disclosure of such information is not required by law.

(b) A party requesting an exemption from public inspection for information submitted in writing shall clearly mark each page ''BUSINESS CONFIDENTIAL'' at the top, and shall submit a non-confidential summary of the confidential information. Such person shall also provide a written explanation of why the material should be so protected.

(c) A request for exemption of any particular information may be denied if it is determined that such information is not entitled to exemption under law. In the event of such a denial, the information will be returned to the person who submitted it, with a statement of the reasons for the denial.

Bennett M. Harman,

Acting Assistant United States Trade Representative for the Americas.

[FR Doc. 03–2705 Filed 2–3–03; 8:45 am]

BILLING CODE 3190–01–M

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 30, and 190

RIN 3038–AB31

Denomination of Customer Funds and Location of Depositories

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is adopting a new Rule 1.49 that permits futures commission merchants and derivatives clearing organizations, under certain conditions, to deposit customer funds in foreign depositories and in certain currencies other than United States dollars. The Commission is also adopting an amendment to Appendix B of its bankruptcy rules that governs the distribution of property where the bankrupt futures commission merchant or derivatives clearing organization maintains customer property in depositories outside the United States or in a foreign currency. This new distributional framework is intended to assure that customers whose funds are held in a United States depository will not be adversely affected by a shortfall in the pool of funds held in a depository outside the United States that is due to the sovereign action of a foreign government or court. The rule replaces Financial and Segregation Interpretation No. 12.

EFFECTIVE DATE: March 6, 2003.

FOR FURTHER INFORMATION CONTACT: Lawrence B. Patent, Deputy Director, Compliance and Registration Section, or Michael A. Piracci, Attorney-Advisor, Division of Clearing and Intermediary Oversight, and for further information regarding amendments to appendix B of part 190, contact Robert B. Wasserman, Associate Director, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Telephone: (202) 418–5430.

SUPPLEMENTARY INFORMATION:

I. Background

One of the most important functions of the Commodity Exchange Act (the ''Act'')[1] and the rules thereunder is the protection of customer funds. Section 4d(a)(2) of the Act requires that every futures commission merchant (''FCM''):

> Treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the trades or contracts of any customer of such person, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held.

Prior to 1988, the Commission, and its predecessor agency, the Commodity Exchange Authority, had construed this provision to require that customer funds deposited with an FCM relating to trading on a domestic exchange be held in the United States (''U.S.''), unless the funds were being held for a foreign-domiciled customer.[2] In light of the growing internationalization of the futures and options markets, the Commission in 1988 issued Financial and Segregation Interpretation No. 12 (''Interp. 12''),[3] which provided that, under certain conditions, an FCM may deposit segregated funds of customers domiciled in the U.S. in foreign depositories.

As stated above, when the Commission issued Interp. 12, it noted that the change in the Commission's interpretation concerning appropriate depositories for segregated customer funds was appropriate ''in light of the growing internationalization of the futures and option markets.''[4] In the more than 14 years since Interp. 12 was issued, the futures and options markets, along with almost all other segments of the business world, have seen greater internationalization. As a result, there is an increased need and desire of certain customers to be able to more easily conduct business in currencies other than the U.S. dollar.

In the Commodity Futures Modernization Act of 2000 (the ''CFMA''),[5] Congress noted that ''regulatory impediments to the operation of global interests can compromise the competitiveness of [U.S.] business'' and that regulatory policy should be ''flexible to account for rapidly changing derivatives industry practices.''[6] Due to restrictions placed on holding segregated funds offshore, U.S. markets and futures professionals may find themselves at a disadvantage to their foreign competitors. One of the purposes of the CFMA is to ''enhance the competitive position of [U.S.] financial institutions and financial markets.''[7]

Based upon the foregoing, on August 7, 2002, the Commission proposed the rule being adopted herein.[8] The Commission received two comment letters on the proposed rule. The commenters were the National Futures Association (''NFA''), a registered futures association, and the Futures Industry Association (''FIA''), an industry trade association. Both commenters stated that they supported the proposed rule and amendments, but each suggested certain changes and clarifications that they believed would be appropriate. These suggestions, along with the Commission's assessment of these suggestions, are discussed more fully in conjunction with the discussion of the appropriate section of the rule and amendments.

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[1] 7 U.S.C. 1 *et seq* (2000).

[2] *See* Commodity Exchange Authority Administrative Determination No. 238 (Sep. 4, 1974); *see also* Foreign Options and Foreign Futures Transactions, 51 FR 12104, note 36 (Apr. 8, 1986); Leverage Transactions, [1982–1984 Transfer Binder] Comm. Fut. L. Rep. ¶ 21,742 at p. 26,952, note 52 (May 25, 1983).

[3] Financial and Segregation Interpretation No. 12—Deposit of Customer Funds in Foreign Depositories, 53 FR 46911 (Nov. 21, 1988). The document was published in the **Federal Register** as a Statement of Agency Interpretation. It was also published in the Commodity Futures Law Reporter at ¶ 7122 together with a series of Financial and Segregation Interpretations issued by the Commission's Division of Trading and Markets.

[4] *Id.* at 46912.

[5] Appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000).

[6] Section 126(a) of the CFMA.

[7] Section 2(8) of the CFMA.

[8] 67 FR 52641 (Aug. 13, 2002).

II. The New Rule and Amendments

A. New Rule 1.49

1. Definitions

In the proposed rule, the Commission had defined the terms ''non-money center country'' and ''non-money center currency.'' These terms, however, were not used elsewhere in Rule 1.49. Accordingly, the Commission is not including these definitions in the final rule.

2. Permissible Currencies

The Commission is adopting Rule 1.49 to provide that FCM obligations owed to customers shall be held in: (1) U.S. dollars; (2) a currency in which funds were deposited by the customer, or converted to at the request of the customer, to the extent of such deposits and conversions; or (3) a currency in which funds have accrued to the customer as a result of trading on a designated contract market or registered derivatives transaction execution facility (''DTF''). Any customer may deposit foreign currency with an FCM if the FCM permits it, not just those customers trading contracts priced and settled in a foreign currency.

As noted above, the internationalization of the futures markets has resulted in customers who, for many different reasons, want funds denominated in currencies other than the U.S. dollar. If a customer or prospective customer of an FCM prefers to deposit funds with an FCM in a currency other than the U.S. dollar, or to convert funds from one currency to another, the FCM should not be prevented from accepting or holding funds in the preferred currency of the customer or prospective customer.

An FCM may not convert customer funds from one currency to another without customer authorization. An account agreement could provide, however, that by placing an order in a contract settled in a particular currency, a customer agrees to convert to the appropriate currency funds sufficient to meet the applicable margin requirement. Under Rule 1.49(b)(2), an FCM is required to prepare and maintain a written record each time customer funds are converted from one currency to another. The record must include the date the transaction was executed, the currencies converted, the amount converted, and the resulting amount. The FCM is also required to make the information contained in this record available to the customer upon the customer's request. Additionally, the Commission noted in the proposing release that, pursuant to Rule 1.33(a), the FCM must include this information in the monthly statements provided to the customer.

FIA noted that FCMs frequently execute multiple transactions on behalf of a customer throughout a trading day. NFA noted that FCMs will often execute foreign currency transactions using bunched orders that combine orders involving multiple customers, multiple counterparties, and multiple transactions. To provide detailed information regarding each transaction on the customer's monthly statement would impose a significant burden on the FCM. FIA asked that the Commission confirm its view that providing the required information on the monthly statement in the aggregate rather than with respect to each transaction would be sufficient to meet the FCM's obligation under Rule 1.33. The Commission concurs that such a procedure would fulfill the FCM's obligation under Rule 1.33. As noted in the FIA comment letter, to be in compliance with Rule 1.49(b)(2), an FCM must be able to prepare a report that provides the details of individual transactions upon a customer's request.

