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May 7, 2007

Ms. Eileen Donovan
Acting Secretary,
Commodity Future Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

OFFICE OF THE SECRETARY

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Re: **Comment letter on "Exemption From Registration for Certain Foreign Persons," Proposed Rule, 72 Fed. Reg. 15637 (April 2, 2007)**

Dear Ms. Donovan:

The Commodity Futures Trading Commission ("Commission") has requested public comment on its proposed "Exemption from Registration for Certain Foreign Persons" that would adopt a new definition of the term "foreign broker" and, subject to certain conditions, provide an exemption for a foreign broker, as newly defined, from registration as a futures commission merchant ("FCM"). The Commission noted that its proposal is intended to "codify past actions of the Commission or its staff permitting certain foreign firms that limit their customers to foreign customers to submit U.S. DCM and DTEF business on behalf of those customers for clearing on an omnibus basis through a registered [FCM], without the foreign firm having to register as an FCM pursuant to section 4d of the Commodity Exchange Act ("Act)." 72 Fed. Reg. 15637. As a general matter, the Futures Industry Association ("FIA") supports the Commission's effort to codify the foreign broker exemption as a means of providing greater legal certainty, and is pleased to submit these comments on the proposed rules.¹

FIA agrees that the exemption for foreign brokers from FCM registration in proposed rule §3.10 (c)(2)(i) is sound as a matter of regulatory policy insofar as it codifies longstanding Commission exemptive relief. FIA is concerned, however, with the condition set forth in proposed rule §3.10 (c)(2)(ii), which provides that a foreign broker acting in accordance with the exemption "remains subject to *all* other provisions of the Act and of the rules, regulations and orders thereunder" (emphasis added). This provision, if read literally, could possibly be misconstrued as subjecting such exempt foreign brokers to Commission regulations that are intended to solely apply to registered FCMs, such as requirements regarding fitness, customer

¹ FIA is a principal spokesman for the commodity futures and option industry. Our regular membership is comprised of approximately 38 of the largest FCMs in the United States ("U.S."), many of whom have affiliates that are foreign brokers. Among our approximately 150 associate members are representatives of virtually all other segments of the futures industry, both national and international, including U.S. and international exchanges, banks, legal and accounting firms, introducing brokers, commodity trading advisors, commodity pool operators, other market participants, and information equipment providers. Reflecting the scope and diversity of our membership, FIA estimates that our members are responsible for more than 90 percent of all customer transactions executed on U.S. contract markets.

funds segregation, and regulatory capital requirements. While FIA presumes that it is not the intent of the Commission to exempt a foreign broker from registration as an FCM and then subject the foreign broker to the full panoply of the requirements under the Act applicable to an FCM, we believe that the current wording of the proposed rule may inadvertently lead to confusion and regulatory uncertainty on the part of foreign brokers that wish to avail themselves of the exemption from registration.

An interpretation of proposed rule 3.10(c)(2)(ii) applying the full breadth of the Act and Commission rules and regulations to exempt foreign brokers would not be consistent with prior Commission precedent, would not be sound regulatory policy, and is not necessary. As noted by the Commission in its release, the Commission has addressed the participation of foreign brokers on U.S. markets with respect to non-U.S. customers through a U.S. FCM on several occasions. In granting relief from registration to brokers located outside the U.S. which engage in commodity interest activities for or on behalf of foreign customers through a U.S. FCM, the Commission has previously conditioned the exemption on the foreign broker's compliance with certain limited provisions of the Act and regulations thereunder.² In none of the exemptions cited, however, has the Commission required blanket compliance with the Act and Commission regulations, rather the Commission has required foreign brokers to comply with those provisions of the Act and the Commission's regulations "*applicable to foreign brokers*" or "*applicable to conduct subject to regulation under the Act.*"³ Thus, for example, the position reporting requirements set forth in Parts 15-21 of the Commission's regulations are specifically cited by the Commission as applicable to foreign brokers. 72 Fed. Reg. 15637, at 15639. Additionally, the margin requirements of Commission regulation 1.58(a) specifically apply to a foreign broker that maintains a customer omnibus account with an FCM.

