

## Commodity Futures Archive - Selected materials, CFTC-OGC Interpretative Letter No. 86-5. (Export Trading Company's Proposed Financial Credit Arrangements.), ¶23,227, Commodity Futures Trading Commission, (Jun. 17, 1986)

¶23,227. Commodity Futures Trading Commission, Office of the General Counsel. June 17, 1986. Correspondence in full text.

**Interpretations: Hedging Service Export Trading Company: Proposed Financial Credit Arrangement.**— The Office of the General Counsel would not recommend enforcement action if an export trading company offered its hedging service via financial credit arrangements only to commercial entities engaged in export or international trade and if the Federal Reserve Board approved the service under the Bank Holding Company Act. The Office's position was predicated on its understanding that the company was an export trading company within the meaning of the Export Trading Company Act and the Bank Holding Company Act and on the company's representation that under no circumstances would the service be offered to the general public.

See ¶12,001, "Liabilities—Prohibitions" division, Volume 1.

By letter dated February 19, 1986, you have asked the staff to issue a "no-action" letter with respect to certain proposed activities by an export trading company ("X"). From your letter (and attached statutory materials), we understand the facts to be as follows.

X is a subsidiary of a bank holding company which is regulated by the Federal Reserve Board ("Board") under the Bank Holding Company Act, 12 U.S.C. §1841 *et seq.* Since its formation in 1983, X has engaged in various types of financing and trading activities related to international trade.

X was formed pursuant to the Export Trading Company Act, 15 U.S.C. §4001 *et seq.*, and the Bank Export Services Act, 12 U.S.C. §1841 *et seq.* Congress enacted the Export Trading Company Act to increase United States exports of products and services by, among other things, promoting the formation of export trading companies. 15 U.S.C. §4001. An "export trading company" is defined as an entity organized and operated principally for the purpose of exporting or facilitating the exportation of goods or services produced in the United States. 15 U.S.C. §4002f(a)(4).

The Bank Export Services Act directs the Board to pursue regulatory policies that, among other things, provide for the establishment of export trading companies. More specifically, the Act amends the Bank Holding Company Act to authorize, in effect, bank holding companies to form export trading companies. 12 U.S.C. §1843(c)(14). The export trading company must be "exclusively engaged in activities related to international trade...." 12 U.S.C. §1843(c)(14)(F).

Under the Bank Holding Company Act, as amended by the Bank Export Services Act, an export trading company that is a subsidiary of a bank holding company may take positions in commodities and commodity contracts to the extent necessary in the course of its business. Purely speculative trading in commodities or commodity contracts is prohibited. The Board may require, among other things, that a bank holding company terminate its investment in an export trading company "if the Board determines that the export trading company has taken positions in commodities or commodity contracts ... other than as may be necessary in the course of the export trading company's business operations." 12 U.S.C. §1843(c)(14)(D).

The Board has access to the books and records and to all other pertinent information relating to the activities of export trading companies that are bank holding company subsidiaries. The Board audits bank holding companies and their subsidiaries regularly. The Board receives periodically from bank holding companies consolidated financial statements. Part 211. Subpart C of the Board's regulations specifically govern export trading companies. 12 C.F.R. 211.31 *et seq.*

Your letter states that the service which X seeks to provide (and for which a staff "no-action" letter is requested) would facilitate international trade by providing United States exporters, foreign importers of domestic goods and services, and others engaged in international trade lines of credit to finance contracts for the purchase or sale of certain commodities. Such arrangements would provide "an opportunity to obtain price protection for commodity transactions through a form of hedging."<sup>1</sup> Under X's "hedging service,"<sup>2</sup> X would enter into contracts with its customers for the purchase or sale of commodities. Settlement on the financial contracts would be by cash. Rather than standardized contract terms, each customer would separately negotiate the particular commodity, quantity and quality of the commodity, price, currency in which payment is to be made, terms of payment, delivery date, and delivery location. About 25% of the transactions would likely involve commodities that are not traded on futures markets anywhere in the world (e.g., certain base metals); about 50% would likely involve commodities similar to, but also different from, commodities traded on

exchanges ( e.g., different grades of certain petroleum products); and about 25% would likely involve commodities identical to commodities traded on exchanges, although the contract terms (e.g., delivery date and location) may be significantly different. X would hedge its risk under these contracts through transactions in the futures and cash markets.

