Commodity Futures Archive - Selected materials, CFTC Interpretative Letter No. 89-5. (Request for Exemption from Registration as FCM, IBs and Principals.), ¶24,471, Commodity Futures Trading Commission, (Dec. 8, 1988)

¶24,471. Commodity Futures Trading Commission. Division of Trading and Markets. December 8, 1988. Correspondence in full text.

Interpretations: Foreign Transactions: Registration Exemption: Futures Commission Merchants..– Notwithstanding the legal status of a firm's U.S. branch office, the existence of the U.S. branch office in the U.S. should not preclude the firm's foreign futures division from being eligible for the exemptive relief in Reg. §30.10. The sales activities undertaken by the U.S. branch in the U.S. are activities which are subject to and require licensing by the Office of the Comptroller of the Currency and the U.S. branch essentially is treated as a separate entity by the OCC.

See ¶12,825, "Liabilities—Prohibitions" division, Volume 1.

Interpretations: Foreign Transactions: Registration Exemption: Introducing Brokers..– The regulatory purposes of limiting Reg. §30.10 relief to firms located outside the U.S. would be adequately addressed provided that neither a firm's U.S. branch office nor any affiliate of the firm would undertake any activity subject to regulation under Part 30 or engage in any clerical capacity related thereto. Should a U.S. affiliate registered as a broker/dealer determine at some future date to engage in introducing broker activities, it must notify the CFTC and NFA prior to engaging in such activities and comply with all of the regulatory requirements applicable to IBs in the CFTC's rules. This means that neither the U.S. branch nor a U.S. affiliate that engages in leveraged buyout services may engage in any activity subject to regulation under Part 30, including referring customers to the U.S. affiliate registered as a broker/dealer for referral to the firm or its foreign futures division, unless such entity also registers in an appropriate capacity. The Division of Trading and Market's no action position was also based upon the representations that the U.S. branch, and the two U.S. affiliates have consented to produce all books and records for inspection by the CFTC and NFA upon request; the three, notwithstanding the broker/dealer's consent to register as an IB, have undertaken not to engage in any activity subject to regulation under Part 30 without prior notice to the CFTC and at least one entity, the registered broker/dealer has agreed to register as an IB.

See ¶12,825, “Liabilities—Prohibitions” division, Volume 1.

Interpretations: Foreign Transactions: Principals: Introducing Brokers: Registration..– The Division of Trading and Markets accepted the designation of one of the vice-presidents of a firm's U.S. affiliate that deals in U.S. Treasury securities and is an underwriter of and dealer in certain municipal securities as the sole principal for purposes of its introducing broker registration. To effectuate this relief, however, the board of directors of the affiliate must certify in writing to the Division that no principal of the affiliate would be precluded from being registered with the CFTC under Section 8a(2) of the Commodity Exchange Act and must further acknowledge that the designated vice president of the affiliate will comply with the regulatory requirements applicable to principals for purposes of the no action position, and that absent further notice and compliance, neither the affiliate, its officers or employees will engage in any IB-related activities at this time. Specifically, the Division noted that pursuant to the terms of relief, the affiliate will have undertaken to notify the Division before it engages in any IB-related activities and otherwise be in compliance with all of the requirements applicable to such an entity, including the requirement in Reg. §3.12 that all persons who act in the capacity of an associated person of an IB, or any person who supervises any person so engaged, up to and including the president or chief executive officer, must register as such.

See ¶12,825, “Liabilities—Prohibitions” division, Volume 1.

This is in reference to your letter to the Division of Trading and Markets (“Division”) dated October 12, 1988 on behalf of your client A in which you requested that the Division confirm that it will not recommend any enforcement action against: (i) A's United Kingdom futures division, B, for failure to register as a futures commission merchant (“FCM”) under the Commodity Futures Trading Commission's (“Commission”) foreign futures and option regulations, 17 C.F.R. Part 30; (ii) A's United States branch, C, and D, a United States affiliate of A for failure to register as introducing brokers (“IBs”); and (iii) certain principals, as defined in Commission rule 3.1(a), [1] of E, a United States affiliate of A, for failure to comply with certain of the regulatory requirements applicable to principals of Commission registrants.