The extent to which the Act applies to any person depends upon the nature of such person's conduct in the U.S or the effect of their conduct undertaken overseas on U.S. markets. *Tamari v. Bache & Co.*, 730 F.2d 1103, 1108 (7th Cir. 1984). Extending the jurisdiction of the Act by rulemaking to conduct undertaken overseas between a foreign broker and its foreign customer, absent a substantial harm caused by such overseas conduct to interests in the U.S., would be inconsistent with principles of foreign relations law. *Id.*, at footnote 6. Under the terms of the proposed exemption, a foreign broker may not be physically present in the U.S., it may not have U.S. customers for U.S. DCM or DTEF transactions, nor may it act in a self-clearing capacity. Its only contact with the U.S. in this context is that it carries a customer omnibus account with a registered U.S. FCM.⁴ A foreign broker that limits its activities in the

² CFTC Staff Letter 89-07 [1987-1990 transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,479 (June 2, 1989); *see also* CFTC Staff Letter 92-19 [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,516 (Oct. 9, 1992) (granting a registration exemption as an IB to a foreign broker with U.S. branches with regard to foreign customers); CFTC Staff Letter 93-113 [1992-1994 transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,930 (Oct. 29, 1993) (granting an exemption from registration to a foreign broker with U.S. branches where the foreign broker introduces its non-U.S. customer omnibus account to a U.S. FCM, or as an IB on a fully disclosed basis).

³ CFTC Staff Letter 89-07, ¶ 24,479 at 36,097; CFTC Staff Letter 92-19 ¶ 25,516; CFTC Staff Letter 93-113, ¶ 25,930.

⁴ Foreign brokers may have other contacts with the U.S. FCM such as maintaining an omnibus account for a U.S. FCM seeking access to non-U.S. markets, or maintaining a proprietary trading account.

U.S. to carrying non-U.S. customer funds and positions in a customer omnibus account with a registered U.S. FCM is more properly viewed as a customer⁵ of the U.S. FCM. Thus, there is no need for the full range of regulations otherwise applicable to registered FCMs to apply to exempt foreign brokers. The Commission itself recognizes that a foreign broker holding a customer omnibus account with a registered FCM does not involve regulatory concerns, such as "requirements concerning fitness, capital, treatment of funds, recordkeeping, and ongoing reporting" that the Commission identified as implicated where the foreign broker would have more direct contact with U.S. markets if the foreign broker were engaged in remote clearing activities. 72 Fed. Reg. 15637, at 15639. Accordingly, FIA recommends that the Commission amend proposed rule §3.10 (c)(2)(ii) to provide that "a foreign broker acting within the limitations of §3.10 (c)(2)(i) remains subject to those provisions of the Act and of the rules, regulations and orders thereunder applicable to a foreign broker in its capacity as an omnibus account customer of a futures commission merchant."

Additionally, in its discussion of Commission precedent regarding the exemption for foreign brokers from registration under the Act, the Commission notes that "a foreign broker would generally not need to register as an introducing broker⁶" if it solicits or accepts orders from persons located outside the U.S. *Id.* at 15638. The Commission further explained that it may be best for local authorities to regulate foreign brokers who solicit or accept orders only from persons located outside the U.S. 48 Fed. Reg. 35247, at 35261. Therefore, FIA encourages the Commission to codify this prior exemptive relief⁷ by including a provision specifically exempting brokers located outside of the U.S. when acting in the capacity of an IB with respect to non-U.S. customers (in other words, when the foreign broker introduces non-U.S. customers on a fully disclosed basis to a registered FCM or IB) from registration as an IB or FCM.

The clarifications to the proposed rule in this letter are consistent with prior Commission precedent regarding the exemption of foreign brokers from registration as an FCM or IB, Commission deference to the home country regulator of the foreign broker, and the Commission's stated desire to provide greater legal certainty to market participants. FIA again thanks the Commission for this opportunity to provide comments on the proposal.

Very truly yours,



John M. Damgard
President

⁵ The term customer is defined as a customer trading in any commodity as defined in the Act provided, however, an owner or holder of proprietary accounts as defined in the 17 C.F.R. §1.3 (y) shall not be deemed a customer. 17 C.F.R. § 1.3 (k).

⁶ An introducing broker ("IB") is defined as a person engaged in soliciting or in accepting orders for futures and options contracts listed on any contract market or derivatives transaction execution facility that does not accept any money, securities, or property to margin any trades that result from such orders. 17 C.F.R. § 1.3(mm).

⁷ CFTC Staff Letter 92-19, at ¶ 25,516; *see also* 48 Fed. Reg. 35247, 35261 (citing 45 Fed. Reg. 18356, at 18360); 45 Fed. Reg. 80490 (Dec. 5, 1980); CFTC Staff Letter 75-12 [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,099 (Oct. 6, 1975).