

Commodity Futures Archive - Selected materials, CFTC Interpretative Letter No. 92-11. (The Entry into the Globex Trading System of U.S. Customer Orders at the Offices of Foreign Affiliates of Exchange Member Firms.), ¶25,325, Commodity Futures Trading Commission, (Jun. 25, 1992)

¶25,325. Commodity Futures Trading Commission. Division of Trading and Markets. June 25, 1992. Correspondence in full text.

Interpretations: Registration: FCMs: Globex: Foreign Affiliates..— Enforcement action would not be recommended against any exchange member firm solely for soliciting, accepting, or entering U.S. customer orders into Globex through designated persons located at a foreign affiliate that is not registered as an FCM. The Globex-related activities of the designated persons would be deemed to be the operation of a branch office of the exchange member firm. This relief was granted subject to certain conditions that set forth the permissible methods of conducting such business and the responsibilities of the firms so engaged.

See ¶7025, "Registration" division, Volume 1.

Interpretations: Registration: APs: Globex: Foreign Affiliates..— Enforcement action would not be recommended with respect to the designated individuals who do Globex-related U.S. customer business at foreign affiliates, the exchange member firms, or the foreign affiliates for soliciting, accepting, or entering Globex orders at foreign affiliates for U.S. customers on behalf of exchange member firms without being registered.

See ¶7425, "Registration" division, Volume 1.

This is in response to your letter of June 25, 1992, in which you requested on behalf of the member firms of the Chicago Mercantile Exchange ("CME") and the Chicago Board of Trade ("CBOT") that the Division of Trading and Markets ("Division") adopt a no-action position with respect to certain Commission registration requirements that would apply to Exchange firms and their foreign affiliates that "pass the book" of customer orders for entry into the Globex electronic trading system and to personnel involved in that process. You have requested that the Division adopt this position by June 25, 1992, the first day of Globex trading.

I. Background

You have presented the following facts:

The Globex Trading System is an after-hours automated order entry and matching system for futures and options on futures that will be available in major financial centers throughout the world. It will operate between the hours of (Chicago time) 6:00 p.m. and 6:00 a.m. Since these hours will overlap with the regular business hours in other time zones, foreign participation is anticipated. For this reason, certain CME and CBOT firms have indicated that they may staff their U.S. operations for part of the Globex Session and then would staff for the remainder of the Globex Session at a foreign affiliate of the Exchange member firm, as qualified pursuant to Exchange rules.

CME Rule 574 provides that wholly-owned affiliates of clearing members are eligible for Globex terminals for entry of proprietary and customer orders. Similarly, the CBOT is permitting such affiliates of member firms to have access to its contracts through Globex if the foreign affiliate is entirely owned by its parent which also entirely owns the CBOT member firm. For tax and other reasons, many foreign affiliates are established as separate legal entities. However, under Exchange rules, the Exchange member firm is responsible for all Globex-related activities of the Globex terminal operators in the affiliate offices, including activity on behalf of U.S. and non-U.S. customers.¹

You have further stated that:

The foreign affiliate's main function will be to service foreign customers that intend to trade through Globex. However, certain individuals in the foreign office would be designated to accept orders on behalf of the U.S. member firm from U.S. customers. Given the hours of Globex, it is unlikely that U.S. customer business through these individuals would be significant. Nonetheless, certain Exchange member firms would like to have the flexibility to enable those designated persons to accept such orders.

You also have stated that the CME and CBOT ("Exchanges") have identified two types of activity in foreign affiliate

offices that may take place on behalf of U.S. customers. The first would include those instances in which individuals in the office of the affiliate would accept and enter orders from U.S. customers of the Exchange member firm,² but would act in only a clerical capacity, exercising no discretion. Such individuals would merely act upon the instructions of U.S. customers and would not solicit U.S. customer orders. The Exchanges propose that, in such situations, the individuals accepting orders in this clerical capacity would not themselves be registered persons, provided that they were supervised by a person at the foreign affiliate who was registered with the Commission as an associated person (“AP”) of the Exchange member firm.

The second type of activity you listed would include situations in which individuals at the foreign affiliate would solicit U.S. customers of the Exchange member firm, or accept or enter orders from such U.S. customers in other than a clerical capacity. The Exchanges propose that each individual who acts in such a capacity would be registered as an AP of the Exchange member firm.