As set forth in your letter, A's futures division, B, which is domiciled in the United Kingdom, intends to solicit and accept orders for foreign futures and option transactions from customers resident in the United States pursuant to an exemption granted under Commission rule 30.10. [2] B is the subject of a petition, which is still pending, filed by the Association of Futures Brokers and Dealers (“AFBD”), a United Kingdom self-regulatory organization, under that rule

for an exemption from the application of certain of the Commission's rules based on the existence of a comparable regulatory system in the United Kingdom. Although A has a branch office located in the United States, that branch solely in banking activities which are subject to regulation by the Office of the Comptroller of the Currency ("OCC"). Other firms related to A doing business in the United States are D, which engages in leveraged buyout services, and E, which is a primary dealer in United States Treasury securities and an underwriter of and dealer in certain municipal securities. Both firms are registered as broker/dealers with the National Association of Securities Brokers and Dealers.

In adopting the exemptive provision in rule 30.10 of the foreign futures and option rules, the Commission clarified that the generalized exemption based on comparability of regulation would be available only to persons *located outside the United States* who are subject to a comparable regulatory system. 52 Fed. Reg. 28980, 28981 (Aug. 5, 1988). As you are aware, in a letter interpreting the scope of that exemption, the Division specifically addressed the issue of a foreign firm's ability to qualify for such exemptive relief in instances where the foreign firm maintains a presence in the United States through an operating division/branch [3] or through an affiliate or subsidiary which acts in the capacity of a securities broker/dealer, a bank or a merchant or processor of cash commodities. [4] In the case of a division or branch of a foreign firm, the Division stated that as such a presence would not constitute a separate entity but would legally be part of the firm as whole, a United States division or branch would render the offshore firm unable to claim that it was not located in the United States and that it therefore could avail itself of the broad exemption in rule 30.10. Accordingly, by letter of July 19, 1988, based on information provided to the Division by the National Futures Association ("NFA"), the Division advised the United Kingdom's Securities and Investments Board ("SIB"), which has oversight responsibility with respect to AFBD, that B might not be eligible for the exemptive relief under rule 30.10 based on the existence of C.

In its letter of January 15, 1988, the Division noted that the existence of an affiliate or subsidiary would not, in and of itself, cause the Division to find that the related foreign firm was located in the United States for purposes of rendering such firm ineligible for rule 30.10 relief. To the extent, however, such entity acted in the capacity of a securities broker/dealer, bank or merchant or processor of cash commodities which potentially could share the same customer base, the Division stated that it would premise eligibility for relief on registration by the subsidiary or affiliate as an IB. In the Division's July 19, 1988 letter to the SIB, however, the Division further stated that the status of firms in the United Kingdom which have affiliates and subsidiaries in the United States would be addressed on a case-by-case basis.

Based upon the foregoing and for the reasons set forth in your October 12, 1988 letter, you seek confirmation that: (i) C may be treated as a subsidiary or affiliate for purposes of Interpretative Letter No. 88-3, thereby allowing B to qualify for exemptive relief under Commission rule 30.10; (ii) C and each United States affiliate of A will not be required to register as IBs if E registers as an IB and A, B, C, D, and E comply with the undertakings described below; and (iii) registration of one of the principals of E will satisfy the Commission's regulatory requirements applicable to principals of Commission registrants [5] in connection with the registration of E as an IB.

Should C be Treated as a Subsidiary or Affiliate for Purposes of Determining B's Eligibility for the Rule 30.10 Relief?