Another aspect of the internationalization of the futures and options markets is the increasing number of contracts offered on foreign financial instruments and indices. These contracts are priced and settled in the currency of the underlying instrument or index. Accordingly, accruals resulting from trading in such instruments will be in currency other than U.S. dollars. Under the rule, such accruals may be held in the applicable currency. A customer, of course, may request that such accruals be converted to U.S. dollars.

Pursuant to Interp. 12, customers had to authorize the deposit of foreign currency funds into foreign depositories as part of a subordination agreement. The Commission is eliminating this written authorization requirement. If a customer deposits funds with an FCM in a currency other than U.S. dollars, or requests a conversion of funds to a non-U.S. dollar currency, the customer will be aware of the fact that the funds are being held in a currency other than U.S. dollars. With regard to funds other than U.S. dollars that are held for margin or have accrued to the customer as a result of trading in contracts priced and settled in a non-U.S. currency, the Commission notes that the specifications for contracts traded on designated contract markets are widely known and generally available.[9] Accordingly, when a customer trades in a futures or options contract that is priced and settled in a currency other than U.S. dollars, a customer should be aware that the margin for and accruals from such trading may be held in the applicable currency.

In the proposing release, the Commission noted ''that if a customer has previously not traded in contracts that are priced and settled in a currency other than U.S. dollars, a firm *should* inform the customer if the accruals from the trades will be held in a currency other than U.S. dollars.''[10] NFA and FIA both objected to this statement, as they believed it seemed to impose disclosure obligations beyond those under Commission Rule 1.55.[11] It was not the Commission's intention to impose a disclosure obligation with respect to such customers and such contracts. Rather, as suggested by FIA in its letter, the Commission ''intended solely to caution FCMs to consider whether they should make such disclosure'' by taking into consideration the facts and circumstances of the particular customer.

3. Location of Depositories

The rule permits an FCM or derivatives clearing organization (''DCO'') to hold customer funds of any denomination in the U.S. or in any money center country (Canada, France, Italy, Germany, Japan, and the United Kingdom). Hence, customer funds of any denomination could be held in any of the Group of Seven (''G7'') countries. The G7 countries represent the world's largest industrial democracies. Representatives from these countries meet several times a year to coordinate their cooperation on issues of economic policy. In this regard, the U.S. and its financial regulatory agencies have had successful cooperation with the respective financial regulatory agencies of these countries.

Both NFA and FIA indicated a desire to have the definition of a money center country expanded. NFA suggested that the definition include ''other locations with stable currencies and other indicia that customer funds will be relatively secure.'' The Commission has decided not to expand the definition in this manner. The Commission believes that the establishment of a broad and

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[9] Section 5(b)(7) of the Act and Section 5a(d)(4) of the Act require contract markets and derivatives transaction execution facilities, respectively, to make contract specifications publicly available. For example, the specifications for contracts traded on the Chicago Mercantile Exchange are available on its Web site at: *http://www.cme.com.*

[10] 67 FR at 52643. (Emphasis added).

[11] Rule 1.55 permits FCMs to open an account for an ''institutional customer'' without first furnishing the customer with a disclosure statement.

subjective standard, as suggested by NFA, would be unwieldy in practice and could require the Commission to expend significant resources. To make a determination as suggested by NFA would require the Commission to conduct a broad evaluation of, among other things, a country's banking, monetary, and economic policies and systems.

FIA suggested that the Commission expand the definition to include any country with which the Commission has an information sharing arrangement. When the Commission enters into an information sharing arrangement with another country, it does not undertake a complete analysis of the country's laws, policies, and systems, as they would pertain to the holding of customer funds. Moreover, a country may deny sharing information with the Commission under these arrangements if, among other things, it would constitute a violation of applicable laws. Accordingly, the Commission has decided not to extend the definition of money center country as suggested by FIA.

In addition to the money center countries, an FCM or DCO also could hold any particular currency in the country of origin of that currency,[12] except that customer funds may not be held in any of the restricted countries subject to sanctions by the Office of Foreign Assets Control (''OFAC'') of the U.S. Department of Treasury.[13]

Proposed Rule 1.49(c)(3) provided that funds could be held outside the U.S. only to the extent specifically authorized by the customer. It further required the FCM to make and maintain a written record detailing the terms and conditions of any such authorization. For the reasons explained below, the Commission has significantly revised paragraph (c). As revised, paragraph (c) makes clear that customer consent will be required only when customer funds are held outside of the U.S. in a jurisdiction other than a money center country or the country of origin of the currency.

As discussed above, an FCM or DCO may hold customer segregated funds in the following denominations: (1) In U.S. dollars; (2) in the currency deposited by the customer or converted at the customer's request; or (3) in the currency in which funds have accrued to the customer as the result of trading on a U.S. contract market or registered DTF. In the absence of customer instructions to the contrary, the Commission believes that a customer that deposits funds with an FCM or DCO in a foreign currency or requests that the funds on deposit be converted to a foreign currency should assume that the currency will be held in an account outside of the U.S. in the currency's country of origin. Similarly, accruals in a foreign currency should also be deemed to be held in the country of origin.[14] Consequently, the Commission has concluded that requiring an FCM or DCO to obtain a customer's consent to hold a foreign currency in the currency's country of origin is unnecessary.

With respect to money center countries, the Commission has previously determined that customer segregated funds denominated in a foreign currency may be held in a money center country. As the Commission noted in proposing Rule 1.49:

> The G7 countries represent the world's largest industrial democracies. Furthermore, representatives from these countries meet several times a year to coordinate their cooperation on issues of economic policy. In this regard, the United States and its financial regulatory agencies have had successful cooperation with the respective financial regulatory agencies of these countries.

In these circumstances and in the absence of customer instructions to the contrary, the Commission believes that it would be appropriate for an FCM or DCO to hold customer funds denominated in a foreign currency in a money center country without receiving the customer's prior consent.

Because funds held outside of the U.S. other than in the currency's country of origin or a money center country might pose different risks and different operational costs and benefits, the Commission believes that the customer must be able to choose whether, and to what extent, to incur such risks and costs. The Commission, however, is not establishing a particular format that a customer authorization must follow. A customer may authorize the holding of funds outside the U.S., a money center country, or in a country other than the currency's country of origin, in writing or orally.[15] Authorization may be satisfied where a customer fails to object when informed that the customer's funds will be held outside the U.S., a money center country, or in a country other than the currency's country of origin. Moreover, the Commission notes that, just as under Rule 1.49(b)(1)(ii) regarding the conversion of customer funds, authorization may be obtained as part of the account agreement.

The rule does not require that a separate customer signature be obtained. Rule 1.49(c) simply requires that an FCM make and maintain a contemporaneous written record of any customer authorization to hold funds outside the U.S. in a country other than the currency's country of origin or a money center country. An FCM may choose to comply with this requirement in whatever manner it finds easiest. An FCM, if it chooses, may comply with this requirement as part of the account opening documents or, if done orally, by making a written memorandum or notation to be placed in the customer's file. The confirmation statement required pursuant to Commission Rule 1.33(b) may serve the purpose of meeting the requirement of a written record under Rule 1.49(c). If, after receiving the confirmation statement, the customer objects to the transaction, the FCM must, of course, take steps to address the customer's concerns.

FCMs and DCOs should also be aware that the Financial Action Task Force (''FATF'') of the Organization for Economic Co-Operation and Development maintains a list of non-cooperative countries or territories with respect to anti-money laundering programs and that the Secretary of the Treasury may designate, in accordance with Section 311 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (''USA PATRIOT'') Act of 2001,[16] certain countries as areas of primary money laundering concern.[17] Before holding any customer funds in a depository in any of these countries or territories, FCMs and DCOs should undertake due diligence to assure themselves that the depository is reputable, has appropriate operational systems to safeguard customer funds, and has an adequate program to deter money laundering.[18]

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[12] For the Euro, the country of origin includes any country that is a member of the European Union and has recognized the Euro as its official currency.

