CFTC Letter No. 97-01

December 12, 1996

Division of Trading & Markets

Re: Section 4(a): Applicability of Commodity Futures Regulations to Transactions Involving Gold Coins and Gold Bullion

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Dear :

This is in response to your letter dated September 24, 1996 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations with Division staff. You raise several questions concerning the applicability of the Commodity Exchange Act[1] (the "Act") to transactions involving gold coins and gold bullion.

Based upon your letter and subsequent telephone conversations, we understand the pertinent facts to be as follows. You are a financial planner and currently hold Series 7 and 63 licenses. Your firm is an NASD member, and you employ eight individuals, all of whom hold a Series 6 or Series 7 license. You inquire as to whether gold coins and gold bullion are considered "commodities" under the Commodity Exchange Act. You also ask whether a general securities representative may sell gold coins and/or gold bullion to another person without being subject to the Commission's jurisdiction under the Act. Finally, you ask whether a general securities representative may sell to a customer gold coins which he has purchased from a wholesaler and collect a "mark-up" or commission on the sale.

The term "commodity" is defined in Section 1a(3) of the Act to include various enumerated items as well as, among other things, "all other goods and articles, except onions . . . ." Gold is a commodity within this definition. Whether a general securities representative, or any person may sell gold coins and/or gold bullion to another person without being subject to the Commission's jurisdiction depends upon whether the transaction involves a futures contract or a commodity option. If the transaction is a futures contract or a commodity option, it is required, with few exceptions, to be conducted on a regulated futures exchange, and in accordance with the regulatory structure administered by the Commission.[2] Registration of a sales agent as a securities representative would not constitute regulatory compliance.

The term "contract for the purchase or sale of a commodity for future delivery," commonly known as a "futures contract," is not specifically defined in the Act or Commission regulations promulgated thereunder. However, based upon various definitions provided in Section 1a of the

Act, futures contracts would include agreements for the purchase or sale of "all . . . goods and articles . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in," but would exclude "any sale of any cash commodity for deferred shipment or delivery,"[3] a type of transaction more fully discussed below.

In determining if a specific transaction constitutes a futures contract, the Commission and the courts have assessed the transaction as a whole with an eye toward its underlying purpose.[4] While the Act and precedent construing the Act do not discuss the elements of a futures contract, the courts and the Commission have generally identified certain common characteristics. These would include the risk-shifting nature of the transaction and the fact that while a party may make or take delivery of the underlying commodity, one need not have an expectation that such performance will occur, and it frequently does not.

As noted above, the Act specifically excludes sales of cash commodities for deferred delivery from the Act's regulation of futures transactions. Deferred delivery contracts, commonly known as "forward contracts," generally have been described as commercial, merchandising transactions in physical commodities in which delivery actually occurs but is delayed or deferred for commercial purposes. Forward contracts thus have been defined as transactions between commercial counterparties in which the parties intend that physical transfer of the actual commodity will occur.[5]

Spot transactions are also excluded from regulation under the Act. Spot transactions possess the general characteristics of forward transactions referred to above. In a spot transaction, immediate delivery of the product and immediate payment for such are expected on or within a few days of the trade date, whereas payment and delivery may occur over a longer period pursuant to forward contracts.[6]

We recommend that you carefully review all of the facts and circumstances relating to the gold transactions described in your letter to determine whether such transactions would constitute futures contracts or commodity options and thus be within the purview of the Commodity Exchange Act and Commission regulations promulgated thereunder. We are not passing on the legality of the transactions you propose or upon your ability to collect a mark-up on such transactions.[7]

You should know that it has been our experience in matters of this kind that the public marketing and oral sales presentations made to prospective purchasers often differ markedly from written offering material describing such transactions which may be used in the marketing effort. In this regard, you should be mindful of the fact that the Commission and the courts have consistently looked beyond the appearance of legitimacy created by such written materials to the underlying economic reality of the transaction itself as reflected in the actual day-to-day operations of those engaged in the business of marketing such transactions. You also may wish to check with other state or federal authorities to see if any restrictions apply with regard to the proposed transactions in gold coins and bullion.

The views expressed herein are those of the Division of Trading and Markets 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 letter, please do not hesitate to contact Monica S. Amparo, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin

Chief Counsel

[1] 7 U.S.C. §1 et seq. (1994).

[2] Section 4(a) of the Act makes it illegal for any person "to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States . . . for the purpose of soliciting, or accepting any order for, . . . or in connection with, a contract for the purchase or sale of a commodity for future delivery . . . unless such transaction is conducted on or subject to the rules of a board of trade which has been designated by the Commission as a 'contract market' for such commodity." (emphasis added).

[3] Although the term "commodity option" is not specifically defined in the Act, see Section 4c(b) of the Act which concerns "any transaction involving any commodity regulated under [the] Act which is of the character of, or is commonly known to the trade as, an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty' . . . ."

[4] See CFTC v. CoPetro Marketing Group, Inc., 680 F.2d 573 (9th Cir. 1982) (finding transaction to be illegal off-exchange futures contract); and In Re Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941 (Dec. 6, 1979) (finding transactions in question were not contracts for deferred delivery but rather illegal off-exchange futures contracts). See also 54 Fed. Reg. 30,694 at 30,694-95 (July 21, 1989)(discussing definition of futures contracts in context of Policy Statement on Swap Transactions).

[5] In 1990, the Commission issued a Statutory Interpretation Concerning Forward Transactions in which it noted that "the Act's regulatory scheme for futures trading should simply not apply to private commercial merchandising transactions which create enforceable obligations to deliver but in which delivery is deferred for reasons of commercial convenience or necessity." 55 Fed. Reg. 39188, 39190 (Sept. 25, 1990).

[6] Timothy J. Snider, Regulation of the Commodities Futures and Options Markets, Vol. 1, §9.01 (2d ed.

1995).

[7] Irrespective of the applicability of the Commodity Exchange Act to the transactions described above, you should also consider whether the Model State Commodity Code adopted by the North American Securities Administrators Association, Inc. ("NASAA") and by several states would apply to such transactions. See NASAA Reports (CCH) ¶4401.