Your assertion that the existence of C in the United States should not preclude B from eligibility for the comparability exemption is premised on your argument that C should be treated as a separate entity as would an affiliate or subidiary. In support of that position, you state the following:

> Although C is not technically a separate legal entity, it is viewed as a separate legal entity in many respects under the federal bank regulatory scheme. As a limited federal branch licensed by the [OCC], C is subject to extensive regulation, including reporting and recordkeeping requirements and examinations. C has the same powers and is subject to the same restrictions and liabilities that would apply to a national bank at the same location.
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> Furthermore, C, like other U.S. federal branches of foreign banks, is subject to separate financial requirements. Under the OCC's so-called "capital equivalency deposit" requirement, A must deposit with a federal reserve member bank investment securities of the type that may be held by a national bank for its own account in an amount equal to at least 5% of the total liabilities of C excluding accrued expenses and amounts due and other liabilities to branches, offices, agencies and subsidiaries of A. C must also maintain a capital equivalency account that keeps track of the liabilities covered by the deposit requirement. The OCC also has the power to impose a special asset maintenance requirement on C requiring A to maintain assets in New York of such type and in such amount as the OCC may prescribe by ruling.

Based upon the foregoing, and subject to the conditions set forth below, notwithstanding the legal status of C, the Division concurs that the existence of C in the United States should not preclude B from being eligible for the exemptive relief in rule 30.10. In this connection, the Division notes that the sales activities undertaken by C in the United States are activities which are subject to and require licensing by the OCC and that C essentially is treated as a separate entity by the OCC.

Should C or any United States Affiliate of A be Required to Register as an IB?

In Interpretative Letter No. 88-3, the Division stated that because United States subsidiaries or affiliates of foreign firms which act as a broker/dealer, a bank or a merchant or processor of cash commodities are entities which potentially could share the same customer base as the foreign firm and, therefore, engage in servicing customers for such foreign firm, such United States affiliates and subsidiaries should be required to register as IBs before the foreign firm could be eligible for an exemption from registration under Commission rule 30.10. This is because although such a firm would refer business to its related foreign firm, the applicable foreign regulator may not scrutinize the activities of an unregulated offshore subsidiary or affiliate of that entity and the Commission and NFA would not, and possibly could not, oversee the activities of a non-registrant.

As an alternative to requiring C and each of the United States affiliates to register, A proposes the following:

1. E will register with the Commission as an IB. In accordance with Interpretative Letter No. 88-3, E will not accept any funds from foreign futures and option customers and does not intend to carry any customer accounts with B. If in the future E decides to carry customer accounts with B, it will do so only on a fully-disclosed basis;

2. B will appoint E as its agent for purposes of accepting delivery and service of communications issued by or on behalf of the Commission, the U.S. Department of Justice, any U.S. self-regulatory organization, or any foreign futures or option customer;

3. Neither C nor any U.S. affiliate of A will refer any foreign futures or option customer to B or otherwise be involved in B's business in foreign futures and option transactions;

4. Neither C nor any U.S. affiliate of A will solicit any foreign futures or option business or purchase or sell foreign futures and option contracts on behalf of any foreign futures or option customers. If any such entity desires to engage in such activities in the future, it will do so only through E which shall comply with all applicable requirements for IBs, including those that apply to principals of IBs;

5. C and each U.S. affiliate of A will agree to provide upon request of the Commission or the National Futures Association access to records for the purpose of ensuring compliance with the terms and conditions of any exemptive relief granted hereto, and will make such records available for inspection at a location in the United States;

6. B will maintain outside the United States all contract documents, books and records regarding foreign futures and option transactions; and

7. Although it will continue to engage in normal commercial banking activities, C will not establish banking relationships in the United States with B's foreign futures and option customers for the purpose of effecting transactions in foreign futures and option contracts in the United States or for the purpose of facilitating B's activities subject to regulation under Part 30.

The Division has reviewed the undertakings proposed by A/B and its C and affiliates and believes that such undertakings, subject to the conditions noted below, will be sufficient to ensure that the regulatory purposes of limiting 30.10 relief to firms located outside the United States would be adequately addressed.

In particular, the Division notes that the C, E and D [6] have consented to produce all books and records for inspection by the Commission and NFA upon request, C, D and E, notwithstanding E's consent to register as an IB, have undertaken not to engage in any activity subject to regulation under Part 30 without prior notice to the Commission and at least one entity, E, has agreed to register as a IB. The Division, however, is adopting the no action position herein subject to the following conditions and clarifications. First, the no action position adopted herein is subject to the condition that neither C nor any affiliate of A will undertake any activity subject to regulation under Part 30 or engage in any clerical capacity related thereto. Should E determine at some future date to engage in IB activities, it must notify the Commission and NFA prior to engaging in such activities and comply with all of the regulatory requirements applicable to IBs in the Commission's rules. This means that neither C nor D may engage in any activity subject to regulation under part 30, including referring customers to E for referral to A/B, unless such entity also registers in an appropriate capacity.