[13] The list of restricted countries may be viewed on OFAC's Web site at *http://www.ustreas.gov/ofac.*

[14] As noted earlier, a customer may request that any such accruals be converted to U.S. dollars.

[15] *See Peltz* v. *SHB Commodities, Inc.,* 115 F.3d 1082 (2d Cir. 1997); [1996–1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,052.

[16] Pub. L. 107–56; 115 Stat. 272 (2001).

[17] The list of non-cooperative countries and territories may be viewed on FATF's Web site at: *http://www1.oecd.org/fatf/.* Countries that have been designated by the Secretary of the Treasury as being of primary money laundering concern may be viewed on the Department of Treasury Web site at: *http://www.ustreas.gov.*

[18] On April 23, 2002, the Commission approved NFA Compliance Rule 2–9(c) and a related Interpretive Notice that set forth minimum standards for anti-money laundering programs of NFA FCM members.

4. Qualifications of Depositories

The Commission proposed that, if the depository is located in the U.S., it must be: (1) A bank or trust company; (2) an FCM registered with the Commission; or (3) a DCO. The Commission also proposed that, if the depository is located outside the U.S., it must be: (1) A bank or trust company that has (a) in excess of $1 billion in regulatory capital, or (b) commercial paper or long-term debt rated in the highest rating category by at least one nationally recognized statistical rating organization (where the bank or trust company is part of a holding company system, the holding company may satisfy the rating criterion); (2) an FCM registered with the Commission; or (3) a DCO.

Both NFA and FIA noted that, under Commission Rule 30.7, a bank located outside the U.S. is recognized as a permitted depository if its commercial paper or long-term debt is rated in one of the two highest rating categories.[19] NFA and FIA urged the Commission to make Rule 1.49 consistent with Rule 30.7. The Commission has determined that this is appropriate. Accordingly, the final rule will permit the use of a bank outside the U.S. whose commercial paper or long-term debt is rated in one of the two highest rating categories of a nationally recognized statistical rating organization. The term ''nationally recognized statistical rating organization'' as used in this release refers to those rating organizations designated as such by the Securities and Exchange Commission (''SEC'').[20] Although the Commission did not receive any comments on this point, in order to avoid any possible confusion, the Commission wishes to make clear that when using the term ''nationally recognized statistical rating organization'' in Rules 1.49 and 30.7, it refers to a rating organization designated as a ''nationally recognized statistical rating organization'' by the SEC.

NFA asked the Commission to confirm that, under Rule 1.49, funds for the trading of security futures could be deposited with an FCM registered pursuant to Section 4f(a)(2) of the Act.[21] The Commission confirms that an FCM registered pursuant to Section 4f(a)(2) would be a qualified depository for security futures funds under Rule 1.49.[22]

Only depositories that provide the FCM or DCO with the written acknowledgment required under Commission Rules 1.20 or 1.26 may hold customer funds required to be segregated.[23] However, a DCO acting as a depository does not need to provide an acknowledgment letter to an FCM where the DCO's rules provide for the segregation of funds held on behalf of customers.[24]

5. Segregation Requirements

As noted above, protection of customer funds is one of the most important purposes of the Act and the Commission's regulations. Customer funds must be segregated so as to assure that the obligations owed to customers will be met. Through segregation, customer funds are readily identifiable in the event that a registrant becomes insolvent. Accordingly, Rule 1.49 requires that the FCM or DCO, at the close of each business day, have in segregated accounts on behalf of its customers sufficient U.S. dollars held in the U.S. to meet all U.S. dollar obligations and sufficient funds in each other currency to meet obligations in such currency with certain permitted substitutions. The segregation requirements of the rule are meant to ensure that FCMs and DCOs maintain enough funds, and in the appropriate currency, to meet the obligations owed to customers.

As noted, the rule permits limited substitutions among currencies. U.S. dollars held in the U.S. may be used to meet obligations denominated in any other currency. Money center currencies and U.S. dollars held in money center countries may be held to meet obligations denominated in currencies other than the U.S. dollar. In essence, three tiers of currencies have been established, U.S. dollars held in the U.S. (''Tier I''), U.S. dollars and money center currencies held in money center countries or money center currencies held in the U.S. (''Tier II''), and currencies other than U.S. dollars and money-center currencies (''Tier III''). Tier I currency could be used for any obligation. For U.S. dollar obligations to customers, only Tier I currency could be used. Tier II currencies could be used for any obligation except U.S. dollars. Tier III currencies could only be used for obligations denominated in that particular currency.

B. Recordkeeping

The Commission is also amending Rule 1.32 to require FCMs to compute segregated funds on a currency-by-currency basis if they are held in other than U.S. dollars, in accordance with new Rule 1.49. Under Rule 1.49, customer funds may be held in the U.S., a money center country, or the country of origin of the currency. Rule 1.49 also would require FCMs and DCOs that hold funds in foreign currency or offshore to maintain records sufficient to demonstrate compliance with the additional segregation requirements set forth in Rule 1.49(e).

C. Bankruptcy

In Interp. 12, the Commission noted two types of risk associated with holding funds offshore that might result in customers failing to fully recover segregated funds, either upon demand or in a bankruptcy or receivership, (1) currency risk and (2) location risk.[25]

Currency risk is the risk of currency exchange rate fluctuations. This can be a concern where an FCM is in bankruptcy or receivership and it holds deposits denominated in currencies other than U.S. dollars. Due to changes in currency exchange rates, the size of the pool of funds available for distribution to customers and the size of claims against the funds may vary from day to day while the bankruptcy is pending, thereby exposing customers with U.S. dollar-denominated claims to currency risk.[26]

Location risk is the risk that funds held in a foreign depository might not be fully recoverable by a customer upon demand or in the event of bankruptcy or receivership. It includes the risk that foreign depositories may not be cooperative with the Commission concerning questions of compliance with segregation requirements, or that a foreign court might refuse to enforce

[19] *See* CFTC Advisory 87–5, [1987–1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,997 (Dec. 3, 1987).

[20] *See, e.g.,* 17 CFR 240.15c3–1; *see also* 17 CFR § 270.2a–7(a)(17).

[21] Section 4f(a)(2) of the Act provides for notice-registration of securities broker-dealers whose only futures-related activity involves security futures products. *See also,* 66 FR 43080 (Aug. 17, 2001).

[22] The Commission notes that FCMs registered pursuant to Section 4f(a)(2) may only accept such funds in accordance with any applicable rules promulgated by the SEC.

[23] Commission Rule 1.20 provides that, when an FCM or DCO deposits customer funds with a depository, the FCM or DCO must obtain and retain a written acknowledgement from the depository that it was informed that the funds are subject to the provisions of the Act and Commission regulations. Rule 1.26 requires an FCM or DCO to obtain such an acknowledgment in regard to the deposit of instruments purchased with customer funds as described under Rule 1.25.

[24] See 65 FR 77993, 78009–13 (Dec. 13, 2000) (amending, among other things, Rules 1.20 and 1.26 to provide that a DCO acting as a depository does not need to provide an acknowledgement letter where the DCO's rules provide for the segregation of funds held on behalf of customers); 65 FR 82270 (Dec. 28, 2000) (moving forward the effective date of the amendments to Rule 1.20 and 1.26 to December 28, 2000).

[25] 53 FR at 46912.