The following example of an actual transaction in which X proposes to engage is set forth in your letter:

[X] would like to provide its hedging service to a Portuguese soybean crusher, which sells soybean meal forward on a fixed price basis in escudos (the domestic currency of Portugal). The crusher's normal practice is to obtain the necessary beans (one transaction . . . would involve 36,000 metric tons) from a U.S. exporter at a price in U.S. dollars based on the Chicago Board of Trade soybean futures prices for the spot month. Under that arrangement, the crusher is at the risk both of fluctuations in the soybean market and of fluctuations in the exchange rate between the dollar and the escudo. [X] would enable the crusher to hedge both of those risks by entering into a contract to sell the crusher 30,000 metric tons of soybeans for forward delivery at a price fixed in escudos, with settlement to be made in cash. On maturity of the contract, if the escudo value of soybeans has increased, the crusher will have lost money on his supply contract with the U.S. exporter, but [X] will make up that loss by paying the crusher the increase in the value of its contract with [X]. On the other hand, if the escudo value of soybeans has decreased, the crusher will pay the difference to [X], but make up for that loss by taking delivery of its soybeans from its supplier at a lower cost.

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The contract between [X] and the crusher will be on a so-called 'dedicated credit line.' This means that the crusher would not be required to deposit any margin or make any down payment.

X's hedging service via financial credit arrangements would be offered only to commercial entities engaged in export or international trade. Under no circumstances would X's service be offered to the general public. X would seek to assure itself that its customers use the contracts as part of their commercial trade business and not for speculation.

Your letter states that "[p]erhaps most important, a description of the proposed activity for which the 'no-action letter' is being requested will be submitted to the [Board] staff for concurrence that such activity would be permissible under the [Bank Holding Company Act]." X believes that its hedging service will further the intent of Congress to increase United States exports.

Based on these facts, and only if Board staff indeed concurs that X's hedging service is permissible under the Bank Holding Company Act,<sup>3</sup> this Office will not recommend enforcement action against X pursuant to section 4(a) of the Commodity Exchange Act, 7 U.S.C. §6(a), if X offers its service as described herein and as concurred in by the Board staff.<sup>4</sup> Our position is particularly predicated on our understanding that X is an "export trading company" within the meaning of the Export Trading Company Act and the Bank Holding Company Act, as amended, and on X's representation that its service will not be offered to the general public.

You should be aware that our position does not excuse X from complying with any otherwise applicable provisions of the Commodity Exchange Act.

The views expressed in this letter are those of the Office of the General Counsel and do not necessarily reflect the views of the Commission or any other office or division within the Commission. Moreover, our position is based upon the representations that have been made to us. Any different, changed, or omitted facts might require us to reach different conclusions. We therefore request that you notify us immediately if Board staff does not concur that X's hedging service is permissible under the Bank Holding Company Act or if X plans to alter its service as described herein.

#### Footnotes

- 1 In this connection, the Office of the General Counsel notes that the transactions in which X wishes to engage would not necessarily fall within the definition of bona fide hedging transactions in Commission rule 1.3(z), 17 C.F.R. §1.3(z)(1985).
- 2 You note that X also plans to open a "consulting service" for foreign buyers of domestic goods. We do not construe this activity as included in your request for a "no-action" letter.
- 3 In this connection, the Office of the General Counsel wishes to make clear that it is expressing no opinion with respect to whether the transactions in which X wishes to engage will facilitate international trade or otherwise implement the intent of Congress in this regard. The Office also wishes to make clear that this letter should not be interpreted as an endorsement of such transactions.

- 4 We interpret your letter as a request for "no-action" under section 4(a) of the Commodity Exchange Act. Section 4(a) generally prohibits a person from soliciting or accepting orders for any commodity futures transaction unless the transaction is conducted on or subject to the rules of a designated contract market. 7 U.S.C. §6(a).