Finally, with respect to the requirement that B, D, and C consent to make their books and records available, the Division notes that B will be subject to certain requirements relating to the availability of its books and records as a condition of obtaining relief under rule 30.10. In the case of D and C, the position adopted herein is subject to the condition that D and C agree to provide access to their books and records generally upon the request of any representative of the Commission, NFA or the United States Department of Justice at the place in the United States designated by such

representative within 72 hours after service of the request. The no action position outlined herein will not take effect until an appropriate officer of A, B, C, D and E each files a notice with the Division affirming his consent to all of the conditions of relief specified herein.

Should Exemptive Relief be Granted to E from Compliance with Certain of the Regulatory Requirements Applicable to Principals?

In connection with the registration of E as an IB, E has requested relief from certain of the regulatory requirements applicable to "principals" of IBs set forth in Commission rule 3.15(a)(2). A "principal" is defined in rule 3.1(a) as:

"(1) any person including, but not limited to … [an] officer, director, branch office manager or designated supervisor, or person occupying a similar status or performing similar functions, having the power … to exercise a controlling influence over its activities which are subject to regulation by the Commission; (2) any holder or beneficial owner of ten percent or more of the outstanding shares of any class of stock; or (3) any person who has contributed ten percent or more of the [applicant's] capital". In connection with the foregoing, A states that E proposes to designate one of its Vice Presidents as a "principal" and requests that the Division adopt a no action position with respect to the failure of *all* persons who fall within the definition of principal of E as defined in Commission rule 3.1 to comply with the Commission's regulatory requirements applicable to principals.

The Division concurs in A's position that requiring all principals of E to comply with all of the Commission's regulatory requirements applicable to principals would be unnecessarily burdensome in view of the fact that E has represented that it will not engage in any activity which requires registration as an IB absent further notice to the Division. Accordingly, under the circumstances, the Division will accept the designation of one of the Vice Presidents of E as the sole principal for purposes of its IB registration. To effectuate this relief, however, the board of directors of E must certify in writing to the Division that no principal of E would be precluded from being registered with the Commission under Section 8a(2) of the Act, 7 U.S.C. §12a(2) (1982), and must further acknowledge that the designated Vice President of E will comply with the regulatory requirements applicable to principals for purposes of the no action position set forth in this letter and that absent further notice and compliance, neither E, its officers or employees will engage in any IB-related activities at this time. Specifically, the Division notes that pursuant to the terms of relief, E will have undertaken to notify the Division before it engages in any IB-related activities and otherwise be in compliance with all of the requirements applicable to such an entity, including the requirement in Commission rule 3.12 [7] that all persons who act in the capacity of an associated person of an IB, or any person who supervises any person so engaged, up to and including the president or chief executive officer, must register as such.

The positions adopted herein are based on the information provided to us. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. Further, these positions 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.

Footnotes

1 17 C.F.R. §3.1(a) (1988).

2 17 C.F.R. §30.10 (1988).

3 In the Division's opinion, for the purposes herein, a "branch" is legally indistinguishable from a "division."

4 Interpretative Letter No. 88-3, 2 Comm. Fut. L. Rep. (CCH) ¶24,085 (January 15, 1988).

5 *See* Commission rules 3.15(a)(2) and 30.4(b), 17 C.F.R. §3.15(a)(2) and 30.4(b) (1988).

6 As a Commission registrant, E would be required under Commission rule 1.31, 17 C.F.R. §1.31 (1988), to produce all books and records required to be maintained under the Commodity Exchange Act ("Act") or regulations thereunder for inspection by any representative of the Commission or the United States Department of Justice.

7 17 C.F.R. §3.12 (1988)