

Authority: Pub. L. 106–51, 113 Stat. 252 (15 U.S.C. 1841 note).

■ 2. Section 400.103 is revised to read as follows:

§ 400.103 Offices.

The principal offices of the Board are in the U.S. Department of Commerce, Washington, DC 20230.

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 3, 4, 15, and 166

RIN 3038–AC26

Exemption From Registration for Certain Foreign Persons

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (“Commission”) has amended Commission Regulation 3.10 concerning the registration of firms located outside the U.S. that are engaged in intermediating commodity interest transactions on U.S. designated contract markets (“DCMs”) and U.S. derivative transaction execution facilities (“DTEFs”).¹ The amended regulation codifies past actions of the Commission or its staff to permit certain foreign firms that limit their customers to foreign customers, and submit U.S. DCM and DTEF business on behalf of those customers for clearing on an omnibus basis through a registered futures commission merchant (“FCM”), to be exempt from registration as an FCM pursuant to section 4d of the Commodity Exchange Act (“Act”). The amended regulation similarly extends the relief from registration to those foreign persons acting in the capacity of an introducing broker (“IB”), commodity trading advisor (“CTA”) and commodity pool operator (“CPO”) solely on behalf of foreign customers.

DATES: *Effective Date:* December 14, 2007.

FOR FURTHER INFORMATION CONTACT: Lawrence B. Patent, Deputy Director, or Andrew V. Chapin, Special Counsel, at (202) 418–5430, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW.,

¹ Commission regulations referred to herein are found at 17 CFR Ch. I (2007). References to trading on U.S. DCMs or DTEFs shall include trading that is subject to the rules of such entities as well.

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SUPPLEMENTARY INFORMATION:

I. Background

The Commission published for comment on April 2, 2007 proposed amendments to Commission Regulation 3.10 (“the Proposal”)² to clarify when certain persons located outside the U.S. may conduct commodity interest activities with respect to U.S. markets on behalf of customers located outside the U.S. without having to register in the appropriate capacity with the Commission. In particular, the Commission proposed to exempt from registration as an FCM certain foreign firms that limit their customers to foreign customers and submit U.S. DCM and DTEF business on behalf of those customers for clearing on an omnibus basis through a registered FCM. These firms were referred to in the Proposal as “foreign brokers.” The Commission also proposed to create a single definition of “foreign broker” and “commodity interest” consistent with the Proposal.

Part 3 of the Commission’s regulations governs the registration of intermediaries engaged in the offer and sale of, and providing advice concerning, futures and commodity options traded on U.S. markets, including both DCMs and DTEFs. In particular, Regulation 3.10 sets forth the manner in which FCMs, IBs, CTAs, CPOs, and leverage transaction merchants must apply for registration with the Commission. Regulation 3.10(c) also provides an exemption from registration for certain persons. Currently, the only exemption from registration as an FCM is for any person trading solely for proprietary accounts, as defined in Regulation 1.3(y).

As explained in the Proposal, the Commission sought to provide clarity to its registration requirements under Part 3 by codifying the longstanding Commission policy, known as the “foreign broker exemption,” regarding the activities of certain foreign intermediaries engaged in soliciting or accepting commodity interest transactions solely on behalf of customers located outside the U.S. In particular, the Commission proposed to exempt from registration as an FCM any person that (1) limits its customers to customers located outside the U.S., (2) confines its commodity interest activities to areas outside the U.S., and (3) submits its trades for clearing on an omnibus basis through a registered FCM.

² 72 FR 15637 (April 2, 2007).

II. Comments Regarding the Proposal

The Commission received two comment letters on the Proposal, one from the National Futures Association (“NFA”) and one from the Futures Industry Association (“FIA”). Both NFA and FIA supported the Commission’s initiative to codify the foreign broker exemption as a means to provide greater legal certainty to futures industry participants. However, FIA commented that the effect of the Proposal would be to extend the Commission’s regulatory requirements over the activities of foreign brokers, rather than simply codify the Commission’s existing policy. In particular, FIA stated that, as proposed, amended Regulation 3.10(c)(2)(ii) would subject foreign brokers to the full panoply of Commission regulations applicable to registered FCMs, such as requirements regarding fitness, customer funds segregation, and regulatory capital.³ As such, FIA recommended that the Commission revise the proposed amendment to Regulation 3.10(c) to limit the extent to which the provisions of the Act and Commission regulations apply in a manner consistent with the Commission’s longstanding policy towards foreign brokers. In support of its request, FIA noted that the Commission has recognized that a foreign broker holding a customer omnibus account with a registered FCM does not implicate the same regulatory concerns as a foreign broker that has more direct contact with U.S. markets, such as a registered FCM clearing on a DCM or DTEF.⁴

