SUPPLEMENTARY INFORMATION:

Comments Invited

Interested parties are invited to participate in this proposed rulemaking by submitting such written data, views, or arguments as they may desire. Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in developing reasoned regulatory decisions on the proposal. Comments are specifically invited on the overall regulatory, aeronautical, economic, environmental, and energy-related aspects of the proposal. Communications should identify the airspace docket and be submitted in triplicate to the address listed above. Commenters wishing the FAA to acknowledge receipt of their comments on this notice must submit with the comments a self-addressed, stamped postcard on which the following statement is made: ''Comments to Airspace Docket No. 97–AWP–22.'' The postcard will be date/time stamped and returned to the commenter. All communications received on or before the specified closing date for comments will be considered before taking action on the proposed rule. The proposal contained in this notice may be changed in the light of comments received. All comments submitted will be available for examination in the Airspace Branch, Air Traffic Division, at 15000 Aviation Boulevard, Lawndale, California 90261, both before and after the closing date for comments. A report summarizing each substantive public contact with FAA personnel concerned with this rulemaking will be filed in the docket.

Availability of NPRM

Any person may obtain a copy of this Notice of Proposed Rulemaking (NPRM) by submitting a request to the Federal Aviation Administration, Airspace Branch, P.O. Box 92007, Worldway Postal Center, Los Angeles, California 90009. Communications must identify the notice number of this NPRM. Persons interested in being placed on a mailing list for future NPRM's should also request a copy of Advisory Circular No. 11–2A, which describes the application procedures.

The Proposal

The FAA is considering an amendment to part 71 of the Federal Aviation Regulations (14 CFR part 71) by amending the Class E airspace at Mammoth Lakes, CA. The development of GPS SIAP has made this proposal necessary. The intended effect of this proposal is to provide adequate airspace for aircraft executing the GPS RWY 27 SIAP at Mammoth Lakes Airport. Mammoth Lakes, CA. Class E airspace designations are published in Paragraph 6005 of FAA Order 7400.9D dated September 4, 1996, and effective September 16, 1996, which is incorporated by reference in 14 CFR 71.1. The Class E airspace designation listed in this document would be published subsequently in this Order.

The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. Therefore, this proposed regulation—(1) is not a ''significant regulatory action'' under Executive Order 12866; (2) is not a ''significant rule'' under DOT Regulatory Policies and Procedures (44 FR 10034; February 26, 1979); and (3) does not warrant preparation of a Regulatory Evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this proposal rule will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

List of Subjects in 14 CFR Part 71

Airspace, Incorporation by reference, Navigation (air)

The Proposed Amendment

In consideration of the foregoing, the Federal Aviation Administration proposes to amend 14 CFR part 71 as follows:

PART 71—[AMENDED]

1. The authority citation for 14 CFR part 71 continues to read as follows:

Authority: 49 U.S.C. 106(g), 40103, 40113, 40120; E.O. 10854, 24 FR 95653 CFR, 1959–1963 Comp., p. 389; 14 CFR 11.69.

§ 71.1 [Amended]

2. The incorporation by reference in 14 CFR 71.1 of the Federal Aviation Administration Order 7400.9D, Airspace Designations and Reporting Points, dated September 4, 1996, and effective September 16, 1996, is amended as follows:

* * * * *

Paragraph 6005 Class E airspace areas extending upward from 700 feet or more above the surface of the earth.

* * * * *

AWP CA E5 Mammoth Lakes, CA [Revised]

Mammoth Lakes Airport, CA
(Lat 37°37′26″N, long. 118°50′19″W)

That airspace extending upward from 700 feet above the surface within a 6.6-mile radius of the Mammoth Lakes Airport. That airspace extending upward from 1,200 feet above the surface within the area bounded by a line beginning at lat. 37°49′00″N, long. 119°00′00″W; to lat. 37°49′00″N, long. 119°13′00″W; to lat. 38°11′00″N, long. 119°13′00″W; to lat. 38°11′00″N, long. 118°27′00″W; to lat. 37°30′00″W, long. 118°27′00″N; to lat. 37°30′00″W, long. 119°00′00″N, thence to the point of beginning.

* * * * *

Issued in Los Angeles, California, on May 27, 1997.

George D. Williams,

Manager, Air Traffic Division, Western-Pacific Region.

[FR Doc. 97–14977 Filed 6–6–97; 8:45 am]

BILLING CODE 4910–13–M

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 32

Trade Options on the Enumerated Agricultural Commodities

AGENCY: Commodity Futures Trading Commission.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: Generally, the offer or sale of commodity options is prohibited except on designated contract markets. 17 CFR 32.11. One of several specified exceptions to the general prohibition on off-exchange options is for ''trade options.'' Trade options are defined as off-exchange options ''offered by a person having a reasonable basis to believe that the option is offered to'' the categories of commercial users specified in the rule, where such commercial user ''is offered or enters into the transaction solely for purposes related to its business as such.'' 17 CFR 32.4(a). Trade options, however, are not permitted on the agricultural commodities which are enumerated in the Commodity Exchange Act, 7 U.S.C. § 1 *et seq.* (Act).

The Division of Economic Analysis of the Commodity Futures Trading Commission recently completed a study of the prohibition on the offer or sale of off-exchange trade options on the enumerated agricultural commodities. Based upon the Division's analysis and recommendations, the Commission is seeking comment on whether it should propose rules to lift the prohibition on trade options on the enumerated agricultural options subject to conditions and, if so, what conditions would be appropriate.

