rather, each customer's securities and "U" positions would be reflected on one statement and would originate from a single securities account.

Furthermore, you propose that "U" will be offered by means of a disclosure document. You state that the disclosure document will be specifically tailored to address all material aspects of the "U" product, including a description of the associated risks of trading "U". In any respect in which they differ, as with the customer's ability to pursue a reparations action before the Commission, the "U" disclosure document will supersede the terms of the existing securities account customer agreement.

LP/FCMs and RR/APs will become members of the NFA by notice to the NFA and will become subject to NFA audit. As NFA members, RR/APs will be subject to the "Know Your Customer" Rule of NFA Compliance Rule 2-30. Because "U" are futures contracts and not securities, National Association of Securities Dealers, Inc ("NASD") Rule 2310's suitability requirement will not apply to BD/FCM and RR/AP sales of "U". (Training will be provided to RR/APs regarding the applicable rules.) Given this arrangement and the anticipated increased efficiencies of maintaining a single account and avoiding multiple sets of account opening

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[19] Before the sponsoring BD/FCM would allow an RR/AP to act on behalf of customers in connection with the purchase or sale of "U", the sponsoring BD/FCM would obtain the RR/AP's acknowledgment, in written or electronic form, that he or she would be subject to the obligations and requirements associated with registration as a limited-purpose AP.

documentation, you request that the Division consider these terms and conditions to be an effective substitute for compliance with Rule 1.55 and Part 180 of the Commission's rules.

Minimum Financial and Related Reporting Requirements

As BDs, BD/FCMs will already be subject to the various accounting, net capital, and risk assessment requirements under the securities laws (Sections 15(c)(3) and 17 of the Exchange Act and the rules promulgated thereunder). Under the proposed account structure, the customer securities accounts of a BD/FCM will not function as a depository for "U" performance bond funds (although the BD/FCM will hold customer securities and funds generally in the securities accounts). Rather, all performance bond payments will be held in the Omnibus Account maintained by the clearing FCM.[20]

When a customer submits an order to purchase or short "U", the BD/FCM will issue Fedwire instructions to transfer the performance bond and any maintenance restoration payment required for short "U" to the clearing FCM no later than the opening the following trading day. Thereafter, performance bond funds will be under the control of the clearing FCM and the "V" until they are transferred back to the customer's securities account at the BD/FCM upon liquidation of a "U" position or, in the case of short "U", a release of excess margin. Thus, you argue, the net capital and related reporting requirements under the futures laws should rest solely on the clearing FCM.

Consistent with Rule 1.10, each BD/FCM would provide to the Commission a copy of its FOCUS Report[21] when it is filed with the SEC. That Report would include the alternative Commission net capital calculation and, to the extent the net capital requirement for "U" exceeds the securities net capital, it would govern the BD/FCM's capital requirement. Separately, in order to address the impact of the Commission's net capital requirement when applied to 100% performance bonds, you request that the Division agree not to recommend enforcement action against the BD/FCM or the clearing FCM, provided that they comply with "V's" risk-based capital requirements with respect to the "U" assets they hold.

Under these circumstances, you propose that by complying with applicable requirements under the securities laws and regulations, BD/FCMs should be considered to be in compliance with the various minimum financial and related reporting requirements under the Act and Commission rules. You further propose that because BD/FCMs will have no customer futures

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[20] As noted before, in the case of a single entity that is both a BD and an FCM the reference would be to an "exchange control" account.

[21] Form X-17A-5, subtitled the Financial and Operational Combined Uniform Single ("FOCUS") Report, is the basic financial and operational report required of brokers or dealers subject to the minimum net capital requirements of Rule 15c3-1 under the Exchange Act.

funds to segregate in their customer securities accounts, BD/FCMs should be considered to be in compliance with Commission customer funds segregation requirements.

Books and Records Requirements

For the same reasons discussed above, you contend that the Commission should not require BD/FCMs to comply with many of the books and records requirements of the Act and Commission rules. BD/FCMs will already be subject to a comprehensive recordkeeping regime under the securities laws (Section 17 of the Exchange Act and the rules promulgated thereunder) in connection with their securities business and, as noted above, customer futures funds will be maintained in the Omnibus Account maintained at the clearing FCM, rather than at the BD/FCM.[22] In addition, BD/FCMs will be subject to Commission inspections. You assert that it would be unnecessarily burdensome for BD/FCMs to comply with two separate books and records regimes. You further assert that many of the futures laws' books and records requirements more appropriately should fall upon the clearing FCMs, given the fact that each clearing FCM will maintain the Omnibus Account, and with it, the customers' "U"-related futures assets.

