



# FUTURES INDUSTRY ASSOCIATION

INC.

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October 15, 2002

Ms. Jean A. Webb  
Secretary to the Commission  
Commodity Futures Trading Commission  
1155 21<sup>ST</sup> Street NW  
Washington DC 20581

**Re: Proposed Rule 1.49—Foreign Depositories,  
67 *Fed.Reg.* 52641 (August 13, 2002)**

Dear Ms. Webb:

The Futures Industry Association (“FIA”)<sup>1</sup> is pleased to submit these comments on the Commodity Futures Trading Commission’s (“Commission’s”) proposed rule 1.49, 67 *Fed.Reg.* 52641 (August 13, 2002). The proposed rule prescribes the terms and conditions pursuant to which FCMs and clearing organizations would be permitted to hold customer funds segregated in accordance with the provisions of section 4d(2) of the Commodity Exchange Act (“Act”) in foreign depositories and in certain foreign currencies. Upon adoption, rule 1.49 would replace the terms and conditions set forth in Division of Trading and Markets Financial and Segregation Interpretation No. 12, which presently governs the deposit of customer funds outside of the US.

FIA commends the Commission for proposing this rule, which successfully addresses FIA’s longstanding objections to the procedures set forth in Financial and Segregation Interpretation No. 12. In particular, FIA has opposed the requirement that, before placing a customer’s funds overseas (or holding a foreign customer’s funds overseas), an FCM obtain from the customer a signed subordination agreement in the form set forth in the interpretation, pursuant to which the customer also authorizes the FCM to maintain funds offshore in that customer’s segregated account. In lieu of the subordination agreement, FIA had recommended that the Commission amend Appendix B of the Commission’s Part 190 rules to establish distribution procedures for FCMs that hold customer funds offshore.

By removing a significant impediment to the efficient conduct of international futures activities, proposed rule 1.49 will greatly enhance the competitive position of US intermediaries. Subject to a few minor modifications recommended below, therefore, FIA supports the adoption of the proposed rule. We also request the Commission to clarify its interpretation of the proposed rule in certain respects.

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<sup>1</sup> FIA is a principal spokesman for the commodity futures and options industry. FIA’s regular membership is comprised of approximately 40 of the largest futures commission merchants (“FCMs”) in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

**Disclosure Regarding Accruals.** Proposed rule 1.49 imposes no specific disclosure obligations on FCMs that hold customer funds in a foreign currency. Nonetheless, in the *Federal Register* release accompanying the proposed rule, the Commission states that, if a customer previously has not traded in contracts that are priced and settled in a currency other than US dollars, “a firm *should* inform the customer if the accruals from trades will be held in a currency other than US dollars, at the time the customer places an order that might result in such accruals.”<sup>2</sup> In support of this statement, the release cites *Clayton Brokerage Company v. Commodity Futures Trading Commission*, 794 F.2d 573 (11 Cir. 1986).

FIA respectfully objects to the use of the word “should” in the Commission’s discussion of an FCM’s potential disclosure obligations, if its purpose is to imply that the recommended disclosure must be made to each customer, without exception. As the Commission itself has noted, “the specifications for contracts traded on designated contract markets are widely known and generally available.”<sup>3</sup> If customers are assumed to have knowledge that certain contracts are priced and settled in a foreign currency, it is incongruous to assume that these customers would not know that accruals with respect to these contracts would be in the same foreign currency.

More important, the apparent imposition of a universal disclosure obligation on this point is contrary to the Commission’s recent decisions regarding disclosure generally. Specifically, the Commission has previously amended rule 1.55 to authorize FCMs to open accounts for certain institutional customers without providing the disclosures prescribed under rules 1.55, 33.7 and 190.6, subject only to the FCM’s obligation to make any disclosures required under applicable law.<sup>4</sup> The Commission reconfirmed its position in December 2000, in adopting amendments to its rules governing intermediaries. At the same time, the Commission adopted the following core principle with respect to risk disclosure: “Intermediaries must provide to customers disclosure *appropriate to the particular instrument or transaction and the customer.*”<sup>5</sup>

FIA respectfully submits that an FCM’s disclosure obligations with respect to accruals, if any, are no different from other disclosure obligations that an FCM may have under Commission rule 1.55. *Clayton Brokerage* does not contradict this position. To the contrary, the Court in that case noted that: “The extent of disclosure necessary to provide full information about risk will vary depending on

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<sup>2</sup> 67 *Fed.Reg.* 52641, 52643 (August 13, 2002). [Emphasis supplied.]

