



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and
Intermediary Oversight

Ananda Radhakrishnan
Director

CFTC Letter No. 10-35
Other Written Communication
September 27, 2010
Division of Clearing and Intermediary Oversight

Re: Withdrawal of Further No-Action Relief Pursuant to CFTC Letters 02-22, 02-90 and 06-20

Dear :

As you are aware, on July 11, 2001, the Division issued Staff Letter 02-22, granting the request of “A” that the Division not recommend enforcement action (*i.e.*, “no-action” relief) against registered securities broker-dealers (“BDs”) and their registered representatives (“RRs”) in connection with their offer and sale of certain futures contracts designated “B”.¹ Subsequently, on June 22, 2002, and September 7, 2006, the Division issued two additional Staff Letters – 02-90 and 06-20, respectively – granting further “no-action” relief to “A” with regard to these products.²

¹ “B” are futures contracts traded on the “A”. They are cash-settled, electronically-traded contracts designed to track the performance of a published index which represents the investment performance of a particular investment strategy based on indices, stocks, bonds, currencies, commodities or other financial instruments. In Staff Letter 02-22, the Division of Trading and Markets (the Division of Clearing and Intermediary Oversight’s predecessor) took a no-action position with respect to securities BDs and RRs who register with the Commission as limited-purpose futures commission merchants (“FCMs”) and associated persons (“APs”) for the sole purpose of trading proprietary electronically-traded broad-based-index futures contracts (known as “B”) on “A”. Under the no-action position, the limited-purpose FCMs and APs would be deemed to have complied with Commission-mandated registration, sales practice, minimum financial, treatment of customer funds, reporting, and books and records requirements by virtue of their limited-purpose registration with the Commission and their compliance with corresponding securities law regulatory and self-regulatory-organization.

² In Staff Letter 02-90, the Division took a no-action position with respect to the BDs and RRs who registered with the Commission as limited-purpose FCMs and APs for the sole purpose of trading “B” pursuant to Staff Letter 02-22. Under the no-action position, such limited-purpose FCMs and APs were permitted to notice-register under Rule 3.10(a)(3) for the purpose of offering and selling security futures products without violating the commodity interest trading

As a result of the relief granted through these three staff letters, “B” can be sold through futures accounts by FCMs and their APs or through securities accounts by registered securities BDs, who notice-register with NFA as FCMs, and their RRs, who notice-register with NFA as APs. Persons who are fully registered both as FCMs and as broker-dealers can sell “B”, as well, through securities accounts or futures accounts. The Division’s determination to grant the relief you requested was based on the facts and circumstances present at the time you requested the relief.

The Division has determined to withdraw the relief previously granted by Staff Letters 02-22, 02-90, and 06-20 as it may apply to new “B” products listed on and after October 1, 2010. “B” products that have been listed before October 1, 2010 can continue to be marketed and traded under the existing relief until expiration. The basis for this withdrawal is the staff’s continued concern over customer protection issues, and its belief that, going forward, “A” can achieve similar ends through means that do not raise the same concerns.

As noted above, staff has long been concerned over the uncertain customer protections that exist with regard to these products. In the event of the insolvency of a broker, the treatment given futures held within securities accounts is uncertain at best. In fact, when it issued the third no-action letter, staff insisted that as a condition of the relief, each “B” prospectus contain the following language in the discussion of risk factors:

This statement is furnished to you because the Commodity Futures Trading Commission requires it for reasons of fair notice unrelated to this company’s current financial condition.