DATES: Comments must be received by July 24, 1997.

ADDRESSES: Comments should be mailed to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581, attention: Office of the Secretariat; transmitted by facsimile at (202) 418–5521; or transmitted electronically to [secretary@cftc.gov]. Reference should be made to ''Prohibition on Agricultural Trade Options.''

FOR FURTHER INFORMATION CONTACT: Paul M. Architzel, Chief Counsel, Division of Economic Analysis, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581, (202) 418–5260, or electronically, [PArchitzel@cftc.gov].

SUPPLEMENTARY INFORMATION: The Commodity Futures Trading Commission (Commission or CFTC) directed its Division of Economic Analysis (Division) to study the prohibition on the offer or sale of off-exchange trade options on the agricultural commodities enumerated in the Act and to report on the Division's findings. On May 14, 1997, the Division forwarded to the Commission its study entitled, ''Policy Alternatives Relating to Agricultural Trade Options and Other Agricultural Risk-Shifting Contracts.'' Based upon the Division's analysis and recommendations, the Commission is seeking comment on whether it should propose rules to lift the prohibition on trade options on the enumerated agricultural options subject to conditions and, if so, what conditions would be appropriate. An abridged version of those portions of the Division's study which might be most useful to commenters in identifying the issues for comment follows. The complete text of that study is available through the Commission's internet site and can be accessed at http://www.cftc.gov/ag8.htm.

I. Statutory and Regulatory Background

A. Options on Commodities Subject to the 1936 Act

In 1936, responding to a history of large price movements and disruptions in the futures markets attributed to speculative trading in options, Congress completely prohibited the offer or sale of option contracts both on and off exchange in all commodities then under regulation.[1] Over the years, this statutory bar continued to apply only to the commodities regulated under the 1936 Act. The specific agricultural commodities regulated under the 1936 Act included, among others, grains, cotton, butter, eggs and potatoes. Later, fats and oils, soybeans and livestock, as well as others, were added to the list. Together, they are referred to as the ''enumerated'' agricultural commodities. Any commodity not so enumerated, whether agricultural or not, was not subject to regulation. Thus, options on such non-enumerated commodities were unaffected by the prohibition.[2]

B. Options on Commodities Not Subject to the 1936 Act

In the years following passage of the 1936 Act, the off-exchange offer and sale of commodity options on the non-enumerated commodities was subject to fraud, abuse and sharp practice. That history was one of the catalysts leading to enactment of the Commodity Futures Trading Commission Act of 1974 (1974 Act), which substantially strengthened the Commodity Exchange Act and broadened its scope. The Act's scope was broadened by bringing all commodities under regulation for the first time. Congress accomplished this by adding to the list of enumerated commodities an expansive catchall definition of ''commodity'' which included all ''services, rights or interests in which contracts for future delivery are presently or in the future dealt in.''[3]

Under the 1974 amendments, the newly created CFTC was vested with plenary authority to regulate the offer and sale of commodity options on the previously unregulated, non-enumerated commodities.[4] The Act's statutory prohibition on the offer and sale of options on the enumerated agricultural commodities was retained.

Shortly after its creation, the Commission promulgated a comprehensive regulatory framework applicable to off-exchange commodity option transactions in the non-enumerated commodities.[5] This comprehensive framework exempted ''trade options'' from most of its provisions.[6] Trade options on non-enumerated commodities are exempt from all of the requirements applicable to off-exchange commodity options except for a rule prohibiting fraud (rule 32.8) and a rule prohibiting manipulation (rule 32.9).

In contrast to the regulatory framework for commodity options on the non-enumerated commodities, commodity options on the enumerated commodities—the domestic agricultural commodities listed in the Act—were prohibited both as a consequence of the continuing statutory bar as well as Commission rule 32.2, 17 CFR 32.2. This prohibition made no exceptions and applied equally to trade options.

The attempt to create a regulatory framework to govern the offer and sale of off-exchange commodity options was unsuccessful. Because of continuing, persistent and widespread abuse and fraud in their offer and sale, the Commission in 1978 suspended all trading in commodity options, except for trade options.[7] Congress later codified the Commission's option ban,

[1] Commodity Exchange Act of 1936, Public Law No. 74–675, 49 Stat. 1491 (1936). *See,* H. Rep. No. 421, 74th Cong., 1st Sess. 1, 2 (1934); H. Rep. No. 1551, 72d Cong., 1st Sess. 3 (1932).

[2] Examples of non-enumerated commodities would include coffee, sugar, gold, and foreign currencies. Before 1974, the Act covered only those commodities enumerated by name. The 1936 Act regulated transactions in wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghum, mill feeds, butter, eggs and Solanum tuberosum (Irish potatoes). Act of June 15, 1936, Public Law No. 74–675, 49 Stat. 1491 (1936). Subsequent amendments to the Act added additional agricultural commodities to the list of enumerated commodities. Wool tops were added in 1938. Commodity Exchange Act Amendment of 1938, Public Law No. 471, 52 Stat. 205 (1938). Fats and oils, cottonseed meal, cottonseed, peanuts, soybeans and soybean meal were added in 1940. Commodity Exchange Act Amendment of 1940, Public Law No. 818, 54 Stat. 1059 (1940). Livestock, livestock products and frozen concentrated orange juice were added in 1968. Commodity Exchange Act Amendment of 1968, Public Law No. 90–258, 82 Stat. 26 (1968) (livestock and livestock products); Act of July 23, 1968, Public Law No. 90–418, 82 Stat. 413 (1968) (frozen concentrated orange juice). Trading in onion futures on United States exchanges was prohibited in 1958. Commodity Exchange Act Amendment of 1958, Public Law No. 85–839, 72 Stat. 1013 (1958).