[26] *See* 53 FR at 46915 (providing an example of currency risk).

provisions of the Commission's rules that prohibit a foreign depository from offsetting obligations of an FCM against customer funds. There is also a risk that, in the event of an FCM becoming insolvent, deposits at a foreign depository might be subject to an insolvency regime that is different from U.S. bankruptcy law. Additionally, a foreign government might limit the availability of funds by freezing or confiscating assets held within its jurisdiction or taking actions that affect its currency, even if the assets are located in the U.S.[27]

Pursuant to Interp. 12, before placing a customer's funds offshore, an FCM had to obtain from the customer a subordination agreement. In the agreement, the customer consented to the subordination of claims concerning funds held offshore or in a foreign currency to the claims of customers whose funds are held in U.S. dollars or in other currencies in the event the FCM was placed in bankruptcy or receivership and there were insufficient funds available for distribution from the funds held in that particular currency to satisfy customer claims against those funds. The subordination agreement was meant to protect customers whose funds were held in the U.S. and denominated in U.S. dollars from both currency and location risk that might result in customers receiving less than their pro-rata share of funds.

In Interp. 12, the Commission stated that ''currency risk is similar to the price risk which can occur in cases where an FCM becomes insolvent while holding customer deposits in forms which fluctuate in value,'' using the example of Treasury securities.[28] The Commission noted, however, that there were distinctions between price risk and currency risk, such that it was more equitable to spread the price risk among all customers in the event of a bankruptcy than it was the currency risk. First, the Commission indicated that all customers had the opportunity to post Treasury securities as margin, but under Interp. 12 only customers trading certain contracts could post foreign currency. Second, shortfalls in foreign currency accounts were more likely because of sovereign or location risk. Third, it would be easier and quicker for a trustee or receiver to convert Treasury securities held in the U.S. to cash than to convert foreign currency held offshore into U.S. dollars.

Under Rule 1.49, subject to exchange margin rules, any customer may deposit foreign currency with an FCM, not just those trading certain contracts, provided the FCM is willing to accept foreign currency. In effect, such deposits would be similar to a customer depositing U.S. Treasury securities, which is currently permitted. In the case of a customer who deposits U.S. Treasury securities with an FCM to satisfy margin, there exists a price and liquidity risk related to the time it would take to convert those securities into U.S. dollars. Similarly, customer funds held in a foreign currency create an exposure during the time in which it takes to convert those currencies into U.S. dollars. As with converting U.S. Treasury securities, converting foreign currency into U.S. dollars, particularly those involving money center countries, is not extremely difficult. As a result, the Commission believes spreading currency risk among all customers is no less equitable than spreading price risk among all customers. Additionally, as discussed below, the rule and the amendment to Appendix B of the Commission's bankruptcy rules limit sovereign risk and protect customers who deposit U.S. dollars from being adversely affected due to the sovereign action of a foreign government or court, including the effect of a non-U.S. insolvency regime. As a result, the Commission believes spreading currency risk among all customers is no less equitable than spreading price risk among all customers.

In adopting the new rule, the Commission has sought to address many aspects of currency and location risks through the safeguards discussed above. One aspect of location risk that remains, however, is sovereign risk. This is the risk that the actions of a foreign government or court might result in a shortfall in segregated funds.

To address sovereign risk, the Commission is amending Framework 2 of Appendix B of its bankruptcy rules to govern the distribution of customer funds segregated pursuant to the Act and Commission rules thereunder, held by an FCM or DCO in a depository outside the U.S. or in a foreign currency.[29] The maintenance of customer funds in a depository outside the U.S. or denominated in a foreign currency would result, in certain circumstances, in the reduction of customer claims for such funds. For purposes of the bankruptcy convention, sovereign action of a foreign government or court would include, but not be limited to, the application or enforcement of statutes, rules, regulations, interpretations, advisories, decisions, or orders, formal or informal, by a federal, state, or provincial executive, legislature, judiciary, or government agency. Commission staff was asked whether the devaluation of a currency by government decree would be considered a sovereign action. The Commission believes such a decree would be a sovereign action for purposes of this bankruptcy convention. The Commission recognizes that it is impossible to envision every possible sovereign action. The Commission has purposely defined sovereign risk broadly so as to afford the bankruptcy trustee the ability to exercise its discretion and judgment to fully effectuate the purpose of this bankruptcy convention.

If an FCM filed, or had filed against it, a petition in bankruptcy and maintained customer funds in a depository located in the U.S. in a currency other than U.S. dollars, or in a depository outside the U.S., the following allocation procedure will be used to calculate the claim of each customer. After reducing each customer's claim by the percentage of the shortfall that is not attributable to sovereign action, certain customer claims will be further reduced based upon their exposure to loss attributable to sovereign action. This framework is designed to prevent a shortfall in funds held outside the U.S. or in a currency other than U.S. dollars resulting from the sovereign action of a foreign government or court from adversely affecting customers whose funds are held in U.S. dollars or in the U.S. or in a currency or a country other than the one undertaking the sovereign action resulting in the shortfall.

NFA, in its comment letter, asked what would happen if a bankruptcy proceeding is commenced while a firm is in the process of converting customer funds between currencies. As noted in the framework, the first step to be taken in the event of a bankruptcy is to convert each customer's claim in each currency to U.S. Dollars at the exchange rate in effect on the Final Net Equity Determination Date as defined in

[27] Presumably, certain sovereign action of a foreign government could affect foreign currency even if held in the U.S. Any discussion of sovereign risk herein pertains to non-U.S. currency, wherever held.

[28] 53 FR at 46915, note 22.

[29] The current Framework 2 sets forth a plan for distribution in the case of trades made on the Chicago Board of Trade-London International Financial Futures and Options Exchange Link (''Link''). Since the Link ceased operations in 1997, there is no need to maintain the existing Framework 2. Accordingly, the Commission is replacing the existing Framework 2 related to the Link with a new Framework 2 that addresses U.S. held segregated funds and non-U.S. held segregated funds.

Commission Rule 190.01(s). Customer funds will be converted to U.S. Dollars from whatever currency in which the customer's funds are denominated as of the close of business on the Final Net Equity Determination Date.

The Commission has drafted the bankruptcy convention as a means to give prospective bankruptcy trustees a certain amount of direction in the event of a bankruptcy involving customer funds denominated in currencies other than U.S. Dollars and held in depositories located throughout the world. Such a bankruptcy, however, is likely to be extremely complicated and it is impossible to anticipate every factual variant. Accordingly, the Commission, in adopting this bankruptcy convention, has endeavored to avoid undermining the ability of the trustee to use his or her own discretion and judgment as required by the particular facts of each bankruptcy.

The rule and the framework to the bankruptcy appendix address the risks associated with holding customer funds outside the U.S. or in currencies other than U.S. dollars. Accordingly, the requirement that each customer who seeks to have funds held outside the U.S. must execute a separate subordination agreement has been eliminated.

III. Comments Regarding the Location of Foreign Futures or Foreign Options Secured Amount

In the proposal, the Commission asked for comments as to whether, in light of the proposed rules, Rule 30.7 should also be amended to expand the types of depositories at which an FCM may hold the funds of foreign futures or options customers. Only NFA provided comments as to the expansion of Rule 30.7. NFA indicated its belief that Rule 30.7 should be expanded to include all depositories permitted under Rule 1.49(d)(3), as well as those already permitted under Rule 30.7. The Commission agrees. Accordingly, Rule 30.7 will be amended to provide that the funds of foreign futures or options customers may, in addition to those depositories already enumerated, be held at a bank or trust company outside the U.S. that has in excess of $1 billion of regulatory capital or whose commercial paper or long-term debt instrument, or if part of a holding company system, its holding company's commercial paper or long-term debt instrument, is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'')[30] requires that agencies, in proposing rules, consider the impact of those rules 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 rules on such entities in accordance with the RFA.[31] The Commission has previously determined that FCMs are not small entities for the purpose of the RFA.[32] Additionally, the Commission has determined that DCOs are not small entities for purposes of the RFA.[33] The Commission notes that no comments were received from the public on the RFA and its relation to the new rule and rule amendments.

