

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 3 and 170

Notice Registration as a Futures Commission Merchant or Introducing Broker for Certain Securities Brokers or Dealers

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: In accordance with certain provisions of the Commodity Futures Modernization Act of 2000 (“CFMA”), the Commodity Futures Trading Commission (“Commission” or “CFTC”) is amending Rule 3.10, which specifies the information that various applicants for registration must file. The amendment provides for notice registration as a futures commission merchant (“FCM”) or introducing broker (“IB”), as applicable, in the case of a broker or dealer (“BD”) registered with the Securities and Exchange Commission (“SEC”) that, among other things, limits its involvement with commodity futures contracts to security futures products. In accordance with certain other provisions of the CFMA, the Commission is amending Rule 170.15, which requires each registered FCM to be a member of a registered futures association. The amendment exempts notice-registered BDs from this requirement.

DATES: [Insert date 30 days after date of publication in the FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

I. Introduction

A. Background

On December 21, 2000, the CFMA was signed into law.¹ Among other things, the CFMA removed the restriction in the Commodity Exchange Act (“CEA”) on the trading of futures contracts on individual equity securities and narrow-based indices of equity securities.² Under the revised law, security futures products³ may be traded on a designated contract market or on a registered derivatives transaction execution facility.⁴

New Section 4f(a)(2) of the CEA now provides that any BD that is registered with the SEC⁵ shall be registered as an FCM or IB, as applicable, “effective contemporaneously with the submission of notice,” if –

(A) the broker or dealer limits its solicitation of orders, acceptance of orders, or execution of orders, or placing of orders on behalf of others involving any contracts of sale of any commodity for future delivery, on or subject to the rules of any contract market or registered derivatives transaction execution facility to security futures products;

(B) the broker or dealer files written notice with the Commission in such form as the Commission, by rule, may prescribe containing such information as the Commission, by rule, may prescribe as

¹ Pub. L. No. 106-554, 114 Stat. 2763. The text of the CFMA may be accessed on the Internet at <http://agriculture.house.gov/txt5660.pdf>.

² See Section 251(a) of the CFMA. This trading previously had been prohibited by Section 2(a)(1)(B)(v) of the CEA.

³ The term “security futures product” is defined in Section 1a(32) of the CEA to mean “a security future or any put, call, straddle, option, or privilege on any security future.” The term “security future” is defined in Section 1a(31) of the CEA. Because the CFMA also provides that options on security futures cannot be traded until at least December 21, 2003, security futures are the only security futures product that may be available for trading during the next 27 months.

⁴ The CFMA also specifically prescribes certain dates on which security futures trading can commence. For example, retail transactions cannot commence until December 21, 2001. Section 202(a) of the CFMA; Section 6(g)(5) of the Securities Exchange Act of 1934.

⁵ Because the CFMA speaks in terms of a “broker or dealer,” the term “BD” as used in this release applies equally to a broker, a dealer or a person registered as both a broker and a dealer.

necessary or appropriate in the public interest or for the protection of investors;

(C) the registration of the broker or dealer is not suspended pursuant to an order of the Securities and Exchange Commission; and

(D) the broker or dealer is a member of a national securities association registered pursuant to section 15A(a) of the Securities Exchange Act of 1934.

Moreover, new Section 4f(a)(4)(C)(i) of the CEA provides that a BD that is registered as an FCM pursuant to notice registration shall not be required to become a member of a registered futures association. Accordingly, on May 14, 2001 the Commission proposed to amend Rule 3.10 to provide for FCM and IB notice registration thereunder and to amend Rule 170.15 to exclude from its scope BDs notice-registered as FCMs (the “CFTC Proposal”).⁶

Among other things, the CFTC Proposal provided that this notice registration would be made “by following such procedures for notice registration as may be specified” by the National

⁶ 66 FR 27476 (May 17, 2001). The comment period on the CFTC Proposal originally was due to expire June 18, 2001. In response to a request it received, the Commission extended the comment period to July 11, 2001. 66 FR 33494 (June 22, 2001).

The Commission did not similarly propose (and is not now adopting) notice registration under Rule 3.12 for the APs of those BDs notice-registered as FCMs and IBs under Rule 3.10, because the CFMA exempts these APs from registration altogether. Specifically, Section 252(d) of the CFMA amends Section 4k of the CEA to provide that:

Any associated person of a broker or dealer that is registered with the Securities and Exchange Commission, and who limits its solicitation of orders, acceptance of orders, or execution of orders, or placing of orders on behalf of others involving any contracts of sale of any commodity for future delivery or any options on such a contract, on or subject to the rules of any contract market or registered derivatives transaction execution facility to security futures products, shall be exempt from [Section 4k(1)] of this Act and the rules thereunder.