[3] The definition of commodity is currently codified in section 1a(3) of the Act.

[4] Section 4c(b) of the Act provides that no person ''shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this Act'' which is in the nature of an option ''contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe.'' 7 U.S.C. 6c(b).

[5] 17 CFR Part 32. *See,* 41 FR 51808 (Nov. 24, 1976) (Adoption of Rules Concerning Regulation and Fraud in Connection with Commodity Option Transactions. *See also,* 41 FR 7774 (Feb. 20, 1976) (Notice of Proposed Rules on Regulation of Commodity Options Transactions); 41 FR 44560 (Oct. 8, 1976) (Notice of Proposed Regulation of Commodity Options). Options were not traded on futures exchanges at this time, *see* p. 18 *infra.*

[6] As noted above, trade options are defined as off-exchange options ''offered by a person having a reasonable basis to believe that the option is offered to the categories of commercial users specified in the rule, where such commercial user is offered or enters into the transaction solely for purposes related to its business as such.'' *Id.* at 51815; Rule 32.4(a) (1976). This exemption was promulgated based upon an understanding that commercials had sufficient information concerning commodity markets insofar as transactions related to their business as such, so that application of the full range of regulatory requirements was unnecessary for business-related transactions in options on the non-enumerated commodities. *See,* 41 FR 44563, ''Report of the Advisory Committee on Definition and Regulation of Market Instruments,'' Appendix A–4, p. 7 (Jan. 22, 1976).

[7] 43 FR 16153 (April 17, 1978). Subsequently, the Commission also exempted dealer options from the general suspension of transactions in commodity options. 43 FR 23704 (June 1, 1978).

establishing a general prohibition against commodity option transactions other than trade and dealer options.[8]

C. Reintroduction of Exchange-Traded Options

The Commission subsequently permitted the introduction of exchange-traded options on the non-enumerated commodities by means of a three-year pilot program.[9] Based on that successful experience, Congress, in the Futures Trading Act of 1982, eliminated the statutory bar to transactions in options on the enumerated commodities, permitting the Commission to establish a similar pilot program to reintroduce exchange-traded options on those agricultural commodities.[10]

D. Retention of Ban on Off-Exchange Options on Enumerated Commodities

In 1984 the Commission permitted exchange trading of options on the enumerated commodities under essentially the same rules that were already applicable to options on all other commodities.[11] In proposing these rules, the Commission noted that section 4c(c) of the Act and Commission rule 32.4 permitted trade options on the non-enumerated commodities and that ''there may be possible benefits to commercials and to producers from the trading of these 'trade' options in domestic agricultural commodities.'' [12] However, ''in light of the lack of recent experience with agricultural options and because the trading of exchange-traded options is subject to more comprehensive oversight,'' the Commission concluded that ''proceeding in a gradual fashion by initially permitting only exchange-traded agricultural options'' was the prudent course.[13] Nevertheless, the Commission requested comment from the public concerning the advisability of permitting trade options between commercials on domestic agricultural commodities. Citing past abuses associated with off-exchange options, the consensus among commenters was that the Commission should proceed cautiously and retain the prohibition on such off-exchange transactions.

Since then, the Commission has reconsidered the issue of whether to remove the prohibition on the offer and sale of trade options on the enumerated commodities several times. In 1991, the Commission proposed deleting the prohibition on trade options on the enumerated commodities and including them under the same exemption applicable to all other commodities. 56 FR 43560 (September 3, 1991). The Commission never promulgated the proposed deletion as a final rule.[14] Most recently, on December 19, 1995, the Commission hosted a public roundtable (December Roundatable) to consider this issue once again and to provide a forum for members of the public to provide their views.

II. Possible Benefits of Trade Options on the Enumerated Agricultural Commodities

The Division in its study identified a number of benefits that may result from lifting the prohibition on agricultural trade options. One such benefit is the potential for a greater supply of, and competition in offering, option contracts.[15] Currently, only standardized, exchange-traded options are available for agricultural product hedging. Presumably, lifting the ban would encourage competition between customized contracts and financing arrangements offered by various off-exchange counterparties and the more standardized but highly liquid, low credit-risk products offered by exchanges.

Moreover, lifting the ban would permit a greater variety of option vendors, which could reduce the informational search costs to certain hedgers. Hedging can be a complex matter involving knowledge by the hedger of his market position, delivery timing, quantities and qualities of commodity production, inventory, financial wherewithal and marketing objectives. In addition, a hedger must be cognizant of risks associated with the counterparty on the cash commodity, particularly default risk.

To reduce search costs, many hedgers may choose to rely on established cash market trading channels to gather information on contracting methods. Established cash trading partners may have a greater understanding of the hedger's marketing position and needs than others. These cash trading partners may, therefore, be better situated to recommend particular hedge strategies and contracts. In addition, ongoing business relationships with these parties may have instilled a level of trust between counterparties, allowing hedgers to make informed assessments as to credit risk and possibly to use cash market obligations as collateral for trade option positions.