Additionally, both FIA and NFA recommended that the Commission provide greater legal certainty to futures industry participants by similarly codifying existing Commission policy with respect to registration exemptions for other foreign intermediaries, i.e., IBs, CTAs and CPOs, that are not engaged in commodity interest activities on behalf of U.S. customers. In support of its request, FIA referred to the **Federal Register** release issued by the Commission promulgating final rules establishing the registration requirements and procedures for introducing brokers and other futures industry professionals. In that release, the Commission stated that:

given this agency’s limited resources, it is appropriate at this time to focus [the

³ Proposed Regulation 3.10(c)(2)(ii) provided that a foreign broker acting in accordance with the codified foreign broker exemption “remains subject to all other provisions of the Act and of the rules, regulations, and orders thereunder.” (emphasis added).

⁴ See, e.g., 72 FR at 15639 (April 2, 2007).

Commission's] customer protection activities upon domestic firms and upon firms soliciting or accepting orders from domestic users of the futures markets and that the protection of foreign customers of firms confining their activities to areas outside this country, its territories, and possessions may best be for local authorities in such areas.⁵

Accordingly, FIA requested that the Commission amend its regulations to provide an exemption from registration to any foreign person engaged in the activity of an IB solely on behalf of customers located outside the U.S.

Similarly, NFA referred to the no-action position taken by the Commission's Office of General Counsel stating that: (1) A person who operates a commodity pool outside of the territorial U.S. is not required to register as a CPO when such a person confines the pool activities to areas outside the territorial U.S., none of the participants in the pool is a resident or citizen of the U.S., and none of the funds or capital contributed to the pool is from U.S. sources; and (2) a trading advisor located outside the territorial U.S. who provides advice as to the advisability of trading futures contracts on domestic and foreign exchanges is not required to register when such a person confines its advisory services to areas outside of the territorial U.S., and none of its clients is a citizen or resident of the U.S.⁶ Accordingly, NFA requested that the Commission amend its regulations to provide an exemption from registration for any foreign person acting in the capacity of a CTA or CPO solely on behalf of customers located outside the U.S.

Consistent with this request, NFA further requested that the Commission amend Regulation 3.12(h) to create an exemption from registration as an associated person for any individual located in the branch office of a Commission registrant that does not solicit or accept orders from customers located in the U.S.

The Commission did not receive any comments regarding its proposal to revise and reserve certain regulations to provide a single definition for "foreign broker" and "commodity interest" that would apply to all of its regulations.

III. Final Regulations

As set forth in the Proposal, the Commission believes it is appropriate to amend its regulations to provide greater legal certainty with respect to the commodity interest activities on behalf of non-U.S. customers that are

undertaken on U.S. markets by persons located outside the U.S. It was the Commission's intent to codify its longstanding policy, and not to extend the scope of its regulations with respect to foreign brokers or other foreign intermediaries. As one of the commenters noted, transactions solicited or accepted by foreign brokers on behalf of non-U.S. customers for trading on U.S. markets directly implicate the pricing and hedging functions of the domestic markets, as would be the case for an entirely domestic transaction.⁷ The Commission believes that the presence of a registered FCM in the clearing process obviates the need for a foreign broker to comply with the full panoply of Commission regulations applicable to registered FCMs. A registered FCM clearing a transaction on a DCM or DTEF, among other requirements, must satisfy the fitness standards administered by NFA and the minimum capital requirements set forth in Commission Regulation 1.17, as well as comply with the requirements regarding the segregation of customer funds set forth in section 4d of the Act.

In light of the comments received and its own reconsideration of the issues involved, the Commission has determined to amend Regulation 3.10 with certain revisions to the Proposal. As amended, Regulation 3.10 will specify that a foreign broker is not required to register as an FCM if it: (1) Limits its customers to customers located outside the U.S., (2) confines its commodity interest activities to areas outside the U.S. and (3) submits its trades for clearing on an omnibus basis through a registered FCM. A foreign broker will remain subject to existing provisions applicable to the activities of a foreign broker, including Parts 15 to 21 of the Commission's regulations regarding large trader reporting,⁸ and Regulation 1.58 regarding gross collection of exchange-set margin. Conversely, a foreign broker will not be subject to any provisions of the Act or Commission rules, regulations and orders thereunder applicable solely to a

registered FCM or to any person required to be so registered. For example, a foreign broker will not be required to comply with the minimum financial requirements or requirements regarding the segregation of customer funds, reporting or disclosure to customers, and related recordkeeping pertaining to the foregoing requirements. However, the provisions of the Act and Commission regulations applicable to "any person" will apply to a foreign broker, such as those prohibiting fraud or manipulation by a foreign broker trading for its own account.