Because the foregoing arrangement raises issues with respect to domestic registration of the foreign affiliate and the individuals handling U.S. customer orders, you have requested no-action relief on behalf of Exchange member firms and their qualified foreign affiliates and certain designated individuals located at the foreign affiliates to permit such designated individuals to accept orders from U.S. customers on behalf of Exchange member firms for entry into Globex. In particular you have requested that any such no-action relief:

- (1) ... permit certain individuals designated by the Exchange member firm as authorized to solicit, accept, or enter orders for U.S. customers on behalf of the Exchange member firm without requiring the foreign affiliate to register with the CFTC or to satisfy certain branch office indicia; and (2) ... permit certain of those designated individuals in foreign affiliate offices to accept and enter such orders on behalf of Exchange member firms without being registered with the CFTC pending processing of their registration applications as APs of Exchange member firms.

II. Entry of Orders at the Foreign Affiliate

Section 4d of the Commodity Exchange Act (“Act”) provides:

It shall be unlawful for any person to engage as [an FCM] or introducing broker in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery, or involving any contract of sale for future delivery, on or subject to the rules of any contract market unless—

- (1) such person shall have registered, under the Act, with the Commission as such [FCM] or introducing broker....

Section 4k of the Act provides:

- (1) It shall be unlawful for any person to be associated with [an FCM] as a partner, officer, or employee, or to be associated with an introducing broker as a partner, officer, employee or agent ... in any capacity that involves (i) the solicitation or acceptance of customers' orders (other than in a clerical capacity) or (ii) the supervision of any person or persons so engaged, unless such person is registered with the Commission under this Act as an [AP] of such [FCM] or of such introducing broker....³

The Commission has stated that an AP must be situated in either the main office or a designated branch office of the registrant.⁴ The Commission has stated further that any branch office must be part of the same legal entity as the main office.⁵ Thus, the Commission generally has prohibited “non-proprietary” branch offices, instead requiring branch offices that maintain separate legal identities to obtain an independent registration status.⁶

The Commission has permitted, however, proprietary branch offices to be maintained within the offices of non-registered entities under certain conditions ensuring clear delineations between the branch office and the host business. In a July 26, 1989 letter, the Division offered general guidance to a registrant interested in establishing branch offices at various agricultural businesses.⁷ The Division stated that, while it might be possible for the FCM to contract with the host business for office space or other support services, no compensation could be provided that would operate as or be characterized as a commission, “finder's fee,” or other fee-sharing arrangement. Finally, the Division, citing Commission Regulation 166.4,⁸ stated that it would be necessary to maintain a very clear distinction between branch office activities and the operations of the host business. The Division cited as indicia of such delineation, separate entrances, clear signs, separate phone lines, and other denotations of the branch office's status as a branch of the FCM independent of the host business.⁹

You have indicated that the individuals soliciting, accepting, and entering orders for U.S. customers on behalf of an Exchange member firm, although located in the foreign affiliate's office, would operate with regard to U.S. customer

business as agents of the Exchange member firm. The Globex-related activities of those individuals located in the foreign affiliate and sponsored and supervised by the Exchange member firm would be deemed to be the operation of a branch office of that firm for purposes of the Act and this relief. Each such branch office would be part of the same corporate entity as its sponsoring Exchange member firm. Such offices, however, would not exhibit all of the indicia of “separate” branch offices set forth in the Division's July 19, 1989 letter. Since all U.S. customer orders, of necessity, would be placed by phone, no physical signs of demarcation would be present. Instead, U.S. customers desiring to place Globex orders outside U.S. business hours would be directed by the Exchange member firm to ask for the Globex order desk at the foreign affiliate. Once connected to that desk, a customer would speak only to a registered AP of the Exchange member firm or a non-registered person supervised by such an AP.

Based on the unique nature of the facts presented and subject to the conditions set forth below, the Division believes that the requested no-action relief may be granted. A significant reason for the general requirement that branch offices located at unrelated entities be clearly distinguishable from their hosts is the avoidance of customer confusion. Since all customers placing Globex orders through the branch offices located in the foreign affiliates would be U.S. customers situated in the U.S., there would be little chance of walk-in business, and hence no need for separate entrances or clear signs. A U.S.-based registrant would disclose to its U.S. customer the arrangement for using the foreign branch office for order entry purposes.