In competing to offer option contracts, option vendors may offer customers a greater variety of desired attributes or services. For example, futures commission merchants (FCMs) can compete by offering exchange-traded options which offer a high degree of liquidity and low credit risk. They may also offer trade options, to the extent permissible, that have features currently unavailable on any exchange, such as average-price options.[16] Elevators and other first-handlers, on the other hand, presumably may offer option contracts having terms or financing arrangements more closely tailored to the hedging or other needs of the customer. Through such competition, a hedger may have a greater number of alternatives from which to choose in deciding which contract source best suits his or her hedging needs, balanced against his or her tolerance for credit risk.

The potentially greater array of contracts and services may enable hedgers to achieve more precise hedging in a variety of ways. For example, more efficient hedges may be attained by more closely matching the size of the option contract to the underlying cash market position. The standard size of exchange-traded option contracts may not correspond to the spot or forward obligations of a hedger. If the contract size is not a multiple of a producers's

[8] Public Law No. 95–405, 92 Stat. 865 (1978). Pursuant to the 1978 statutory amendments, option transactions prohibited by new Section 4c(c) could not be lawfully effected until the Commission transmitted to its Congressional oversight committees documentation of its ability to regulate successfully such transactions, including its proposed regulations, and thirty calendar days of continuous session of Congress after such transmittal had passed.

[9] 46 FR 54500 (Nov. 3, 1981).

[10] Public Law No. 97–444, 96 Stat. 2294, 2301 (1983).

[11] 49 FR 2752 (January 23, 1984).

[12] 48 FR 46797, 46800 (October 14, 1983) (footnote omitted).

[13] Id.

[14] By letter dated January 30, 1997, the National Grain and Feed Association (NGFA) petitioned the Commission to repeal immediately the prohibition on agricultural trade options in its entirety. NGFA's petition advocated that the Commission proceed to promulgate final rules on the basis of the 1991 Notice of Proposed Rulemaking. The Commission, in light of its publication of this Advance Notice of Proposed Rulemaking and consideration of whether to lift the prohibition subject to conditions, denied that petition by letter dated May 23, 1997.

[15] Options provide a highly effective tool for hedging and have unique pay-out characteristics. Options differ from futures contracts in that they are a limited price-risk instrument. That is, the purchaser of an option contract can profit from a price rise (in the case of a call) or price fall (in the case of a put), but limit any losses on the contract to the price of the premium paid for the contract.

[16] For example, on May 29, 1991, the Commission issued a no-action letter to Gelderman, Inc., a registered FCM, to offer averaging European-style off-exchange options on agricultural commodities to certain commercial purchasers. *See* CFTC Letter No. 91–1, Comm. Fut. L. Rep. (CCH) ¶ 25,065 (May 29, 1991). However, under Commission rule 1.19, appropriate haircuts to FCMs' net capital requirements would have to be promulgated before FCMs could offer such trade options generally.

output, the hedger is forced to under- or over-hedge.[17]

Trade options also allow a hedger to specify expiration or delivery dates to coincide more closely with harvest dates, processing schedules or the timing of forward contracts. This reduces a hedger's exposure to the risk from mismatching the expiration date of an exchange-traded contract. Basis risk also can be reduced for the hedger by allowing a closer match to the grade of crop or livestock at a particular delivery location.

In addition to tailoring contracts to match more closely the underlying commodity, customers, through the bundling of various options, can also gain access to contracts which hedge multiple risks. Producers, for example, face production risks and price risk associated with inputs and outputs. Currently, a producer can hedge these risks separately by purchasing, to the extent that they exist, separate options on the inputs and outputs and either purchasing crop insurance or possibly an option on crop yield futures. However, a counterparty might be able to offer at a lower price a single trade option contract that hedges all of these risks.[18]

Trade option contracts also may address the need for sufficient cash flow to maintain margins on open futures contracts or to prepay option premiums. Although trade options typically are not margined, depending on the terms of the contract, they may allow the option purchaser to delay payment of the premium. In certain cases the option may be collateralized implicitly by linking the option and a contract to deliver the crop or livestock to the same counterparty. The premium can then be incorporated into the cash contract by deducting it from the final price of the commodity at delivery.

III. Risks of Trade Options on the Enumerated Commodities

The Division also identified a number of potential risks which may cause heightened concern if the prohibition on agricultural trade options were lifted. These include fraud, credit risk, liquidity risk, operational risk, systemic risk and legal risk. Trade options on the enumerated commodities, as with all commodity-related over-the-counter instruments, would trade in a less-regulated environment than exchange-traded options. The Act imposes legal requirements on an exchange, mandating that it police itself and its participants for illicit activity. In addition, the regulatory structure imposes a variety of prophylactic protections against egregious forms of fraudulent and abusive conduct. When trading is conducted on a centralized market with standardized trading instruments and procedures, it is possible for the government to offer a broad level of customer and market protection by applying relatively modest levels of its resources.