Each BD/FCM will maintain books and records of the customers' names and corresponding "U"-related futures positions in each Omnibus Account. The clearing FCM, however, will not be required to maintain the individual customer names on its books and records. Instead, each customer's positions will be separately identified by account number or other account identifier on the clearing FCM's books and records.[23] For this reason, you believe that it is appropriate that BD/FCMs should be required to file only Form 102, which the Commission should link to the report of the clearing FCM. Alternatively, you propose that the BD/FCM could elect to file the large trader reports.

Accordingly, based on these representations, you assert that the Division should recognize that compliance with the terms proposed in your correspondence will constitute compliance with the recordkeeping and reporting requirements of the Act and Commission rules.

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[22] We note that the Exchange Act provisions and rules thereunder refer to records in connection with purchases and sales of securities. For purposes of the position taken in this letter, although "U" are not securities, you agree that any record required to be kept in connection with a securities transaction will be kept, to the extent it is not otherwise kept, for each "U" transaction.

[23] You state that it would not be appropriate to require a fully disclosed Omnibus Account at the clearing FCM. Creating such an arrangement would be contrary to the analogous current industry practice by which non-clearing FCMs clear through clearing member FCMs. Moreover, non-affiliated BDs would be dissuaded from trading "U" if they would have to provide customer names or other contact information to clearing FCMs.

Bankruptcy considerations.

In the event of a bankruptcy of the BD/FCM, Section 7(b) of the Securities Investor Protection Act[24] provides that the trustee will be subject to the same duties as a trustee in a case under Chapter 7 of the Bankruptcy Code,[25] including the duties specified in Subchapter IV applicable to commodity brokers. Accordingly, you conclude that the Bankruptcy Code procedures for liquidating a commodity broker and Part 190 of the Commission's rules would apply with respect to customer assets of the BD/FCM that are related to futures contracts and commodity options. This conclusion mandates that the BD/FCM must maintain records of which assets in a customer's securities account are securities and securities-related assets and which ones are "U" (i.e., commodities) and "U"-related assets, including the amounts of performance bond pledged to and held by the clearing FCM. You propose that this will be accomplished by each BD/FCM separately coding the two asset types, which will allow assets to be readily identified on the books and records of the BD/FCM in the event of a bankruptcy of the BD/FCM.[26] In the event of the bankruptcy of the clearing FCM, the BD/FCM would be considered the "customer" of the clearing FCM, and the Division concludes that "U" customers should be afforded the same protection that would apply to any other futures customer.

Conclusion

"U" are futures contracts on broad-based, dynamic indices of stocks, bonds, currencies and other financial instruments that are fully subject to the Act and rules thereunder. Nevertheless, based upon the representations made in your letter, and subject to the conditions set forth below, the Division will not recommend that the Commission commence any enforcement action against a BD/FCM or an RR/AP in connection with the offer, sale and confirmation of "U" on behalf of non-institutional customers based solely upon the failure of the BD/FCM or RR/AP to comply with the provisions of the Act and Commission rules to the extent specified as follows:

1. BD/FCMs and RR/APs who restrict their Commission-regulated activities to the offer and sale of "U" instruments will be permitted to register as limited purpose FCMs and APs, respectively by filing an immediately effective notice to that effect with the NFA certifying that the person submitting the notice is registered as a BD or RR, as the case may be, and that the person's registration is not subject

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[24] 15 U.S.C. § 78fff-1(b) (1994).

[25] 11 U.S.C. §§ 701-766 (1994).

[26] A copy of the form of BD/FCM customer account statement reflecting "U" has been submitted to the Division, and you have represented that a copy of the final form of disclosure document will be submitted.

to any suspension or revocation. Each BD/FCM will undertake promptly to inform the Commission and the NFA if the BD/FCM in fact becomes subject to a statutory disqualification, or if any RR/AP whom it has sponsored becomes subject to a statutory disqualification. The Commission will have the authority to pursue a statutory disqualification action against a BD/FCM or RR/AP based on any conduct that occurs after notice registration. The Commission will retain the authority to restrict, suspend, or revoke registration in such a statutory disqualification proceeding and thereby to disqualify the notice registrant from engaging in "U" business.

