



July 3, 2002

VIA MESSENGER

Annette L. Nazareth, Director
Division of Market Regulation
Mail Stop 1001
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: Interim Relief Related to the Trading of Foreign Security Futures Products

Dear Ms. Nazareth:

On behalf of the Steering Committee on Security Futures (“Steering Committee”) established jointly by the Futures Industry Association (“FIA”)¹ and the Securities Industry Association (“SIA”)² I hereby request interim interpretative or “no action” relief from various provisions of the Securities Exchange Act of 1934 (“Exchange Act”), to the extent necessary, to permit Futures Commission Merchants (“FCMs”) that are dually registered (including through notice registration) as FCMs and broker-dealers (hereinafter referred to collectively as “BD/FCMs”), to provide certain services with respect to non-U.S. security futures products (“Foreign SFPs”) for customers who are not “U.S. persons”, as such term is defined in Rule 902(k) of Regulation S.

For purposes of this request, we define a Foreign SFP to mean a security future as that term is defined in Section 3(a)(55) of the Exchange Act (i) that is traded on or subject to the rules

¹ FIA is a principal spokesman for the commodity futures and options industry. FIA’s regular membership is composed of approximately 50 of the largest futures commission merchants (“FCMs”) in the United States, the majority of which are also registered broker-dealers. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international.

² SIA’s members include more than 740 securities firms (including investment banks, broker-dealers, and mutual fund companies) that are active in all US and foreign markets and in all phases of corporate and public finance. The US securities industry manages the accounts of more than 80 million investors directly and indirectly through corporate, thrift and pension plans.

of a foreign exchange or board of trade; and (ii) (A) in the case of a Foreign SFP on a single security, that has an underlying security issued by a non-U.S. issuer, or (B) in the case of a Foreign SFP that is a narrow-based security index contract as defined in Section 3(a)(55)(B) of the Exchange Act, that has no more than ten percent (10%) of the securities underlying the index (based on the measure used to construct the index) issued by a U.S. issuer or issuers.

Specifically, the Steering Committee seeks to ensure that BD/FCMs are permitted to clear and carry on their books positions of non-U.S. customers in Foreign SFPs and, in connection with positions so cleared, to (i) solicit new and existing non-U.S. customers for the purpose of engaging in such activities, (ii) accept and transmit for execution orders of such non-U.S. persons for the purchase or sale of Foreign SFPs, and (iii) provide research reports³ of the type currently or previously provided with respect to Foreign SFPs to non-U.S. customers in connection with such activities (collectively, the "Covered Activities"). The requested relief would be temporary, remaining in effect only until the date as of which the SEC and the CFTC final rules governing the offer and sale to U.S. persons of Foreign SFPs become effective and would be subject to compliance with the conditions enumerated below.

Specifically, the Steering Committee seeks interim relief for BD/FCMs, in connection with the Covered Activities, from the obligation to comply with any provision of the Exchange Act, or any rule or regulation thereunder, establishing compliance obligations specifically applicable to brokers or dealers thereunder, subject to the following exceptions:

- (1) Exchange Act rule 15c3-1;⁴
- (2) Exchange Act rule 15c1-2;
- (3) Any Exchange Act provision or rule thereunder to the extent such provision or rule is applicable to non-securities transactions conducted by a broker or dealer;
- (4) Any Exchange Act provision or rule thereunder requiring a broker or dealer to provide the SEC with copies of, or access to, any records or information; and
- (5) Exchange Act Section 17(b).

This relief would be conditioned on the following:

- (a) BD/FCMs relying on the interim relief described in this request would be obligated to comply with such rules as the SEC and CFTC may jointly adopt with respect to security futures, as though Foreign SFPs were security futures under such rules, to the extent applicable to the carrying

³ For purposes hereof, research reports would not include reports that incorporate advice individually tailored to a specific customer.

⁴ Compliance with Exchange Act rule 15c3-1 would not, however, be required in the case of a BD/FCM that is notice registered with the SEC as a broker-dealer and that complies with CFTC rule 1.17.

and clearing of foreign futures for non-U.S. customers, subject to the following exceptions:

- (i) First, with respect to a Foreign SFP, BD/FCMs shall be obligated to comply only with margin rules jointly adopted by the SEC and CFTC that, by their terms, apply to such Foreign SFP, or any category of security futures including such Foreign SFP.
- (ii) Second, a BD/FCM carrying Foreign SFPs in a futures account may comply with Part 30 of the CFTC's regulations applicable to foreign futures where such rules impose different regulatory requirements in respect of foreign futures.
- (b) The BD/FCM will continue to remain fully registered as a BD/FCM and will continue to comply with the Commodity Exchange Act, all applicable CFTC regulations and interpretive releases.
- (c) The Foreign SFP does not require delivery of an underlying security in the U.S.
- (d) The BD/FCM will collect customer margin in amounts no less than that required to be collected by members of the foreign exchange or board of trade on which the applicable Foreign SFP is executed and will reflect in computing its capital, in accordance with applicable SEC or CFTC capital requirements, any failure timely to receive such margin.
- (e) The BD/FCM will comply with all foreign law applicable to its activities in connection with the acceptance and transmission for execution of orders from non-U.S. customers (and will remain subject to applicable SEC and CFTC antifraud rules).