In contrast, much of the appeal of trade options stems from the desire to deal with known counterparties or to customize the contracts. However, regulatory oversight and enforcement is limited in such circumstances to the extent that vendors of the instrument are not themselves regulated. Although the vendors in a decentralized market could be subject to a regulatory scheme, the absence of a centralized market and a self-regulatory organization reduces the effectiveness of any such regulatory protections. Because transactions in trade options would be decentralized, the resources necessary to surveil that activity would be far greater than those necessary to oversee the operations of a centralized market. Finally, the ability of the government to police such activity directly, without the assistance of a self-regulatory organization, would require a commitment of greater resources.

Customization of particular contracts also increases the possibility of fraud. The lack of standardization may make the oversight and policing of trade practices more difficult. Providing prophylactic protections, as well as establishing general rules of appropriate conduct, is more difficult when contract terms are not standardized. Moreover, where practices vary greatly from one vendor to another, enforcement is made more difficult.[19]

Just as a lack of standardization may make it more difficult to police trading in these instruments, it may also make it more difficult for customers to protect themselves from fraudulent or wrongful practices. Initially, it is expected that agricultural producers and users would enter into put and call options that were very similar to those already offered on-exchange. However, to the extent that the terms of the contracts or financing arrangements for them became more complex, greater time will be required for individuals to become familiar with a particular product. Moreover, individuals will by necessity progress through a learning curve as they become familiar with a particular product and how it interacts with their set of circumstances. During the early stages of this process, individuals may be more susceptible to fraudulent activity. This, and the possible variation among instruments from one source to another and the time it takes to familiarize oneself with each new or different product, increase the chance that certain individuals will exploit the opportunity to commit fraud.[20] Of course, educational efforts aimed at potential participants in such instruments might, to some degree, ameliorate these effects. Conversely, this problem may be exacerbated to the extent that the fraudulent activity is carried out through the guise of providing education on these instruments.[21]

In such a decentralized market, participants find it more difficult to detect possible fraudulent conduct by their counterparty. The lack of transparent prices may make it difficult for parties to accurately ascertain a reasonable value for the contract. Moreover, to the extent that there is a lack of daily marking of positions to market or reporting of account position statements, as a matter of practice or regulatory requirement, it may make it more difficult for a counterparty to uncover possible fraudulent activity. These weaknesses may exacerbate other information inequalities and create a climate where fraudulent or sharp practices are made easier.

Finally, certain counterparties, particularly those who are also Commission registrants, could have conflicts of interest and customers may be confused as to the role of the counterparty. For example, to the extent that FCMs are permitted to offer trade options as principals, but also to act as fiduciaries in relation to executing exchange-traded options, confusion on

[17] ''Under-hedging'' means that the hedger has a futures or option position that is less than the total cash market position. This, in essence, leaves the cash market commitment, in part, without price protection. ''Over-hedging'' means that the futures or options position is greater than the cash market commitment.

[18] Under certain conditions, a contract that bundles options on multiple commodities has a lower premium than the total premia of the individual options on those commodities.

[19] For example, during the late spring and summer of 1996, the Commission received many complaints concerning so-called HTA contracts. As the Commission noted at the time, because the terms and circumstances surrounding each contract varied so much, it could only make a case-by-case determination regarding the legality of the contracts. Such an approach requires a relatively large commitment of Commission resources.

[20] A good example of this learning process has been the recent experience with flexible hedge-to-arrive contracts. These contracts had been entered into by elevators and producers for several years before recent variations in practice coupled with an inversion in the corn markets exposed the weaknesses associated with these contracts.

[21] Concerns about potential fraudulent activity are not limited to option vendors. They also extend to those rendering advisory or educational services in connection with such instruments.

the part of the customer may result as to the FCM's role and responsibilities. Of course, where the counterparty is a Commission registrant, the potential conflicts could be addressed through required disclosures or other mechanisms.

In the past, the Commission has found fraud in connection with the offer and sale of off-exchange option contracts to be a serious problem. In 1978 the Commission adopted a rule that suspended the offer and sale of commodity options to the general public.[22] In adopting the rule, the Commission noted that ''[t]he Commission's experience to date indicates that the offer and sale of commodity options has for some time been and remains permeated with fraud and other illegal or unsound practices notwithstanding a substantial investment of the Commission's resources in attempting to regulate rather than prohibit option trading.'' The Commission also expressed its view that the absence of exchange trading in the United States at that time may have contributed to problems with option trading.

Credit risk is the risk that a counterparty will be unable to perform on an obligation. In the case of an option, where a purchaser pays the premium up-front, the credit risks faced by the purchaser and the writer differ. The writer of an option faces significant market exposure, such that the writer's out-of-pocket losses may exceed the premium paid by the purchaser. Thus, the purchaser is at risk that the writer will not perform. The writer of an option typically does not face credit risk, however, because, unless the premium is financed or deferred, the purchaser has already performed on the contract by paying the premium.[23] An option purchaser, therefore, must take particular care to assure himself or herself that the option writer is able and will be willing to perform on the contract under all market conditions.

Liquidity enables customers quickly to enter into a transaction without significantly raising or lowering the purchase or sale price in the process. The market for trade options differs markedly in liquidity from exchange markets. Exchange markets permit trading among a diverse group of participants. Moreover, contracts are standardized and fungible, allowing any contract to be traded with any participant. The potential pool of participants for a specific trade option is much more limited. An individual entering into a trade option will likely have only a handful of offerors from which to choose. In addition, because trade options are typically not fungible, once one is entered into, the holder of the option can exit only by returning to the offeror. This may result in a higher cost to the hedger than would be the case with a more liquid, exchange-traded instrument.