2. BD/FCMs and RR/APs will not be required to provide the prescribed risk disclosure statement set forth in Rule 1.55 or to comply with the specific requirement of Part 180 of the Commission's rules, provided that the disclosure materials provided to "U" customers contain all disclosures necessary to make the information contained therein, in the context in which it is furnished, not misleading, and provided, further, that customers are clearly informed that they remain entitled to pursue a Commission reparations proceeding, notwithstanding any mandatory arbitration provision in their securities account documents.

3. BD/FCMs, and clearing FCMs carrying "U" positions for non-institutional customers may substitute compliance with the "V's" risk-based capital requirements, for the corresponding requirements under Section 4f(b) of the Act and Rule 1.17(a)(1)(i)(B) to the extent that they are carrying funds related to "U".

4. BD/FCMs may substitute compliance with the risk assessment requirements of the securities laws for the requirements of Rules 1.14 and 1.15.

5. The proposed transfer of customer funds by the BD/FCM directly to the clearing FCM as described above will be treated as placement of those funds at an acceptable segregation location (*i.e.*, a fully-regulated FCM subject to the full segregation requirements) pursuant to Section 4d of the Act and Rules 1.20-1.29. BD/FCMs will remain subject to the daily computation and record requirements of Rule 1.32. BD/FCMs may substitute compliance with securities law requirements for compliance with Rule 1.36, provided all securities and property received in connection with "U" are clearly identified as such.

6. BD/FCMs may substitute compliance with securities law recordkeeping and reporting requirements (including SEC and NASD rules, as applicable) in satisfaction of the corresponding requirements under Sections 4f(a), 4f(c), 4g(a), 4g(c) and 4g(d) of the Act and Rules 1.31 (except insofar as Rule 1.32 (c) requires that records be kept in accordance with the requirements of Rule 1.31) and 1.33

through 1.37(a),[27] subject to the following conditions: (a) All "U" positions are clearly identified as such on all relevant books and records; (b) BD/FCMs must maintain "U"-related books and records for at least the five-year period prescribed in Commission Rule 1.31, notwithstanding the applicability of a shorter retention period for certain books and records under the securities laws and regulations; (c) documents on which trade information is originally recorded in writing, and written orders, must be retained in hard-copy form for a period of five years; and (d) BD/FCMs will assure that all "U"-related books and records are open to inspection by representatives of the Commission or the Department of Justice, and will cause a copy or original of any required record to be provided promptly to a Commission representative upon request at the BD/FCM's expense (BD/FCMs will also be subject to requests for supplemental information and inspections by Commission and NFA staff). The filing of large trader reports by the clearing FCM will be sufficient without requiring that the BD/FCM also do so.

7. The BD/FCM must be able to demonstrate compliance with applicable securities law requirements as they apply to the BD/FCM's "U" business. Failure to comply with the applicable securities law requirements will be considered a violation of the Commission rules with respect to which substituted compliance is being permitted hereby.

The Division's position is also subject to the condition that a BD/FCM or RR/AP comply with the terms and conditions set forth in your correspondence and to which reference is made in this letter concerning registration, sales practice, minimum financial and related reporting, treatment of customer funds, and books and records requirements, some of which involve substituted compliance with related rules of the SEC and NASD.

This letter does not excuse "V", or any BD/FCM or RR/AP, or any clearing FCM from compliance with any other applicable requirements contained in the Act or in the Commission's rules issued thereunder. For example, each remains subject to the relevant antifraud provisions of the Act and Commission rules. This letter is applicable to "V", BD/FCMs and RR/APs solely in connection with the activities described above.

This letter is based upon the representations made to us. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. We request that you notify us immediately in the event that the operations or activities of "V" or any BD/FCM or

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[27] As noted above, the Exchange Act provisions and rules thereunder refer to records in connection with purchases and sales of securities. For purposes of the position taken in this letter, although "U" are not securities, you agree that any record required to be kept in connection with a securities transaction will be kept, to the extent it is not otherwise kept, for each "U" transaction.

RR/AP concerning "U" change in any respect from those as represented to us. Further, the no-action positions taken in this letter represent the views of this Division only and do not necessarily represent the views of the Commission or of any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, an attorney on my staff, at (202) 418-5445.

Very truly yours

John C. Lawton
Acting Director