The Commission also has determined to adopt new Regulation 3.10(c)(3) to provide an exemption from registration to other foreign intermediaries acting solely on behalf of customers located outside the U.S. In particular, the Commission is adopting new Regulation 3.10(c)(3)(i) to provide an exemption from registration for any foreign person acting in the capacity of an IB, CTA or CPO solely with the respect to customers located outside the U.S., provided that all commodity interest transactions are submitted for clearing to a registered FCM. A foreign person acting in the capacity of a CTA or CPO will remain subject to the antifraud prohibition of section 4o of the Act. Otherwise, consistent with the revised regulation applicable to foreign brokers, new Regulation 3.10(c)(3)(ii) states that any foreign person acting in accordance with this registration exemption is not required to comply with those provisions of the Act and of the rules, regulations and orders thereunder applicable solely to any person registered in such capacity, or any person required to be so registered.

Consistent with the amendments applicable to foreign intermediaries, the Commission also has determined to amend Regulation 3.12 to provide an exemption from AP registration for any foreign individual located in the foreign branch office of a Commission registrant that engages in any activity as an AP, as defined in Regulation 1.3(aa), solely on behalf of customers located outside the U.S.⁹ A person exempt from AP registration pursuant to this provision may not supervise other individuals engaged in the solicitation of customers located in the U.S. for trading on a DCM or DTEF.

Any person seeking to act in accordance with any of the foregoing exemptions from registration should

⁷ See *Tamari v. Bache & Co.*, 730 F.2d 1103, 1108 (7th Cir. 1984), cert. denied, 469 U.S. 871 (1984) (holding that a U.S. federal district court had subject matter jurisdiction under the Act over a cause of action arising from trading on U.S. exchanges, even though the parties were located outside the U.S. and contacts between them occurred in a foreign country).

⁸ See, e.g., Regulation 15.05, which states that, absent an existing agency agreement between a foreign broker and another U.S. person, an FCM is designated as the agent of a foreign broker for purposes of accepting delivery and service issued to the foreign broker by the Commission. The agency requirement similarly applies to any IB who introduces such an account to an FCM.

⁹ *Supra*, n. 5. Regulation 1.3(aa) defines "associated person" to mean a natural person engaged in the solicitation or acceptance of customer orders, or the supervision of any person or persons so engaged.

⁵ 48 FR 35248, 35261 (August 3, 1983).

⁶ CFTC Staff Letter 76-21, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,222 (August 15, 1976).

note that the prohibition on contact with U.S. customers applies to solicitation as well as acceptance of orders. If a person located outside the U.S. were to solicit prospective customers located in the U.S. as well as outside of the U.S., these exemptions would *not* be available, even if the only customers resulting from the efforts were located outside the U.S.¹⁰

The Commission's adoption of these rule amendments supersedes prior staff positions on these subjects. Because the rule amendments contain no substantive changes to prior staff letters, no party should be disadvantaged. The new regulations will make these staff positions more accessible and widely understood and obviate the need for individual relief.

IV. Related Matters

A. Administrative Procedure Act

The Administrative Procedure Act generally requires that, before an agency adopts a rule, the agency provide an opportunity for notice and comment thereon. That opportunity is not required, however, when the agency for good cause finds such procedure unnecessary. The Commission has determined to amend Regulation 1.55(f) without opportunity for notice or comment. Notice and comment is unnecessary in this instance because the amendment to Regulation 1.55(f) solely corrects the reference to the citation for "institutional customer" in Regulation 1.3.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601–611, requires that agencies, in proposing regulations, consider the impact of those regulations on small businesses. The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its regulations on such entities

¹⁰ A person wishing to act as an intermediary for security futures transactions on a U.S. DCM or DTEF may notice register as a securities broker-dealer ("BD") if it is registered as an FCM or IB and is a member of NFA. See Section 15(b)(11) of the Securities Exchange Act (15 U.S.C. 78o(b)(11)) and 17 CFR 240.15b11–1. Foreign brokers taking advantage of the exemption from registration under the Act discussed herein would not qualify for notice registration as BDs. Accordingly, if such foreign brokers want to solicit or accept orders for security futures products traded on U.S. DCMs or DTEFs, they must fully register as BDs in accordance with Section 15(b)(1) of the Securities Exchange Act and regulations thereunder, unless other relief from such registration is available. Foreign brokers may wish to consult the U.S. Securities and Exchange Commission ("SEC") and/or private counsel regarding how taking advantage of this relief might affect their registration status with the SEC.