Operational risk is the risk that the monitoring and control of operations cannot be sufficiently maintained and that financial losses occur as a result. Exchange-traded contracts are highly standardized. As a result, the terms and conditions of the contracts and the environment in which they are traded are well understood. In addition, familiarity with these contracts has become highly developed over the years. Familiarity with exchange-traded options tends to reduce the operational risk associated with their use. This risk is further reduced because of exchange and CFTC disclosure rules and other requirements, including daily marking-to-market of positions and regular customer position statements, which keep individuals informed of accruing losses.

In contrast, trade options are not traded in a transparent environment or on a continuous basis. As a result, prices may not regularly be reported, and positions may not be marked to market on a regular basis. Thus, it may be more difficult to monitor the market value of a position,[24] thereby increasing the degree of operational risk.

It should also be noted that, in the case of agricultural trade options, the most likely counterparty to producers is the local country elevator. Adding option contracts, particularly those with unusual terms, to the marketing mix of contracts already offered by an elevator may increase the complexity of the elevator's overall position and make it more difficult to hedge. Thus, the elevator's operational risk related to the use of trade options may be higher than under the current situation.

Generally, systemic risk is the risk of a broader collapse of entities or contracts that can be traced back to the collapse of an initial contract or group of contracts. While the repercussions from a widespread default can be problematic wherever it occurs, they can be particularly troublesome in rural areas where the economies of a town or region can be relatively isolated and highly dependent on agriculture. Thus, a default relating to agriculture could potentially spread quickly to other sectors of the local or even regional economy.

Lifting the ban on trade options on the enumerated commodities would provide an additional exemption from the general rule requiring commodity futures and option contracts to be traded only on designated contract markets. To the degree that the current prohibition is removed or relaxed, entities choosing to operate pursuant to that exemption would have to take care to conform their activities to the terms of the exemption. Failure to do so might expose such an entity to the legal risk that a particular over-the-counter derivative contract offered by it was not covered by the exemption and that its offer or sale violated either that exemption or some other provision of the Act or Commission rules.

The degree of risk of this occurring would depend upon the extent to which a simple option contract were modified. In a simple option position, the holder of the option has the right but not the obligation to make or take delivery of a commodity at a given price. However, as has been seen in the development of derivative contracts in the financial markets, this simple contract can evolve into more complicated instruments with payout structures significantly different from those associated with a simple option. These structures give rise to the risk that the resulting instrument comes more closely to resemble a futures contract, rather than an option contract. Accordingly, in order to avoid a violation, those offering option contracts in reliance on the trade option exemption would have to assure themselves that the instruments they offer adhere closely to the terms of that exemption.

IV. Possible Regulatory Restrictions

The Division in its study identified and analyzed a variety of regulatory protections or conditions which could be fashioned to address many of the risks noted above. These conditions could apply to the nature of eligible

[22] 43 FR 16153 (April 17, 1978).

[23] This lack of credit exposure may create a greater likelihood of fraudulent practices. For example, an enterprise may sell options with no intention of performing on the contracts. Because a period of time passes between the time options are written and when they expire, the enterprise may be able to collect a substantial amount of funds before its intentions not to perform are discovered.

[24] Based upon observation of forward contracting and associated hedging practices, it is anticipated that, although the terms of agricultural trade options will be individually negotiable, they nonetheless would be expected initially to resemble closely the terms of exchange-traded options with respect to exercise dates, delivery grades and strike prices. To the extent that the terms are similar, it will be easier to monitor the financial condition of a position by observing prices on the exchange markets. In addition, for individuals who have purchased an option, the price of the option is determined up-front, reducing the need to monitor the value of the position.

parties, conditions on the instrument or its use and regulation of marketing.

A. Nature of the Parties

As the Division noted, an indirect means of discouraging unsophisticated individuals from entering into trade options would be to use transaction size as a proxy for sophistication. A high minimum transaction size effectively would bar smaller, less well-capitalized—and presumably less sophisticated—commercials from participating. This approach has been a stipulated condition of transactions permitted under several Commission and staff no-action letters.[25] Transaction size limitations are a clear, easily applied—albeit crude—means of measuring sophistication.[26] Similarly, the net worth of the customer counterparty could be used as proxy for determining sophistication.

Proxy limitations may be over- or under-inclusive. In the case of size restrictions, they may limit hedging flexibility. As mentioned above, many producers do not use exchange-traded contracts because they prefer not to post margin, do not have brokers to sell them exchange-traded options or must arrange financing for the position. Entering into a trade option contract with a local elevator may address these producer concerns. Using these proxy limitations, however, may make trade options unavailable to the smaller entities that might otherwise find them the most useful. Conversely, such proxy limitations may also be a crude, though clear, means of distinguishing among entities when determining to which, if any, various conditions for lifting the ban on agricultural commodities should not apply.

Another method of limiting access to agricultural trade options as a means of maintaining regulatory oversight is to limit those entities or individuals which may become trade option vendors. For example, option vendors could be required to register in some capacity with the Commission as a condition of doing business.[27] Alternatively, the Commission could consider creating new requirements that would be applicable only to the offer and sale of agricultural trade options.[28] Such requirements could establish a new category of special registration or could simply require that those offering such instruments identify themselves by notifying the Commission. In lieu of, or in combination with, required registration, the Commission could restrict vendors of trade options to commercial entities involved in the handling or use of the commodity.