Futures Association (“NFA”).⁷ As the Commission explained, this was consistent with the Commission’s previous delegations of registration authority to NFA and with the study on regulation of intermediaries required of the Commission by Section 125 of the CFMA.⁸ Subsequent to the publication of the CFTC Proposal, NFA submitted, and the Commission approved, a notice registration rule and related form.⁹ In a separate release published elsewhere in today’s edition of the **Federal Register**, the Commission is announcing its delegation to NFA of the processing of notice forms filed by BDs for registration as an FCM or IB.

B. Comments

Three comment letters were filed on the CFTC Proposal: one by NFA, one by the Chicago Mercantile Exchange Inc. (“CME”), and one by the Futures Industry Association (“FIA”). While all of these commenters supported the CFTC Proposal (and the Commission’s contemplated notice registration delegation to NFA), two of them took exception to the corresponding CFMA-mandated proposal of the SEC that would provide for notice registration as a BD of certain registered FCMs and IBs for the limited purpose of effecting transactions in security futures products (“SEC Proposal”).¹⁰ Specifically, CME and FIA commented that while the notice registration form proposed by NFA was simple and straightforward, the SEC Proposal appeared to have taken a different approach and would discriminate against FCMs and IBs

⁷ NFA is a futures association registered under section 17 of the CEA.

⁸ See 66 FR 27476 at 27478.

⁹ Specifically, this was done by way of Commission approval of NFA’s amendment to its Rule 204 on August __, 2001, effective immediately.

¹⁰ 66 FR 34041 (June 26, 2001).

seeking to notice register as BDs.¹¹ CME stated that the notice registration procedures for the CFTC and the SEC should be virtually identical and urged the Commission to defer implementation of notice registration rules until it could more closely and fairly coordinate its rules and those of the SEC in this area. FIA also stated that it saw no reason why the SEC could not adopt a procedure similar to the CFTC proposal and FIA encouraged the Commission to consult with the SEC to that end. Additionally, CME and FIA objected to the provision in the SEC Proposal that would prohibit notice-registered FCMs from becoming members of a national securities exchange for the limited purpose of effecting securities futures products on that exchange. Here, too, they claimed that this would result in disparate treatment for FCMs notice-registered as BDs.

In response to these comments, the Commission notes that it has conferred with the SEC on these issues and that it continues to do so in this area as well as others concerning security futures products. Nonetheless, the Commission continues to believe that, as stated by FIA, its BD notice registration procedures (i.e., the NFA notice registration procedures that the Commission has approved) are “consistent with the relevant provisions of the CFMA and . . . the spirit underlying it.” Accordingly, in light of that belief and the deadlines imposed by the CFMA, the Commission has determined not to defer final action on the CFTC Proposal and is adopting the amendments to Rules 3.10 and 170.15 as proposed.

II. The Rule Amendments

A. Rule 3.10

¹¹ Briefly stated, the NFA registration form is on one piece of paper, with one side asking for basic identifying information and necessary certifications and the other side providing instructions. The SEC Proposal would have an FCM or IB complete and file Form BD, which is the form an applicant currently must complete and file to register as a “full service” BD.

As proposed, the Commission is amending Rule 3.10 in several ways. First, paragraph (a)(1)(i) is being revised to alert applicants for registration that there is a special, limited registration procedure under new Rule 3.10(a)(3). Second, paragraph (a)(3) is being added. Captioned “Notice registration as a futures commission merchant or introducing broker for certain securities brokers or dealers,” it adds an exception to the FCM and IB registration requirements of Rule 3.10(a) for BDs who meet the criteria of new Section 4f(a)(2) of the CEA. Registration under paragraph (a)(3) is to be made “by following such procedures for notice registration as may be specified” by NFA. This registration will be effective upon the filing of the notice prescribed by NFA, as mandated by Section 252(b)(2) of the CFMA. Finally, paragraph (d) is being amended to relieve these notice registrants from the annual update requirement.

The Commission similarly is amending as proposed Rule 170.15. The amendment adds a provision to exempt FCMs registered in accordance with Rule 3.10(a)(3) from the requirement to become and remain a member of a registered futures association.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (“RFA”), 5 U.S.C. 601 *et seq.*, requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The rule amendments discussed herein would affect persons seeking to be registered under notice registration procedures as an FCM or IB pursuant to new Section 4f(a)(2). The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the

impact of its rules on such entities in accordance with the RFA.¹² The Commission previously determined that registered FCMs are not small entities for the purpose of the RFA.¹³ With respect to IBs, the Commission has stated that it would evaluate within the context of a particular rule proposal whether all or some affected IBs would be considered to be small entities and, if so, the economic impact on them of any rule.¹⁴

As noted in the CFTC Proposal, these amendments would provide exemptive relief from provisions of the Commission's rules that otherwise will be applicable to such persons. Consequently, the Commission believes that the adoption of these rule amendments would reduce the burden of compliance by persons seeking to be registered as an FCM or IB. No comments were received in response to the Commission's specific request for comments on this issue.

B. Paperwork Reduction Act

This rulemaking contains information collection requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").¹⁵ As required by the PRA, the Commission has submitted a copy of this part to the Office of Management and Budget ("OMB") for its review. In response to the Commission's invitation in the notice of proposed rulemaking to comment on any potential paperwork burdens associated therewith, no comments were received.