in accordance with the RFA.¹¹ The Commission previously has determined that registered FCMs are not small entities for the purpose of the RFA because each FCM has an underlying fiduciary relationship with its customers, regardless of the size of the FCM.¹² The Commission notes that certain foreign persons affected by the changes to the Commission's regulations would be registered as FCMs if not for the exemption provided therein and, as such, would maintain a fiduciary relationship with customers similar to the relationship maintained by each registered FCM. The Commission also previously has determined that registered CPOs are not small entities for the purpose of the RFA.¹³

Other foreign persons affected by the changes would be registered as IBs and CTAs if not for the exemption provided therein. The Commission has stated that it would evaluate within the context of a particular rule whether all or some affected IBs and CTAs would be considered to be small entities and, if so, the economic impact on them of any rule.¹⁴ Although certain foreign IBs and CTAs might be small entities for purposes of the rule, the amended rules will reduce the regulatory burden on all foreign IBs and CTAs.

Therefore, the Acting Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that these regulations will not have a significant economic impact on a substantial number of small entities. No comment was received regarding the impact of these amendments on small businesses.

C. Paperwork Reduction Act

As required by the Paperwork Reduction Act of 1995,¹⁵ the Commission submitted a copy of the proposed rule amendments to the Office of Management and Budget for its review. The Commission did not receive any public comments relative to its analysis of paperwork burdens associated with this rulemaking.

D. Costs and Benefits Analysis

Section 15(a) of the Act requires the Commission to consider the costs and benefits of its actions before issuing new regulations under the Act. By its terms, Section 15(a) does not require the Commission to quantify the costs and benefits of new regulations or to determine whether the benefits of the

regulations outweigh their costs. Rather, Section 15(a) requires the Commission to "consider the cost and benefits" of the subject regulations.

The Commission published an analysis of costs and benefits when it proposed the rule amendments that it is now adopting.¹⁶ It did not receive any public comments pertaining to the analysis.

List of Subjects

17 CFR Part 1

Definitions, Registration, Minimum financial and reported requirements, Prohibited transactions in commodity options, Customers' money, securities and property, Miscellaneous.

17 CFR Part 3

Definitions, Foreign futures, Consumer protection, Foreign options, Registration requirements.

17 CFR Part 4

Advertising, Commodity futures, Consumer protection, Recordkeeping and reporting requirements.

17 CFR Part 15

Brokers, Reporting and recordkeeping requirements.

17 CFR Part 166

Authorization to trade, Customer protection.

■ In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act and, in particular, Sections 2(a)(1), 4(b), 4c and 8a thereof, 7 U.S.C. 2, 6(b), 6c and 12a (1982), and pursuant to the authority contained in 5 U.S.C. 552 and 552b (1982), the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

■ 1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24, unless otherwise noted.

■ 2. Section 1.3 is amended by adding paragraphs (xx) and (yy) to read as follows:

§ 1.3 Definitions.

* * * * *

(xx) *Foreign Broker*. This term means any person located outside the United States, its territories or possessions who

¹¹ 47 FR 18618–18621 (April 30, 1982).

¹² 47 FR 18619–18620.

¹³ 47 FR 18619–18620.

¹⁴ 47 FR 18618–18620; see also 48 FR at 35276 (August 3, 1983).

¹⁵ Pub. L. 104–13 (May 13, 1995).

¹⁶ 72 FR at 15640 (April 2, 2007).

is engaged in soliciting or in accepting orders only from persons located outside the United States, its territories or possessions for the purchase or sale of any commodity interest transaction on or subject to the rules of any designated contract market or derivatives transaction execution facility and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

(yy) *Commodity Interest*. This term means:

(1) Any contract for the purchase or sale of a commodity for future delivery; and

(2) Any contract, agreement or transaction subject to Commission regulation under section 4c or 19 of the Act.

■ 3. Section 1.55 is amended by revising paragraph (f) to read as follows:

§ 1.55 Distribution of "Risk Disclosure Statement" by futures commission merchants and introducing brokers.