As an alternative for, or in conjunction with, other requirements and restrictions, the Commission could institute an educational program or condition. Many of the participants in the December Roundtable expressed the concern that individuals need better education in the use of option contracts and in the principles of risk management generally.[29] The appeal of such a program rests on the assumption that better educated individuals can better protect their own interests, thereby reducing the need for other regulatory restrictions or monitoring procedures.

Although the Commission currently does not have any educational requirements for individuals using futures or option contracts, the exchange-traded option pilot program established under the 1990 farm bill,[30] a program limited to a relatively limited number of counties, required persons participating in the program to complete educational training. Seminars on marketing and the use of exchange-traded options were developed by the United States Department of Agriculture and presented through the State Cooperative Extension Service together with representatives from the State and County Consolidated Farm Service Agency. The instruction included an introduction to the Options Pilot Program and a review of option trading procedures.

Although an educational program or requirement has great appeal, implementing the program could be very costly, especially in light of its potential nationwide scope. Moreover, mandatory attendance to fulfill an education requirement may not achieve the desired effect of raising the level of understanding or sophistication among potential participants, however. Unless competency also is tested, an attendance requirement alone may not be indicative of the actual sophistication of a participant and could lead to a false sense of security by the government, potential vendors, and the customers themselves, that those who met the education requirement were in fact knowledgeable or suitable customers. Finally, to the extent that private providers or organizations undertook this role, there would be a risk that educational programs could resemble or become marketing seminars.

B. Restrictions on the Instruments or Their Use

Several restrictions, either direct or indirect, could be placed on the use of agricultural trade options, in addition to the requirement that they be offered only to commercial entities. Section 32.4 of the Commission's regulations requires that trade options be offered only to a commercial entity ''solely for purposes related to its business as such.'' Although the Commission has not had occasion to address the scope of this restriction definitively, the Commission could delineate, by either specific restrictions or more general guidance, at least initially, those practices which in the context of agricultural trade options will ensure that the use of such options remains within the intent of the exemption.[31]

For example, the requirement that trade options be for a business-related use suggests that the overall size of all agricultural trade option contracts and any other derivative positions should not exceed the size of the cash or forward market position being hedged. Under most circumstances, a position in a derivative contract that exceeds the

[25] The Commission, in May 1991, issued a no-action letter to Gelderman, Inc., with respect to the offering of agricultural trade options. *See,* n. 39, *supra.* A condition of the letter was that the options be offered in units of no less than 100,000 bushels. Subsequently, in June 1992 the staff issued a no-action letter to a commodity merchant and processor to allow the offer of agricultural trade options. A condition of that letter was that the minimum transaction size of an option be at least 1,000,000 bushels. *See,* CFTC Letter No. 92–10, Division of Trading and Markets, Comm. Fut. L. Rep (CCH) ¶ 25,309 (June 9, 1992).

[26] The minimum appropriate transaction size levels would have to be considered as part of a notice and comment rulemaking procedure.

[27] An additional alternative would be to permit registration and oversight of option vendors by other federal or state regulators to substitute for CFTC registration. For example, under this alternative a bank subject to state or federal banking oversight could also offer trade options. However, an elevator could not offer such options unless it became registered with the Commission as an introducing broker or, as discussed below, in a new category of Commission registration or was subject to oversight under some other specified regulatory scheme.

[28] However, there are costs associated with registration requirements, both for the registrant and the Commission which must be taken into consideration.

[29] December Roundtable, tr. pp. 17, 19, 32, 45, 49, 53 and 62.

[30] FACT Act—Food, Agriculture, Conservation and Trade Act of 1990 (P.L. 101–624).

[31] In connection with HTA contracts, the Division of Economic Analysis frequently was asked for further specificity concerning the extent to which various forms of the contracts fell within the boundaries of the Commission's rules or policies or staff no-action positions. In response, the Division issued a Statement of Guidance on May 15, 1996. This statement provided specific guidance that could be applied to contracts or transactions to determine whether or not they were ''prudent,'' that is, could be used to reduce price risks. Such a format, if applied to trade options, also might prove valuable to the industry.

size of the underlying cash or forward position increases price risk. Other circumstances associated with managing risk include the existence of a predictable relationship between the crop produced and the commodity on which the option is written, the timing of option expiration and harvest of the commodity, and the expiration of the option in a crop year which coincides with the delivery period for the underlying commodity.

Consideration should also be given to whether, or under what circumstances, the practice of a producer or other agricultural business selling options to generate premium income is ''solely for purposes related to its business as such.'' While the purchaser of an option holds a limited risk instrument, option sellers potentially face unlimited price risk. A practice sometimes used by individuals having positions in the underlying commodity is to enter into what is known as a covered position. A producer enters a covered call position when he or she writes a call option that can be satisfied through delivery from production. In this sense, if prices fall, a producer writing covered calls is better off by the amount of the premium income received than if the cash position is not hedged. However, if prices rise, the producer is not able to participate in the market rally, although he or she may, nonetheless, receive a price sufficient to cover production costs and provide a satisfactory profit margin.