¹² 47 FR at 18618-21 (April 30, 1982).

¹³ 47 FR at 18619-20.

¹⁴ 47 FR at 18618, 18620.

¹⁵ 44 U.S.C. 3501 et seq.

The final rule does not contain any disclosure requirements or any consumer reporting requirements. It does, however, require the collection of certain information from BDs seeking to be notice-registered as an FCM or IB. The Commission may not conduct or sponsor, and a person is not required to respond to, an information collection unless it displays a currently valid OMB control number. The Commission has received a control number for this information collection from OMB.

C. Cost-Benefit Analysis

Section 119 of the CFMA amended Section 15 of the CEA to require that the Commission, before promulgating a rule or issuing an order under the CEA, consider the costs and benefits of the Commission's action in light of five criteria.¹⁶ As explained in the preamble of the CFTC proposal, the main relevant considerations with respect to notice registration are the first two considerations set forth in the CEA, "protection of market participants and the public" and "efficiency, competitiveness and financial integrity of the futures markets."¹⁷ The Commission then expressed its views that: (1) persons who are registered as BDs with the SEC are appropriate subjects for notice registration where their futures-related activity is restricted to security futures products; and (2) these additional registrants may promote the efficiency and competitiveness of those markets on which security future products may be traded and that their presence as intermediaries in these markets may serve to promote the financial integrity of those markets, and further noted that the CFMA specifically mandates that registered BDs be noticed-

¹⁶ These considerations include: (A) protection of market participants and the public; (B) efficiency, competitiveness, and financial integrity of futures markets; (C) price discovery; (D) sound risk management practices; and (E) other public interest considerations.

¹⁷ 66 FR 27476 at 27478.

registered with the Commission as an FCM or IB.¹⁸ The Commission did not receive any comments on this cost-benefit analysis.

List of Subjects

17 CFR Part 3

Brokers, Commodity futures, Reporting and recordkeeping requirements.

17 CFR Part 170

Authority delegations (Government agencies), Commodity futures.

For the reasons discussed in the preamble, the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 3 – REGISTRATION

1. The authority citation for Part 3 continues to read as follows:

Authority: 5 U.S.C. 552, 552b; 7 U.S.C. 1a, 2, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6o, 6p, 8, 9, 9a, 12, 12a, 13b, 13c, 16, 18, 19, 21, 23.

2. Section 3.10 is amended by revising paragraph (a)(1)(i), by adding a new paragraph (a)(3) and by revising the first sentence of paragraph (d), to read as follows:

§3.10 Registration of futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.

(a) Application for registration. (1)(i) Except as provided in paragraph (a)(3) of this section, application for registration as a futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant must be on Form 7-R, completed and filed with the National Futures Association in accordance with the instructions thereto.

¹⁸

Id.

* * * * *

(3) Notice registration as a futures commission merchant or introducing broker for certain securities brokers or dealers. (i) Any broker or dealer that is registered with the Securities and Exchange Commission may be registered as a futures commission merchant or introducing broker, as applicable, by following such procedures for notice registration as may be specified by the National Futures Association, if –

(A) The broker or dealer limits its solicitation of orders, acceptance of orders, or execution of orders, or placing of orders on behalf of others involving any contracts of sale of any commodity for future delivery, on or subject to the rules of any contract market or registered derivatives transaction execution facility, to security futures products as defined in Section 1a(32) of the Act;

(B) The registration of the broker or dealer is not suspended pursuant to an order of the Securities and Exchange Commission; and

(C) The broker or dealer is a member of a national securities association registered pursuant to Section 15A(a) of the Securities Exchange Act of 1934.

(ii) The registration will be effective upon the filing of the notice prescribed by the National Futures Association in accordance with the instructions thereto.

* * * * *

(d) Annual filing. Any person registered as a futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant in accordance with paragraph (a)(1) and (a)(2) of this section must file with the National Futures Association a Form 7-R, completed in accordance with the instructions thereto, annually on a date specified by the National Futures Association. * * *

PART 170 – REGISTERED FUTURES ASSOCIATIONS

3. The authority citation for Part 170 continues to read as follows:

Authority: 7 U.S.C. 6p, 12a and 21, unless otherwise noted.

Subpart C – Membership in a Registered Futures Association

4. Section 170.15 is revised to read as follows:

§170.15 Futures Commission Merchants.

(a) Except as provided in paragraph (b) of this section, each person required to register as a futures commission merchant must become and remain a member of at least one futures association which is registered under section 17 of the Act and which provides for the membership therein of such futures commission merchant, unless no such futures association is so registered.

(b) The requirements of paragraph (a) of this section shall not apply to a futures commission merchant registered in accordance with §3.10(a)(3) of this chapter.

Issued in Washington, DC on _____, 2001 by the Commission.

Jean A. Webb
Secretary of the Commission