B. Paperwork Reduction Act

This rulemaking contains information collection requirements. As required by the Paperwork Reduction Act of 1995, 44 U.S.C. 3507(d), the Commission has submitted a copy of the new rule and rule amendments to the Office of Management and Budget (OMB) for its review. No comments were received in response to the Commission's invitation in the proposed rules to comment on any potential paperwork burden associated with this regulation.

C. Cost-Benefit Analysis

Section 15(a) of the Act, as amended by Section 119 of the CFMA, requires the Commission to consider the costs and benefits of its action before issuing a new regulation under the Act. By its terms, Section 15(a) as amended does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the regulation outweigh its costs. Rather, Section 15(a) simply requires the Commission to ''consider the costs and benefits'' of its action.

Section 15(a) of the Act further specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern: protection of market participants and the public; efficiency, competitiveness, and financial integrity of futures markets; price discovery; sound risk management practices; and other public interest considerations. Accordingly, the Commission could in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

The new rule and rule amendments are intended to provide greater flexibility for FCMs, DCOs, and their customers in their methods of doing business. The Commission is considering the costs and benefits of these rules in light of the specific provisions of Section 15(a) of the Act:

1. *Protection of market participants and the public.* To protect market participants and the public, the rule requires that depositories used to hold customer funds meet certain requirements to assure that customer funds are dealt with properly. Additionally, the rule includes a new framework to the bankruptcy appendix to protect customer funds held in U.S. dollars in the U.S. from being diluted if there is an insufficiency in the funds held outside the U.S. or in a currency other than U.S. dollars due to the sovereign action of a foreign government or court.

2. *Efficiency and competition.* The rules are expected to benefit competition and market efficiency. The rule will help to facilitate continued international growth of the futures industry by permitting customer funds to be denominated in currencies other than U.S. dollars and to be held in offshore depositories.

3. *Financial integrity of futures markets and price discovery.* The rule should have no effect, from the standpoint of imposing costs or creating benefits, on the financial integrity or price discovery function of the futures and options markets.

4. *Sound risk management practices.* The Commission in adopting the rule and amendments has included risk-limiting features, such as requiring FCMs and DCOs to maintain sufficient funds to meet obligations in each currency, and requiring depositories to meet certain criteria, including signing an acknowledgment regarding the segregation requirements under the Act and Commission rules, to minimize the risks to customer funds.

5. *Other public interest considerations.* The rule and amendments contained herein offer greater opportunity for taking full advantage of contracts being offered by domestic designated contract markets and registered DTFs and the ever increasing internationalization of the futures industry, while establishing safeguards for customer funds.

[30] 5 U.S.C. 601 *et seq.*

[31] 47 FR 18618 (April 30, 1982).

[32] 47 FR at 18619.

[33] 66 FR 45604, 45609 (Aug. 29, 2001).

After considering these factors, the Commission has determined to adopt the rule and amendments discussed above. The Commission invited public comment on its application of the cost-benefit provision. The Commission did not receive any comments regarding the application of the cost-benefit provision.

List of Subjects

17 CFR Part 1

Brokers, Commodity Futures, Consumer protection.

17 CFR Part 30

Commodity Futures, Consumer Protection

17 CFR Part 190

Bankruptcy, Reporting and recordkeeping requirements.

In consideration of the foregoing and pursuant to the authority contained in the Commodity Exchange Act and, in particular, Sections 2(a)(1)(A), 4d, 8a(5), and 20, 7 U.S.C. 2(a)(1)(A), 6d, 12a(5), and 24, and 11 U.S.C. 362, 546, 548, 556 and 761–766, 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, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000).

2. Section 1.32 is amended by revising paragraph (a) introductory text to read as follows:

§ 1.32 Segregated account; daily computation and record.

(a) Each futures commission merchant must compute as of the close of each business day, on a currency-by-currency basis:

* * * * *

3. Section 1.49 is added to read as follows:

§ 1.49 Denomination of customer funds and location of depositories.

(a) *Definitions.* For purposes of this section:

(1) *Money center country.* This term means Canada, France, Italy, Germany, Japan, and the United Kingdom.

(2) *Money center currency.* This term means the currency of any money center country and the Euro.

(b) *Permissible denominations of obligations.* (1) Subject to the terms and conditions set forth in this section, a futures commission merchant's obligations to a customer shall be denominated:

(i) In the United States dollar;

(ii) In a currency in which funds were deposited by the customer or were converted at the request of the customer, to the extent of such deposits and conversions; or

(iii) In a currency in which funds have accrued to the customer as a result of trading conducted on a designated contract market or registered derivatives transaction execution facility, to the extent of such accruals.

(2)(i) A futures commission merchant shall prepare and maintain a written record of each transaction converting customer funds from one currency to another.

(ii) A written record prepared under paragraph (b)(2)(i) of this section must include the date the transaction was executed, the currencies converted, the amount converted, and the resulting amount.

(iii) The information required under paragraph (b)(2)(ii) of this section must be provided to the customer upon the customer's request.

(c) *Permissible locations of depositories.* (1) Unless a customer provides instructions to the contrary, a futures commission merchant or a derivatives clearing organization may hold customer funds:

(i) In the United States;

(ii) In a money center country; or

(iii) In the country of origin of the currency.

(2) A futures commission merchant or derivatives clearing organization may hold customer funds outside the United States, in a jurisdiction that is not a money center country, or the country of origin of the currency only to the extent authorized by the customer, *provided,* that the futures commission merchant or derivatives clearing organization must make and maintain a written record of such authorization. Notwithstanding the foregoing, in no event shall a futures commission merchant or a derivatives clearing organization hold customer funds in a restricted country subject to sanctions by the Office of Foreign Assets Control of the U.S. Department of Treasury.

(d) *Qualifications for depositories.* (1) To hold customer funds required to be segregated pursuant to the Act and §§ 1.20 through 1.30, 1.32 and 1.36, a depository must provide the depositing futures commission merchant or derivatives clearing organization with the appropriate written acknowledgment as required under §§ 1.20 and 1.26.

(2) A depository, if located in the United States, must be:

(i) A bank or trust company;

(ii) A futures commission merchant registered as such with the Commission; or

(iii) A derivatives clearing organization.

(3) A depository, if located outside the United States, must be:

(i) A bank or trust company:

(A) That has in excess of $1 billion of regulatory capital; or

(B) Whose commercial paper or long-term debt instrument or, if a part of a holding company system, its holding company's commercial paper or long-term debt instrument, is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization;

(ii) A futures commission merchant that is registered as such with the Commission; or

(iii) A derivatives clearing organization.

(e) *Segregation requirements.* (1) Each futures commission merchant and each derivatives clearing organization must, as of the close of each business day, hold in segregated accounts on behalf of commodity or option customers:

(i) Sufficient United States dollars, held in the United States, to meet all United States dollar obligations; and

(ii) Sufficient funds in each other currency to meet obligations in such currency.

(2) Notwithstanding paragraph (e)(1)(ii) of this section, assets denominated in one currency may be held to meet obligations denominated in another currency as follows:

(i) United States dollars may be held in the United States or in money center countries to meet obligations denominated in any other currency; and

(ii) Funds in money center currencies may be held in the United States or in money center countries to meet obligations denominated in currencies other than the United States dollar.

(3) Each futures commission merchant and each derivatives clearing organization shall make and maintain records sufficient to demonstrate compliance with this paragraph (e).

