As with the Commission's pilot program for domestic exchange-traded options, the program for foreign exchange-traded commodity options also has proceeded cautiously. Thus, in issuing the order for any foreign market, the Commission has considered: (1) The availability of certain information relevant to preventing abuses including, but not limited to trade confirmation data; (2) the arrangements in place for assuring that sales practice abuses do not occur; (3) the arrangements for U.S. customers to redress grievances; and (4) the regulatory environment in which such options are traded.18

In particular, the Commission placed great stress initially on its ability to obtain information from the foreign exchange with respect to transactions entered into on that exchange on behalf of U.S. customers. ¹⁹ As stated in the final rules: ²⁰

In order to ensure that foreign commodity exchanges are both willing and able to share appropriate information with the Commission * * * the Commission has determined to make the issuance of a Commission order a prerequisite to the lawful offer and sale of such products.

Reevaluation of foreign options rules.

Since 1987 foreign option sales to U.S. customers have been permitted under the Commission's part 30 rules. Such sales have occurred without the type of sales abuses that historically had been associated with commodity option activities. Contributing to this success has been the requirement that foreign options be sold to U.S. customers by futures commission merchants (which ensures among other things the adequacy of firm capital, fitness of personnel and proper supervision of sales practices); the Commission's Part 30 rules, which seek to ensure that foreign firms directly soliciting U.S. customers for foreign products are otherwise regulated as to their sales practices; 21 and the undertaking by the National Futures Association (NFA) to audit the foreign options sales practices of domestic firms marketing foreign options to domestic customers.22 In

particular, under the current regulatory scheme, firms engaged in the offer or sale of foreign commodity options (and futures) to U.S. customers must either be a Commission registrant or a foreign firm which has qualified to sell foreign products in the United States under the Commission's Part 30 rules based on substituted compliance with a foreign jurisdiction's licensing and fitness requirements and subject to certain other conditions to assure the availability of the firms' records and its submission to Commission jurisdiction under the CEA and U.S. law otherwise.

In the case of NFA, NFA audits generally include the review and analysis of a member firm's trading records, sales materials and practices (sales practices compliance audits), and for FCMs and independent IBs, accounting procedures, financial statements and records (financial audits). NFA's audit programs are designed so that the auditors must perform a certain amount of work at the member firm's office, testing records and resolving any discrepancies. While all NFA members are subject to audit, decisions concerning whether to audit a particular firm are based on a number of factors, including NFA's review of financial statements, monitoring of media advertising, receipt of customer complaints, knowledge of the past history of the firm and its principals, the time elapsed since the previous NFA audit, potential effects of market movements and referrals outside of NFA.

NFA compliance audits have two major objectives: to determine whether the firm is maintaining records in accordance with NFA rules and applicable Commission regulations, and

responsibility for each FCM, which is a member of more than one of the SROs, to one of the Plan participants. The SRO which has the primary responsibility is known as that FCM's DSRO. NFA is the DSRO for all FCMs which are not members of any commodity exchange and therefore, do not have an exchange SRO and, in some cases, NFA by agreement is the DSRO for certain exchange member firms. NFA also is the DSRO responsible for surveillance over the financial reporting and recordkeeping by all member CPOs, and independent introducing brokers (IBs), as well as guaranteed IBs whose guaranteeing FCMs have NFA as the DSRO. NFA also is charged with auditing for sales practice compliance all member IBs, CTAs and CPOs, and branch offices of FCMs for which NFA is DSRO, as well as all futures sales practices compliance not contracted to another SRO

To date, NFA has undertaken, in conjunction with specific Commission orders under rule 30.3(a), to conduct sales practice compliance auditing of registrants marketing particular foreign commodity options under relevant arrangements with such firms' DSRO. Therefore, any revisions to Commission rule 30.3 would be premised on the existence of an audit program to assure general sales practice compliance for all foreign commodity option transactions. *See also* n. 21.

to ascertain that the firm is being operated in a professional manner and that customers are protected against unscrupulous activities, including fraudulent or high-pressure sales practices. The compliance program specifically examines the firm's practices in soliciting accounts and audits could review, among other things: records of customers' orders; customer confirmations and other account statements; records regarding handling of discretionary accounts; disclosure documents, advertising and other promotional material; records of customer complaints; and records relative to the internal supervision of account executives, order handling or sales personnel.²³

The Commission believes that its experience since 1987 with foreign options justifies a reexamination of the necessity of requiring a specific option authorization order for each options contract offered and sold in the United States, that is, the continuing need for differential treatment of the offer or sale of foreign futures and foreign options in the United States. Just as the Commission's domestic exchangetraded option program has evolved on the basis of accumulated operational experience, the Commission believes that a similar measured evolution, based on experience, is warranted with respect to foreign commodity options.

However, as noted above, the Commission believes that its existing regulatory scheme governing domestic registered firms which deal directly with the public in conjunction with the sales practice program of the NFA—all subject to Commission oversightshould provide adequate sales practice protections for customers who would engage in foreign options transactions through registered FCMs. In this connection, prior to adopting any final rules in this regard, the Commission would need to be assured that arrangements exist through NFA or otherwise to ensure that sales practice compliance audits of registrants offering foreign commodity options will be undertaken, thereby ensuring complete sales practice compliance audit coverage of firms (which heretofore has been mandated on a product-specific basis under rule 30.3 orders).

Similarly, the Commission's rule 30.10 orders permitting foreign firms to directly solicit U.S. persons for foreign products address options and futures sales practice concerns. In addition, the Commission notes that existing 30.10 orders have been accompanied by information-sharing arrangements

¹⁸ See, e.g., 53 FR 28840 (July 29, 1988).

¹⁹ See 52 FR 28980, 28988 (August 5, 1987). ²⁰ Id.

²¹ In reviewing the foreign regulatory program for purposes of rule 30.10, the Commission's staff considers the sales practice compliance review program in effect in the foreign jurisdiction.

²² Part 33 requires exchanges as a condition of designation as a contract market to have specific options sales practice compliance responsibilities. NFA and the futures exchanges participate in a Joint Audit Plan (Plan) to reduce the duplication of audit and financial surveillance work which otherwise could occur with respect to FCMs which are members of more than one exchange. The plan assigns primary audit and financial surveillance

²³ See Commission rule 33.4(c); see also n. 22.