* * * * *

(f) A futures commission merchant or, in the case of an introduced account, an introducing broker, may open a commodity futures account for an "institutional customer" as defined in § 1.3(g) without furnishing such institutional customer the disclosure statements or obtaining the acknowledgments required under paragraph (a) of this section §§ 1.33(g) and 1.65(a)(3), and §§ 30.6(a), 33.7(a), 155.3(b)(2), 155.4(b)(2) and 190.10(c) of this chapter.

* * * * *

§ 1.56 [Amended]

■ 4. Section 1.56 is amended by removing and reserving paragraph (a).

PART 3—REGISTRATION

■ 5. The authority citation for part 3 continues to read as follows:

Authority: 5 U.S.C. 522, 522b; 7 U.S.C. 1a, 2, 4, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6n, 6o, 6p, 8, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21, 23, unless otherwise noted.

§ 3.1 [Amended]

■ 6. Section 3.1 is amended by removing and reserving paragraph (f).
■ 7. Section 3.10 is amended by revising paragraph (c) to read as follows:

§ 3.10 Registration of futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.

* * * * *

(c) *Exemption from registration for certain persons*. (1) A person trading solely for proprietary accounts, as defined in § 1.3(y) of this chapter, is not required to register as a futures commission merchant: *Provided*, that such person remains subject to all other provisions of the Act and of the rules, regulations and orders thereunder.

(2)(i) A foreign broker, as defined in § 1.3(xx) of this chapter, is not required to register as a futures commission merchant if it submits any commodity interest transactions executed on or subject to the rules of designated contract market or derivatives transaction execution facility for clearing on an omnibus basis through a futures commission merchant registered in accordance with section 4d of the Act.

(ii) A foreign broker acting in accordance with paragraph (c)(2)(i) of this section is not required to comply with those provisions of the Act and of the rules, regulations and orders thereunder applicable solely to any registered futures commission merchant or any person required to be so registered.

(3)(i) A person located outside the United States, its territories or possessions engaged in the activity of: An introducing broker, as defined in § 1.3(mm) of this chapter; a commodity trading advisor, as defined in § 1.3(bb) of this chapter; or a commodity pool operator, as defined in § 1.3(nn) of this chapter, in connection with any commodity interest transaction made on or subject to the rules of any designated contract market or derivatives transaction execution facility only on behalf of persons located outside the United States, its territories or possessions, is not required to register in such capacity: *Provided*, that any such commodity interest transaction executed on or subject to the rules of designated contract market or derivatives transaction execution facility is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act.

(ii) A person acting in accordance with paragraph (c)(3)(i) of this section remains subject to section 4o of the Act, but otherwise is not required to comply with those provisions of the Act and of the rules, regulations and orders thereunder applicable solely to any person registered in such capacity, or any person required to be so registered.

* * * * *

■ 8. Section 3.12 is amended by removing "or" at the end of paragraph (h)(1)(ii), removing the period and

adding a semi-colon and "or" at the end of paragraph (h)(1)(iii)(D), and adding paragraph (h)(1)(iv) to read as follows:

§ 3.12 Regulation of associated persons of futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.

* * * * *

(h) * * *
(1) * * *

(iv) Engaged in any activity as an associated person, as defined in § 1.3(aa) of this chapter, from a location outside the United States, its territories or possessions, and limits such activities to customers located outside the United States, its territories or possessions.

* * * * *

PART 4—COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

■ 9. The authority citation for part 4 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 4, 6(c), 6b, 6c, 6l, 6m, 6n, 6o, 12a and 23.

§ 4.10 [Amended]

■ 10. Section 4.10 is amended by removing and reserving paragraph (a).

PART 15—REPORTS—GENERAL PROVISIONS

■ 11. The authority citation for part 15 continues to read as follows:

Authority: 7 U.S.C. 2, 5, 6(c), 6a, 6c(a)-(d), 6f, 6g, 6i, 6k, 6m, 6n, 7, 9, 12a, 19 and 21, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106-554, 114 Stat. 2763 (2000).

§ 15.00 [Amended]

■ 12. Section 15.00 is amended by removing and reserving paragraph (g).

PART 166—CUSTOMER PROTECTION RULES

■ 13. The authority citation for part 166 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6b, 6c, 6d, 6g, 6h, 6k, 6l, 6o, 7, 12a, 21, and 23, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106-554, 114 Stat. 2763 (2000).

§ 166.1 [Amended]

■ 14. Section 166.1 is amended by removing and reserving paragraph (b).

Dated: November 7, 2007.

By the Commission.

David Stawick,

Secretary of the Commission.

[FR Doc. E7-22110 Filed 11-13-07; 8:45 am]

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