PART 30—FOREIGN FUTURES AND FOREIGN OPTIONS TRANSACTIONS

4. The authority citation for Part 30 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 4, 6, 6c and 12a, unless otherwise noted.

5. Section 30.7 is amended by revising paragraph (c) to read as follows:

§ 30.7 Treatment of foreign futures or foreign options secured amount.

* * * * *

(c)(1) The separate account or accounts referred to in paragraph (a) of this section must be maintained under an account name that clearly identifies them as such, with any of the following depositories:

(i) A bank or trust company located in the United States;

(ii) A bank or trust company located outside the United States:

(A) That has in excess of $1 billion of regulatory capital; or

(B) Whose commercial paper or long-term debt instrument or, if a part of a holding company system, its holding company's commercial paper or long-term debt instrument, is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization; or

(C) As designated;

(iii) A futures commission merchant registered as such with the Commission;

(iv) A derivatives clearing organization;

(v) A member of any foreign board of trade; or

(vi) Such member or clearing organization's designated depositories.

(2) Each futures commission merchant must obtain and retain in its files for the period provided in § 1.31 of this chapter an acknowledgment from such depository that it was informed that such money, securities or property are held for or on behalf of foreign futures and foreign options customers and are being held in accordance with the provisions of these regulations.

* * * * *

PART 190—BANKRUPTCY

6. The authority citation for Part 190 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 4a, 6c, 6d, 6g, 7, 7a, 12, 19, 23, and 24, and 11 U.S.C. 362, 546, 548, 556 and 761–766, unless otherwise noted.

7. Part 190 is amended by revising at the end of Appendix B, Framework 2 to read as follows:

Appendix B to Part 190—Special Bankruptcy Distributions

* * * * *

Framework 2—Special Allocation of Shortfall to Customer Claims When Customer Funds are Held in a Depository Outside of the United States or in a Foreign Currency

The Commission has established the following allocation convention with respect to customer funds segregated pursuant to the Act and Commission rules thereunder held by a futures commission merchant (''FCM'') or derivatives clearing organization (''DCO'') in a depository outside the United States (''U.S.'') or in a foreign currency. The maintenance of customer funds in a depository outside the U.S. or denominated in a foreign currency will result, in certain circumstances, in the reduction of customer claims for such funds. For purposes of this proposed bankruptcy convention, sovereign action of a foreign government or court would include, but not be limited to, the application or enforcement of statutes, rules, regulations, interpretations, advisories, decisions, or orders, formal or informal, by a federal, state, or provincial executive, legislature, judiciary, or government agency. If an FCM enters into bankruptcy and maintains customer funds in a depository located in the U.S. in a currency other than U.S. dollars or in a depository outside the U.S., the following allocation procedures shall be used to calculate the claim of each customer.

I. Reduction in Claims for General Shortfall

A. Determination of losses not attributable to sovereign action

1. Convert each customer's claim in each currency to U.S. Dollars at the exchange rate in effect on the Final Net Equity Determination Date, as defined in § 190.01(s) (the ''Exchange Rate'').

2. Determine the amount of assets available for distribution to customers. In making this calculation, *include* customer funds that would be available for distribution but for the sovereign action.

3. Convert the amount of assets available for distribution to U.S. Dollars at the Exchange Rate.

4. Determine the Shortfall Percentage that is *not* attributable to sovereign action, as follows:

$$\text{Shortfall Percentage} = \left(1 - \left[\frac{\text{Total Customer Assets}}{\text{Total Customer Claims}}\right]\right)$$

B. Allocation of Losses Not Attributable to Sovereign Action

1. Reduce each customer's claim by the Shortfall Percentage.

II. Reduction in Claims for Sovereign Loss

A. Determination of Losses Attributable to Sovereign Action (''Sovereign Loss'')

1. If any portion of a customer's claim is required to be kept in U.S. dollars in the U.S., that portion of the customer's claim is not exposed to Sovereign Loss.

2. If any portion of a customer's claim is authorized to be kept in only one location and that location is:

a. The U.S. or a location in which there is no Sovereign Loss, then that portion of the customer's claim is not exposed to Sovereign Loss.

b. A location in which there is Sovereign Loss, then that entire portion of the customer's claim is exposed to Sovereign Loss.

3. If any portion of a customer's claim is authorized to be kept in only one currency and that currency is:

a. U.S. dollars or a currency in which there is no Sovereign Loss, then that portion of the customer's claim is not exposed to Sovereign Loss.

b. A currency in which there is Sovereign Loss, then that entire portion of the customer's claim is exposed to Sovereign Loss.

4. If any portion of a customer's claim is authorized to be kept in more than one location and:

a. There is no Sovereign Loss in any of those locations, then that portion of the customer's claim is not exposed to Sovereign Loss.

b. There is Sovereign Loss in one of those locations, then that entire portion of the customer's claim is exposed to Sovereign Loss.

c. There is Sovereign Loss in more than one of those locations, then an equal share of that portion of the customer's claim will be exposed to Sovereign Loss in each such location.

5. If any portion of a customer's claim is authorized to be kept in more than one currency and:

a. There is no Sovereign Loss in any of those currencies, then that portion of the customer's claim is not exposed to Sovereign Loss.

b. There is Sovereign Loss in one of those currencies, then that entire portion of the customer's claim is exposed to Sovereign Loss.

c. There is Sovereign Loss in more than one of those currencies, then an equal share of that portion of the customer's claim will be exposed to Sovereign Loss.

B. Calculation of Sovereign Loss

1. The total Sovereign Loss for each location is the difference between:

a. The total customer funds deposited in depositories in that location and

b. The amount of funds in that location that are available to be distributed to customers, after taking into account any sovereign action.

2. The total Sovereign Loss for each currency is the difference between:

a. The value, in U.S. dollars, of the funds held in that currency on the day before the sovereign action took place and

b. The value, in U.S. dollars, of the funds held in that currency on the Final Net Equity Determination Date.

C. Allocation of Sovereign Loss

1. Each portion of a customer's claim exposed to Sovereign Loss in a location will be reduced by:

$$\text{Total Sovereign Loss} \times \frac{\text{Portion of the customer's claim exposed to loss in that location}}{\text{All portions of customer claims exposed to loss in that location}}$$

2. Each portion of a customer's claim exposed to Sovereign Loss in a currency will be reduced by:

$$\text{Total Sovereign Loss} \times \frac{\text{Portion of the customer's claim exposed to loss in that currency}}{\text{All portions of customer claims exposed to loss in that currency}}$$

3. A portion of a customer's claim exposed to Sovereign Loss in a location or currency will not be reduced below zero. (The above calculations might yield a result below zero where the FCM kept more customer funds in a location or currency than it was authorized to keep.)

4. Any amount of Sovereign Loss from a location or currency in excess of the total amount of funds authorized to be kept in that location or currency (calculated in accord with Section II.1 above) (''Total Excess Sovereign Loss'') will be divided among all customers who have authorized funds to be kept outside the U.S., or in currencies other than U.S. dollars, with each such customer claim reduced by the following amount:

$$\text{Total Excess Sovereign Loss} \times \left[\frac{\left(\begin{array}{c} \text{This customer's total claim} - \text{The portion of this Customer's claim} \\ \text{required to be kept in U.S. dollars, in the U.S.} \end{array} \right)}{\begin{array}{c} \text{Total customer claims} - \text{Total of all customer claims} \\ \text{required to be kept in U.S. dollars, in the U.S.} \end{array}} \right]$$

The following examples illustrate the operation of this convention.

Example 1. No shortfall in any location.

Customer	Claim	Location(s) customer has consented to having funds held
A	$50	U.S.
B	50	U.K.
C	50	Germany
D	£300	U.K.

Location	Actual asset balance
U.S.	$50
U.K.	£300
U.K.	50
Germany	50

Note: Conversion Rates: 1 = $1; £1=$1.5.