The Exchanges have set forth in their June 25, 1992 letter certain conditions to their request for no-action relief that they believe should be met by the Exchanges, Exchange member firms, and designated individuals seeking to obtain such relief.¹⁰ Those conditions are as follows:

- All Exchange member firms that intend to operate pursuant to the relief granted herein must identify themselves and their foreign affiliates in writing to the Exchanges, the National Futures Association (“NFA”), and the Commission.
- All U.S. customer accounts must be carried on the books of the Exchange member firm as customer accounts of that firm.
- All written communication with U.S. customers must be by the Exchange member firm on its own stationery.
- All monies, securities, and property of U.S. customer accounts must be maintained with the Exchange member firm.
- No compensation can be paid by the Exchange member firm to the foreign affiliate beyond reasonable provision for reimbursement of costs incurred in entering orders for U.S. customers.
- Each Exchange member firm must disclose the nature of the arrangement to its U.S. customers and provide specific instructions concerning the placement of orders pursuant to the arrangement.
- Each Exchange member firm must identify to the appropriate Exchange and the NFA all individuals authorized to solicit, accept, or enter orders from U.S. customers on behalf of such member at the foreign affiliate.
- All such individuals will act as agents of the Exchange member firm and be deemed to be located in a foreign branch office of such firm.
- At least one AP of the Exchange member firm must be present in the foreign affiliate, regardless of whether discretionary or non-discretionary orders are accepted and entered.
- All individuals who solicit U.S. customer orders or accept or enter such orders on a discretionary basis must be registered as APs of the Exchange member firm.
- Each AP must be sponsored by the Exchange member firm.
- Any non-registrant accepting or entering U.S. customer orders must be subject to the supervision of an AP sponsored by the Exchange member firm.
- The Exchange member firm must have the right to terminate the authority of any individual at the foreign affiliate to solicit, accept, or enter orders on behalf of U.S. customers.
- The Exchanges' Globex trading restrictions, including those with respect to trading ahead of or against customer orders, will apply to all orders entered at the foreign affiliate, whether for U.S. or other customers.
- The Exchanges' disciplinary authority regarding activities that occur at the foreign affiliate will include authority over the individuals soliciting, accepting, or entering U.S. customer orders. The Exchanges will be responsible for requiring that Exchange member firms determine and maintain the appropriate level of supervision of such individuals and acquire necessary registrations.
- Each Exchange member firm must obtain from any individual not required to be registered who accepts or enters U.S. customer orders at the foreign affiliate an acknowledgment that he is subject to the Act, the Commission's regulations, and Exchange rules with respect to that activity.
- The Exchange member firm will be responsible under the Act, the Commission's regulations, and

Exchange rules for all actions of individuals soliciting, accepting, or entering U.S. customer orders on behalf of such member at the foreign affiliate and for the supervision of such individuals.

—Each Exchange member firm will provide upon request prompt access, consistent with Commission Regulation 1.31 and applicable self-regulatory organization rules, to original books and records, wherever located, that relate to the soliciting, accepting, or entering of U.S. customer orders on behalf of such member at the foreign affiliate.

—Each Exchange member firm must acknowledge in writing to the appropriate Exchange that the firm accepts the conditions set forth herein and that all documents at the foreign affiliate related to the solicitation, acceptance, or entry of Globex-related orders for U.S. customers on behalf of the Exchange member firm are documents of that firm.

In light of the foregoing facts and subject to the conditions stated above, the Division will not recommend enforcement action under Section 4d of the Act against any Exchange member firm solely for soliciting, accepting, or entering U.S. customer orders into Globex through persons located at a foreign affiliate that is not registered as an FCM.¹¹

III. AP Registration

You also have asked the Division to adopt a no-action position regarding the registration of certain individuals in the foreign affiliates' offices designated by Exchange member firms as authorized to accept and enter U.S. customer orders on behalf of those firms pending processing of their registration applications as APs of Exchange member firms. The Exchanges have set forth the following conditions to their request for no-action relief, which they believe should be met by Exchange member firms and the designated individuals seeking to obtain such relief.

Those conditions are as follows:

—Prior to the designated individuals soliciting, accepting, or entering orders:

—Each Exchange member firm must provide to the appropriate Exchange and the NFA a list of those individuals who will solicit, accept, or enter orders at the foreign affiliate from U.S. customers on behalf of an Exchange member firm;

—Each Exchange member firm must certify in writing to the NFA that none of the listed individuals required to obtain Commission registration could be refused registration with the Commission on the grounds stated in Section 8a(2) of the Act and that the Exchange member firm will be responsible under Section 2(a)(1) of the Act and Commission regulations for violations of the Act by those individuals in foreign affiliate offices soliciting, accepting, or entering U.S. customer orders on behalf of such firm; and

—Each Exchange member firm must furnish to the NFA appropriate documents evidencing the authority of the officer of the Exchange member firm to make such certification.

—Each Exchange member firm must obtain from any individual soliciting, accepting, or entering U.S. customer orders at the foreign affiliate an acknowledgment that he is subject to the Act, the Commission's regulations, and Exchange rules with respect to that activity.