Prior to the enactment of the CFMA, FCMs were permitted to perform certain actions related to Foreign SFPs for customers located outside the U.S., provided they acted in compliance with the CFTC's statements regarding such activity. We discuss the CFTC's pre-CFMA positions on Foreign SFPs below.

In 1992, the CFTC staff provided regulatory relief for FCMs, which permitted the FCMs to solicit and accept orders and funds for customers located outside the U.S.⁵ for certain foreign exchange traded futures and options thereon.⁶ Specifically, the CFTC staff, after consultation with the staff of the SEC, determined to allow FCMs to solicit and accept orders and funds from customers located outside the U.S. (1) for foreign exchange-traded futures contracts based on a

⁵ The CFTC stated that its order may not be used by resident U.S. customers to engage indirectly in transactions which they would be prohibited from participating in while in the U.S.

⁶ CFTC, 57 Fed. Reg. 36369 (Aug. 13, 1992).

foreign stock index which has not been the subject of a CFTC no-action letter, provided that the foreign stock index product is not based on an index of which 10% of the weighting of the index is derived from securities whose primary trading market is in the U.S., and (2) for foreign exchange traded futures based on foreign government debt which has not been designated as an exempted security under Rule 3a12-8 under the Exchange Act, provided that the foreign government debt futures or option contract requires delivery of the underlying debt instrument outside the U.S., its possessions or territories. The CFTC conditioned this relief on the FCMs continued compliance with any otherwise applicable CFTC rules and regulations. Furthermore, the CFTC clarified that the prohibitions against fraud under the Commodity Exchange Act would continue to apply to FCMs with regard to these types of transactions.

The CFTC permitted this relief because there appeared to be no U.S. customer protection interest advanced by prohibiting registered FCMs from engaging in the designated transactions on behalf of customers located outside of the U.S., where such customers could purchase such products directly from authorized foreign intermediaries. Furthermore, the CFTC concluded that the transactions did not appear to have any unique impact on the financial and operational viability of a registered FCM. Conversely, the CFTC recognized that the failure to provide relief, by limiting the products for which U.S. brokerage firms could provide services to non-U.S. customers, would impair the competitive position of U.S. firms competing with non-U.S. brokers for the broader range of global investment business of non-U.S. investors and investment managers.

The CFTC expanded upon its 1992 relief in a no-action letter a few years later.⁷ In this no-action letter, the CFTC, based on consultations with the SEC staff, concluded that it would not recommend enforcement action against an FCM based upon the fact that the FCM clears on an omnibus basis an Australian broker's trades on the Sydney Futures Exchange ("SFE") involving three cash-settled SFE futures on individual equity securities. This no-action relief was based on the representation that the FCM will neither solicit nor accept any U.S. customer business and that no trades in SFE futures on individual equity securities will be executed or cleared for, or on behalf of, U.S. customers. This position was further premised on the understanding that the primary trading market of the securities underlying the SFE futures contracts was located outside the U.S. Finally, the CFTC required the FCM to otherwise comply with all applicable provisions of the Commodity Exchange Act and the rules and regulations thereunder.

In making this request, the Steering Committee emphasizes that the proposed relief would not pose any risks to investors, the markets or otherwise, while providing significant benefits to the BD/FCMs and their customers and enabling U.S. BD/FCMs to compete globally with respect to Foreign SFPs and investment products generally.

Furthermore, such relief would allow BD/FCMs to continue to trade Foreign SFPs for their non-U.S. customers without interruption, thus providing their customers continuous access to the services offered by the BD/FCMs, including such critical services as centralized clearing. Finally, the relief sought would apply only on an interim basis until, as described above, final

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regulations are promulgated by the SEC and the CFTC with respect to Foreign SFPs. Therefore, for all these reasons, the Steering Committee requests that the SEC provide any relief necessary from the above provisions of the Exchange Act and rules thereunder to facilitate the BD/FCMs' activities as described above.

We greatly appreciate your consideration of this matter. If you have any questions regarding this letter, please do not hesitate to contact the undersigned.

Very truly yours,

Jonathan Barton, Chairman
FIA/SIA Steering Committee on Security Futures

cc: Robert L. D. Colby
Catherine McGuire
Elizabeth King
John Lawton, Commodity Futures Trading Commission
Elizabeth Ritter, Commodity Futures Trading Commission
Larry Patent, Commodity Futures Trading Commission