Convert each customer's claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in U.S. dollars
A	$50	1.0	$50
B	50	1.0	50
C	50	1.0	50
D	£300	1.5	450
Total			600.00

Determine assets available for distribution to customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$50	1.0	$50			$50
U.K.	£300	1.5	450			450
U.K.	50	1.0	50			50
Germany	50	1.0	50			50
Total			600.00		0	600.00

There are no shortfalls in funds held in any location. Accordingly, there will be no reduction of customer claims.

Claims:

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
A	$50	$0	$50

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
B	50	0	50
C	50	0	50
D	450	0	450
Total	600.00	0.00	600.00

Example 2. Shortfall in funds held in the U.S.

Customer	Claim	Location(s) customer has consented to having funds held
A	$100	U.S.
B	50	U.K.
C	100	U.K., Germany, or Japan

Location	Actual asset balance
U.S.	$50
U.K.	100
Germany	50

Note: Conversion Rates: 1=$1.

Reduction in Claims for General Shortfall

There is a shortfall in the funds held in the U.S. such that only ½ of the funds are available.
Convert each customer's claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$100	1.0	$100
B	50	1.0	50
C	100	1.0	100
Total	....	....	250.00

Determine assets available for distribution to customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$50	1.0	$50.00	....	....	$50
U.K.	100	1.0	100	....	....	100
Germany	50	1.0	50	....	....	$50
Total	....	....	200.00	....	....	200.00

Determine the percentage of shortfall that is not attributable to sovereign action: Shortfall Percentage = $(1-200/250) = (1-80\%) = 20\%$.
Reduce each customer's claim by the Shortfall Percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$100	$20.00	$80.00
B	50	10.00	40.00
C	100	20.00	80.00
Total	250.00	50.00	200.00

Reduction in Claims for Shortfall Due to Sovereign Action

There is no shortfall due to sovereign action. Accordingly, the customer claims will not be further reduced.

Claims After Reductions

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
A	$80	....	$80.00
B	40	....	40.00
C	80	....	80.00
Total	200.00	0	200.00

Example 3. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, not due to sovereign action.

Customer	Claim	Location(s) customer has consented to having funds held
A	$150	U.S.
B	100	U.K.
C	50	Germany
D	$100	U.S.
D	100	U.K. or Germany

Location	Actual asset balance
U.S.	$250
U.K.	50
Germany	100

Note: Conversion Rates: 1=$1.

Reduction in Claims for General Shortfall

Convert each customer's claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$150	1.0	$150
B	100	1.0	100
C	50	1.0	50
D	$100	1.0	100
D	100	1.0	100
Total	....	....	500.00

Determine assets available for distribution to customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$250	1.0	$250	....	....	$250
U.K.	50	1.0	50	....	....	50
Germany	100	1.0	100	....	....	100
Total	....	....	400.00	....	0	400.00

Determine the percentage of shortfall that is not attributable to sovereign action: Shortfall Percentage = $(1-400/500) = (1-80\%) = 20\%$. Reduce each customer's claim by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$150	$30.00	120.00
B	100	20.00	80.00
C	50	10.00	40.00
D	200	40.00	160.00
Total	500.00	100.00	400.00

Reduction in Claims for Shortfall Due to Sovereign Action

There is no shortfall due to sovereign action. Accordingly, the claims will not be further reduced.

Claims After Reductions

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action	Claim after all reductions
A	$120.00		$120
B	80.00		80
C	40.00		40
D	160.00	0	160
Total	400.00	0	400

Example 4. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action.

Customer	Claim	Location(s) where customer has consented to have funds held
A	$50	U.S.
B	50	U.K.
C	50	Germany
D	$100.	U.S.
D	100	U.K. or Germany

Location	Actual asset balance
U.S.	$150
U.K.	100
Germany	100

Notice: Conversion Rates: 1 = $1; ¥1= $0.01, £1= $1.5.

Reduction in Claims for General Shortfall

Convert each customer's claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$50	1.0	$50
B	50	1.0	50
C	50	1.0	50
D	$100	1.0	100
D	100	1.0	100
Total			350.00

Determine assets available for distribution to customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$150	1.0	$150			$150
U.K.	100	1.0	100			100
Germany	100	1.0	100	50%	50	50
Total			350.00		50.00	300.00

Determine the percentage of shortfall that is not attributable to sovereign action: Shortfall Percentage = $(1 - 350/350) = (1 - 100\%) = 0\%$. Reduce each customer's claim by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$50	0	$50.00
B	50	0	50.00
C	50	0	50.00

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
D	200	0	200.00
Total	350.00	0.00	350.00

Reduction in Claims for Shortfall Due to Sovereign Action

Due to sovereign action, only ½ of the funds in Germany are available.

Customer	Presumed location of funds		
	U.S.	U.K.	Germany
A	$50		
B		$50	
C			$50
D	100		100
Total	150.00	50.00	150.00

Calculation of the allocation of the shortfall due to sovereign action—Germany ($50 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$50/$150	33.3% of $50	$16.67
D	100/$150	66.7% of $50	33.33
Total			50.00

Claims After Reductions:

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action from Germany	Claim after all reductions
A	$50		$50
B	50		50
C	50	$16.67	33.33
D	200	33.33	166.67
Total	350.00	50.00	300.00

Example 5. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action and a shortfall in funds held in the U.S.

Customer	Claim	Location(s) customer has consented to having funds held
A	$100	U.S.
B	50	U.K.
C	150	Germany
D	$100	U.S.
D	£300	U.K.
D	150	U.K. or Germany

Location	Actual asset balance
U.S.	$100
U.K.	£300
U.K.	200
Germany	150

Conversion Rates: 1=$1; £1=$1.5.

Reduction in Claims for General Shortfall

Convert each customer's claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$100	1.0	$100

Customer	Claim	Conversion rate	Claim in US$
B	50	1.0	50
C	150	1.0	150
D	$100	1.0	100
D	£300	1.5	450
D	150	1.0	150
Total			1000.00

Determine assets available for distribution to customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$100	1.0	$100			$100
U.K.	£300	1.5	450			450
U.K.	200	1.0	200			200
Germany	150	1.0	150	100%	$150	0
Total			900.00		150.00	750.00

Determine the percentage of shortfall that is not attributable to sovereign action: Shortfall Percentage = (1–900/1000)= (1—90%) = 10%. Reduce each customer's claim by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$100	$10.00	$90.00
B	50	5.00	45.00
C	150	15.00	135.00
D	700	70.00	63.00
Total	1000.00	100.00	900.00

Reduction in Claims for Shortfall Due to Sovereign Action

Due to sovereign action, none of the money in Germany is available.

Customer	Presumed location of funds		
	U.S.	U.K.	Germany
A	$100		
B		$50	
C			$150
D	100	450	150
Total	200.00	500.00	300.00

Calculation of the allocation of the shortfall due to sovereign action Germany ($150 shortfall to be allocated):

Customer	Allocation share	Allocation Share of actual shortfall	Actual shortfall allocated
C	$150/$300	50% of $150	$75
D	150/$300	50% of $150	75
Total			150.00

Claims After Reductions

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action from Germany	Claim after all reductions
A	$90		$90
B	45		45
C	135	$75	60
D	630	75	555

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action from Germany	Claim after all reductions
Total	900.00	150.00	750.00

Example 6. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action, shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, not due to sovereign action, and a shortfall in funds held in the U.S.