—No later than July 25, 1992, each Exchange member firm must file the requisite Forms 8-R on behalf of the designated individuals.

—No later than December 24, 1992, each Exchange member firm must obtain the registration of the designated individuals.

The Division recognizes that individuals located at foreign affiliates cannot become registered prior to the June 25, 1992 date for the initiation of trading on Globex. Accordingly, provided that the preceding requirements are met, the Division will not recommend enforcement action under Section 4d or 4k of the Act with respect to such individuals, the Exchange member firm, or the foreign affiliate for soliciting, accepting, or entering Globex orders at foreign affiliates for U.S. customers on behalf of Exchange member firms without being registered. This relief will expire with respect to any designated individual on the earliest of July 25, 1992, if no Form 8-R is filed, the granting of registration, or December 24, 1992.

The views expressed in this letter are based on the representations that you have made in your June 25, 1992 letter and are strictly limited to those representations. Any different, changed, or omitted facts or conditions might require the Division to reach a different conclusion and we therefore request that you notify us immediately if the facts change in any way from those as represented in your letter. The relief described above is limited to orders entered into Globex. Further, the Division will monitor the amount of activity engaged in pursuant to the above arrangement to determine whether the relief provided for remains appropriate. The relief provided above is premised on terminals in foreign affiliates being located initially in France and the United Kingdom. Before the Exchanges place terminals in other foreign jurisdictions, they should notify the Division to confirm the applicability of this relief. Finally, the relief granted does not excuse any person from compliance with any otherwise applicable requirements contained in the Act or the

Commission's regulations.

The views expressed in this letter are solely those of the Division and do not necessarily represent the views of the Commission or of any other division of the Commission.

Footnotes

- 1 CME Rule 901.M; CBOT Ruling 9A.04A.
- 2 The term "Exchange member firm" refers to a CME or CBOT member firm that is located in the U.S. and registered as a futures commission merchant ("FCM").
- 3 The Division has stated its belief that, in the context of Globex, those terminal operators entering non-discretionary customer orders (*i.e.*, those merely translating customer instructions into keystrokes) should be exempt from the Commission's AP registration requirements. Memorandum of the Division to the Commission dated February 2, 1989, recommending approval of CME's Globex proposal ("CME Globex memo"), at pp. 20-22. *See also*, Memorandum of the Division to the Commission dated June 20, 1992, recommending approval of CBOT's Globex proposal ("CBOT Globex memo"), at pp. 15-17. The Division's belief in the appropriateness of this arrangement was based in part on the Exchanges' assurances that such terminal operators would be supervised by Commission-registered APs. CME Globex memo at p. 21 and CBT Globex memo at p. 16. *See also* CFTC Interpretative Letter No. 82-2, Comm. Fut. L. Rep. (CCH) [1982-1984 Transfer Binder] ¶21,784 at 27,168 (June 9, 1982).
- 4 "Final Rules on Registration and Other Regulatory Requirements and Notice of Qualification for 'No-Action' Position Regarding Introducing Brokers," 48 *Fed. Reg.* 35248, 35252-35253 (August 3, 1983), reprinted in Comm. Fut. L. Rep. (CCH) [1982-1984 Transfer Binder] ¶21,792 at 27,198.
- 5 CFTC Interpretative Letter No. 89-8, Comm. Fut. L. Rep. (CCH) [1987-1990 Transfer Binder] ¶24,495, at 36,148 (July 19, 1989).
- 6 CFTC Interpretative Letter No. 84-26, Comm. Fut. L. Rep. (CCH) [1984-1986 Transfer Binder] ¶22,472, at 30,096 (December 6, 1984). *But see* CFTC Interpretative Letter No. 84-18 (CCH) [1984-1986 Transfer Binder] ¶22,388 (September 26, 1984) (Division no-action letter regarding non-proprietary branch office.)
- 7 CFTC Interpretative Letter No. 89-8, ¶24,495, at 36,149.
- 8 Commission Regulation 166.4 provides:
Each branch office of each Commission registrant must use the name of the firm of which it is a branch for all purposes, and must hold itself out to the public under such name.
- 9 CFTC Interpretative Letter No. 89-8, ¶24,495, at 36,149.
- 10 The Exchanges' proposed conditions are substantially similar to those set forth by the Securities and Exchange Commission in granting no-action relief regarding the entering of orders into the NASDAQ International Service by foreign affiliates of member firms. SEC Release No. 34-29812, 56 *Fed. Reg.* 52082, 52088 (October 17, 1991).
- 11 This relief does not alter the requirement that any foreign affiliate doing U.S. customer business on its own behalf must be registered with the Commission.