<sup>3</sup> *Id.*

<sup>4</sup> Commission rule 1.55(e)

<sup>5</sup> 65 *Fed.Reg.* 77993, 77994 (December 13, 2000). [Emphasis supplied.] In addition, the *Federal Register* release seems to assume that FCMs have a ready means of tracking when a customer first trades a particular type of contract and of providing this information to all associated persons and clerical personnel who may thereafter accept orders from that customer. FCMs have no practical ability to maintain records in this way. The increasing customer use of direct order entry systems only emphasizes this point. Consequently, if we have correctly interpreted the Commission’s intent, FCMs would have little choice but to make this disclosure each time a customer places an order for a contract for which accruals are held in a foreign currency.

the facts and circumstances of trading as well as on the nature of the relationship between the broker and the customer.”<sup>6</sup> Therefore, we ask the Commission to confirm that the Commission did not intend to imply that an FCM would have an obligation to disclose to each customer trading contracts that are priced and settled in a foreign currency, if accruals from that contract would also be in a foreign currency. Rather, we believe this statement was intended solely to caution FCMs to consider whether they should make such disclosure in appropriate circumstances.

**Records of Foreign Currency Transactions.** Proposed rule 1.49(b)(2) provides that an FCM “shall prepare and maintain a written record of *each transaction* converting customer funds from one currency to another.” The record must include (i) the date the transaction is executed, (ii) the currencies converted, (iii) the amount converted, and (iv) the resulting amount. The paragraph provides that an FCM must furnish the required information to the customer upon the customer’s request. The *Federal Register* release notes, in addition, that an FCM must furnish this information to the customer in the monthly statement under Commission rule 1.33.

FIA requests the Commission to clarify the obligations of FCMs in this latter regard. Frequently, an FCM may execute multiple transactions on behalf of a customer throughout a trading day. Providing details of each transaction on a customer’s monthly statement would be contrary to current practice and would impose significant operational burdens on FCMs. We ask the Commission, therefore, to confirm that an FCM would satisfy its obligations under rule 1.33, if the FCM provides the customer the required information in the aggregate and as an average price rather than with respect to each transaction. The FCM, of course, will have records of each transaction and would be able to prepare a report with details of the transactions upon a customer’s request.

**Record of Customer Authorization.** Proposed rule 1.49(c)(3) provides that customer funds may be held outside of the US “only to the extent specifically authorized by the customer.” The rule does not require a written record of the customer’s authorization. However, in the accompanying *Federal Register* release, the Commission states that the FCM must make and maintain a written record detailing the terms and conditions of any the customer’s authorization to hold funds outside of the United States.<sup>7</sup> In its discussions with Division of Clearing and Intermediary Oversight (“Division”) staff, representatives of the FIA Law and Compliance Executive Committee understood Division staff to have agreed that the confirmation and monthly statements furnished to the customer, which set forth the foreign currencies held in the customer’s account, will be sufficient to confirm the customer’s intent for purposes of this paragraph. We believe the Division’s position should be contained in the rule itself, and we ask the Commission to amend paragraph (c)(3) accordingly.

**Permitted Location of Depositories.** Proposed rule 1.49(c) provides that currencies may be held in the US, in any money center country and in the country of origin. The term “money center country” is defined in subparagraph (a) to mean a G-7 country. We respectfully submit that this definition is too narrow. Switzerland, for example, would not be included. We previously have suggested that funds

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<sup>6</sup> 794 F.2d 573, at 580.

<sup>7</sup> 67 *Fed.Reg.* 52641, 52644 (August 13, 2002).

should be able to be held in any country with which the Commission has information sharing arrangements: the United Kingdom; Australia; France; Canada; Germany; Spain; Italy; The Netherlands; New Zealand; Japan; Brazil; Mexico; Argentina; Hong Kong; Taiwan; South Africa; and Switzerland. We ask the Commission to extend the definition of a “money center country” for purpose of this rule to each of these countries.

**Qualification of Depositories.** Proposed rule 1.49(d)(3)(i)(B) provides that a foreign bank will be an acceptable depository for customer segregated funds if, among other requirements, the bank’s (or its holding company’s) commercial paper or long term debt is rated in the highest category by at least one nationally recognized statistical rating organization.<sup>8</sup> FIA notes that, under Commission rule 30.7, a foreign bank will be an acceptable depository for US customer funds deposited to margin or secure foreign futures and options contracts if the bank’s commercial paper or long term debt is rated in one of the two highest categories by a nationally recognized statistical rating organization.<sup>9</sup> The *Federal Register* release accompanying rule 1.49 does not explain why the Commission adopted a different, narrower standard in this instance. We ask the Commission to revise paragraph (d)(3)(i)(B) to provide, consistent with the Commission’s interpretation under rule 30.7, that a foreign bank would be an acceptable depository if the bank’s (or its holding company’s) commercial paper or long term debt is rated in one of the two highest categories by a nationally recognized statistical rating organization.

## Conclusion

FIA appreciates this opportunity to comment on proposed rule 1.49. If the Commission has any questions concerning the comments in this letter, please contact Barbara Wierzynski, FIA’s General Counsel, at (202) 466-5460.

Sincerely,

John M. Damgard  
President

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<sup>8</sup> In the alternative, the bank could have in excess of \$1 billion in regulatory capital.

<sup>9</sup> Division of Trading and Markets Advisory 87-5, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,997 (December 3, 1987).