Customer	Claim	Location(s) customer has consented to having funds held
A	$50	U.S.
B	50	U.K.
C	$20	U.S.
C	50	Germany
D	$100.	U.S.
D	£300	U.K.
D	100	U.K., Germany, or Japan
E	$80	U.S.
E	¥10,000	Japan

Location	Actual asset balance
U.S.	$200
U.K.	£200
U.K.	100
Germany	50
Japan	¥10,000

Conversion Rates: £1 = $1; ¥1=$0.01, £1=$1.5.

Reduction in Claims for General Shortfall

Convert each customer s claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$50	1.0	$50
B	50	1.0	50
C	$20	1.0	20
C	50	1.0	50
D	$100.	1.0	100
D	300	1.5	450
D	£100	1.0	100
E	$80	1.0	80
E	¥10,000	0.01	100
Total			1000.00

Determine assets available for distribution to customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$200	1.0	$200			$200
U.K.	£200	1.5	300			300
U.K.	100	1.0	100			100
Germany	50	1.0	50	100%	$50	0
Japan	¥10,000	0.01	100	50%	50	50
Total			750		100.00	650.00

Determine the percentage of shortfall that is not attributable to sovereign action:
Shortfall Percentage = (1–750/1000) = (1–75%) = 25%.
Reduce each customer's claim by the shortfall percentage:

Customer	Claim in U.S.$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$50	$12.50	$37.50

Customer	Claim in U.S.$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
B	50	12.50	37.50
C	70	17.50	52.50
D	650	162.50	487.50
E	180	45.00	135.00
Total	1000.00	250.00	750.00

Reduction in Claims for Shortfall Due to Sovereign Action

Due to sovereign action, none of the money in Germany and only ½ of the funds in Japan are available.

Customer	Presumed location of funds			
	U.S.	U.K.	Germany	Japan
A	$50			
B		$50		
C	20		$50	
D	100	450	50	$50
E	80			100
Total	250.00	500.00	100.00	150.00

Calculation of the allocation of the shortfall due to sovereign action—Germany ($50 shortfall to be allocated):

Customer allocation	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$50/$100	50% of $50	$25
D	50/100	50% of 50	25
Total			50

Japan ($50 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
D	$50/$150	33.3% of $50	$16.67
E	100/150	66.6% of 50	33.33
Total			50.00

Claims After Reductions

Customer	Claim in US dollars after allocated non-sovereign shortfall	Allocation of shortfall due to soverign action from Germany	Allocation of shortfall due to sovereign action from Japan	Claim after all reductions
A	$37.50			37.50
B	37.50			37.50
C	52.50	$25		27.50
D	487.50	25	16.67	445.83
E	135.00		33.33	101.67
Total	750.00	50.00	50.00	650.00

Example 7. Shortfall in funds held outside the U.S., or in a currency other than U.S. dollars, due to sovereign action, where the FCM kept more funds than permitted in such location or currency.

Customer	Claim	Location(s) customer has consented to having funds held
A	$50	U.S.
B	50	U.S.
B	50	U.K.
C	50	Germany.
D	100.	U.S.
D	100	U.K. or Germany.
E	50	U.S.
E	50	U.K.

Location	Actual asset balance
U.S.	$250
U.K.	50
Germany	200

Conversion Rates: 1 = $1.

Reduction in Claims for General Shortfall

Convert each customer's claim in each currency to U.S. Dollars:

Customer	Claim	Conversion rate	Claim in US$
A	$50	1.0	$50
B	50	1.0	50
B	50	1.0	50
C	50	1.0	50
D	100.	1.0	100
D	100	1.0	100
E	50	1.0	50
E	50	1.0	50
Total			500.00

Determine assets available for distribution to customers, converting to U.S. dollars:

Location	Assets	Conversion rate	Assets in U.S. dollars	Shortfall due to sovereign action percentage	Actual shortfall due to sovereign action	Amount actually available
U.S.	$250	1.0	$250			$250
U.K.	50	1.0	50			50
Germany	200	1.0	200	100%	200	0
Total			500.00		200	300.00

Determine the percentage of shortfall that is not attributable to sovereign
Shortfall Percentage = (1–500/500) = (1–100%) = 0%.

Reduce each customer's claim by the shortfall percentage:

Customer	Claim in US$	Allocated shortfall (non-sovereign)	Claim in U.S. dollars after allocated shortfall
A	$50	$0	$50.00
B	100	0	100.00
C	50	0	50.00
D	200	0	200.00
E	100	0	100.00
Total	500.00	0.00	500.00

Reduction in Claims for Shortfall Due to Sovereign Action

Due to sovereign action, none of the money in Germany is available.

Customer	Presumed location of funds		
	U.S.	U.K.	Germany
A	$50		
B	50	50	
C			50
D	100		100
E	50	50	
Total	250.00	100.00	150.00

Calculation of the allocation of the shortfall due to sovereign action—Germany ($200 shortfall to be allocated):

Customer	Allocation share	Allocation share of actual shortfall	Actual shortfall allocated
C	$50/$150	33.3% of $200	$66.67
D	$100/$150	66.7% of $200	$133.33
Total			$200.000

This would result in the claims of customers C and D being reduced below zero.

Accordingly, the claims of customer C and D will only be reduced to zero, or $50 for C and $100 for D. This results in a Total Excess Shortfall of $50.

Actual shortfall	Allocation of shortfall for customer C	Allocation of shortfall for customer D	Total excess shortfall
$200	$50	$100	$50

This shortfall will be divided among the remaining customers who have authorized funds to be held outside the U.S. or in a currency other than U.S. dollars.

Customer	Total claims of customers permitting funds to be held outside the U.S.	Portion of claim required to be int the U.S.	Allocation share (column B–C/column B Total—all customer claims in U.S.)	Allocation share of actual total excess shortfall	Actual total excess shortfall allocated
B	$100	$50	$50/$200	25% of $50	$12.50
C	50	0	(1)		0
D	200	100	$100/200	50% of $50	25
E	100	50	50/100	25% of $50	12.50
Total	450.00				50.00

[1] Claim already reduced to $0.

Claims After Reductions

Customer	Claim in U.S. dollars after allocated non-sovereign shortfall	Allocation of shortfall due to sovereign action Germany	Allocation of total excess shortfall	Claim after all reductions
A	$50			$50.00
B	100		12.50	87.50
C	50	50		0
D	200	100	25	75.00
E	100		12.50	87.50
Total	500.00	150.00	50.00	300.00

Issued in Washington, DC on January 29, 2003, by the Commission.

Jean A. Webb,

Secretary of the Commission.

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DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Part 529

Certain Other Dosage Form New Animal Drugs; Formalin Solution

AGENCY: Food and Drug Administration, HHS.

ACTION: Final rule; technical amendment.

SUMMARY: The Food and Drug Administration (FDA) is amending the animal drug regulations to reflect approval of a supplemental new animal drug application (NADA) filed by Natchez Animal Supply Co. The supplemental NADA provides for use of formalin in a water bath for the control of certain external parasites on finfish and shrimp and for the control of certain fungi on finfish eggs. Minor corrections to the regulations are also being made.

DATES: This rule is effective February 4, 2003.

FOR FURTHER INFORMATION CONTACT: Joan C. Gotthardt, Center for Veterinary Medicine (HFV–131), Food and Drug Administration, 7500 Standish Pl., Rockville, MD 20855, 301–827–7571, e-mail: *jgotthar@cvm.fda.gov*.

SUPPLEMENTARY INFORMATION: Natchez Animal Supply Co., 201 John R. Junkin Dr., Natchez, MS 39120, filed a supplement to NADA 137–687 that provides for use of formalin in a water bath for the control of certain external parasites on finfish and shrimp and for the control of certain fungi on finfish eggs. The supplemental NADA is approved as of November 25, 2002, and the regulations are amended in 21 CFR 529.1030 to reflect the approval. The basis of approval is discussed in the freedom of information summary.

In accordance with the freedom of information provisions of 21 CFR part