1. **You should know that, in the unlikely event of this company’s bankruptcy, positions related to “B” and money, securities and other property margining such positions will not be protected by the Securities Investors Protection Corporation (SIPC).**
2. **Positions related to “B” and money securities and other property margining such positions may or may not be protected under the commodity broker provisions of the bankruptcy code, 11 U.S.C. §§ 761-767. The Commission’s**

activity restrictions of Rule 3.10(a)(3)(A), provided they otherwise complied fully with the terms and conditions of Staff Letter 02-22 with respect to the offer and sale of “B”, and the requirements of Rule 3.10(a)(3) with respect to the offer and sale of security futures products. Staff Letter 06-20 extended relief previously granted to permit institutional customers to trade “B” in a securities account with a registered broker-dealer notice-registered as a limited-purpose FCM (for purposes of accepting and executing orders for the contracts). The relief consisted of substitution of compliance with applicable securities law regulatory requirements for compliance with various otherwise applicable requirements under the Commodity Exchange Act and Commissions rules..

regulations concerning bankruptcies of commodity brokers can be found at 17 Code of Federal Regulations Part 190.³

Concerns over uncertain treatment in the event of insolvency remain. Furthermore, while the “B” product and the use of securities brokers as sales personnel may have been unique at the time the relief was first granted, the Commission has subsequently issued several exemptive and no-action letters that permit the operation of pools whose units of participation are listed for trading on national securities exchanges.⁴ These pools – commonly called “commodity ETFs” – are offered pursuant to a registration statement filed under the provisions of the Securities Act of 1933. Such pools are designed to emulate exchange traded funds and, like “B”, seek to track or replicate the performance of a specific commodity index and are marketed through BDs and their APs. However, commodity EFTs are operated by registered commodity pool operators, subject to the Commission’s jurisdiction. Given the existence and growth of such vehicles, the Division no longer sees a compelling reason to permit sale of futures contracts through securities accounts by securities broker-dealers and their registered representatives especially where, as here, the nature of the product causes significant uncertainty regarding the treatment of customer funds in the event of a bankruptcy.⁵

³ See Staff Letter 06-20.

⁴ See CFTC Staff Letter 05-19 [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,164 (Nov. 10, 2005); CFTC Staff Letter 06-15 [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,310 (Jul. 12, 2006); CFTC Staff Letter 06-16 [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,311 (Jul. 6, 2006); CFTC Staff Letter 06-26 [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,396 (Sep. 26, 2006); CFTC Staff Letter 06-27 [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,397 (Sep. 26, 2006); CFTC Staff Letter 08-01 [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,795 (Jan. 11, 2008); CFTC Staff Letter 08-02 [2008-2009 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 30,796 (Jan. 29, 2008); CFTC Staff Letter 08-15 [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,924 (Aug. 20, 2008); CFTC Staff Letter 08-16 [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,925 (Sep. 3, 2008); CFTC Staff Letter 09-39 [Current Transfer Binder] Comm. Fut. L. Rep. ¶ 31,473 (Jul. 30, 2009). The Commission has proposed rules that, if approved, will formalize the relief granted through these exemptive letters. See, 75 Fed. Reg. 54794 (Sept. 9, 2010).

⁵ As is acknowledged in the “B” disclosure document,

purchases and sales of “B” through RR/APs and BD/FCMs will not be subject to the same customer protections under the Commodity Exchange Act, as amended, and rules promulgated thereunder as will purchases and sales of “B” through IBs and FCMs. For example, BD/FCMs will not have to provide you with a standard futures “Risk Disclosure Statement”, which highlights the risks associated with trading futures contracts.

The Division's withdrawal of the three no action letters is not intended to affect "B" listed before October 1, 2010.⁶ As stated above, these futures contracts can continue to be offered, sold and traded pursuant to the relief previously granted until their final settlement dates; customers holding a long position in "B" may sell the position in the market to close out their open long position, and customers holding a short position in "B" may purchase "B" in the market to close out their open short position. However, any "B" products listed on or after October 1, 2010 must be marketed and traded in accordance with the Commodity Exchange Act and Commission's regulations governing registration, sales practices, treatment of customer funds, reporting and recordkeeping.

Very truly yours,

Ananda Radhakrishnan
Director

⁶ The Division notes that, according to the "A" website, there are currently [number] active contracts: .