A second practice which generates premium income involves contracts which incorporate both written and purchased options. A contract having a cap and floor is an example of this practice. In conjunction with a long cash position, these contracts set a floor price for the commodity. The cost of providing that floor, however, is reduced in return for the producer agreeing to limit the upside profit potential, essentially incorporating a written call into the contract. To the extent that such contracts provide for a ratio of written options in excess of purchased options, they raise issues similar to those of writing covered calls or naked options. Certain trading strategies, such as placing and lifting a ''hedge'' multiple times, also raise the issue of whether such practices are consistent with the requirement that trade options be for a business purpose.

In addition, the design of trade option contracts could be restricted to assure that they do not violate other provisions of the Act or Commission regulations. While a basic option contract is a limited-risk financial instrument, options can be bundled to create instruments with more complex payout scenarios. Because option contracts can be ''bundled'' to create a synthetic futures contract and the regulatory treatment of trade options differs substantially from that of off-exchange futures contracts, the Commission could delineate trade options from futures contracts, either through guidance or as a condition of the exemption.

C. Regulation of Marketing

Required disclosures are a common customer protection. The Commission, in determining whether required disclosures should be mandated in connection with lifting the ban on agricultural trade options, must also determine the nature of the disclosure that is appropriate to this instrument. A second common protection is the requirement that customers be provided with periodic information regarding accounts. Information regarding the value of a customer's position would be useful to customers in guiding them as to the current value of their position and determining the prudence of their future activities.

D. Other Possible Limitations

As the Division noted, a major concern when entering into over-the-counter transactions is the risk of counterparty default. A variety of measures have been used in commerce, and on various occasions required by the Commission, to attempt to ensure that parties to a contract meet their obligations. These include collateral requirements, minimum capital requirements, cover requirements in the form of hedges or cash market inventories, third party guarantees and minimum credit ratings. For example, under the Commission's Part 34 exemption for hybrid instruments, as initially promulgated, the eligibility of hybrid instruments issuers for the exemption was conditioned upon meeting one of four credit-related criteria. These criteria were that the instrument be rated in one of the four highest categories by a nationally recognized investment rating organization, the issuer had at least $100 million in net worth, the issuer maintained letters of credit or cover, consisting of the physical commodity, futures, options or forward contracts for the commodity or interests consisting of acceptable cover, or that the instrument be eligible for insurance by a U.S. government agency or chartered corporation. In contrast, a futures exchange, during the December Roundtable, advocated that parties offering agricultural trade options be required to maintain cover by holding a one-to-one hedge with an exchange-traded contract.[32]

Requiring one-to-one hedging would restrict the flexibility of certain option vendors. For example, offerors with sufficient capital reserves might be in a position more effectively to cover the risk associated with their option contracts in a manner other than by one-to-one hedging.

Generally, the Commission imposes internal controls requirements as a condition of registration. These include the requirement that FCMs provide audited financial statements, have in place a system of internal controls, and supervise the conduct of all employees. The Commission could impose similar requirements on agricultural trade option vendors, with or without mandating their registration. However, in the absence of a registration requirement and a self-regulatory organization to assist in enforcing that requirement, such conditions would be more difficult to mandate and to enforce.

Many country elevators and others at the first-handler level of the marketing chain do not now have in place adequate internal controls to engage in a variety of off-exchange transactions,[33] nor are they subject to a regulatory scheme requiring such controls. Accordingly, a possible condition on those wishing to become vendors of such instruments might be to require that they have in place systems to track changes in the value of their positions and to notify customers periodically of the value of such positions. The adequacy of such systems could be required to be subject to a review by a certified public accountant.

V. Related Issues

The Division's study also touched on a number of issues which have been raised regarding the applicability of other exemptions to agricultural contracts. Those issues relate to forward contracts having option-like payment features and to the applicability of the Commission's exemptions under Part 35 of its rules—for swaps, and Part 36 of its rules—for professional markets. Although the Division's recommendations with respect to these issues are not directly applicable to the Commission's determination whether to lift the prohibition on the enumerated agricultural commodities, and are not the subject of this Advance Notice of Proposed Rulemaking, the Division recommended that the Commission

[32] *See*, December Roundtable, tr. pp. 30, 31, 36, 47, 48 and 78.

[33] *See*, December Roundtable, tr. p. 56.

decide that the prohibition on agricultural trade options does not limit the scope of the Commission's swaps exemption under Part 35 of its rules and that staff update a previous interpretative letter of the Commission's Office of General Counsel.

VI. Issues for Comment

Based upon the Division's study and its recommendation, the Commission is considering whether to lift the prohibition on agricultural trade options subject to conditions. The Division identified an array of possible regulatory conditions for lifting the prohibition, each having differing benefits and costs. The receipt of public comment on these issues, particularly an assessment by commenters of the costs and benefits of the potential regulatory conditions identified by the Division, will assist the Commission in considering whether to lift the prohibition and, if so, what conditions would establish an appropriate regulatory predicate for so doing. Accordingly, the Commission invites commenters to respond to the following specific questions, as well as additional comments they may have on the above analysis.

A. Benefits

1. Are there additional potential benefits of permitting the offer or sale of trade options on the enumerated agricultural commodities that were not identified in the Division's analysis?

2. Who, in addition to first handlers, likely would become vendors of agricultural trade options? Who would likely be purchasers of such instruments? Would they attract commercials who do not currently engage in risk-management practices?

3. Would the availability of agricultural trade options likely result in the introduction of new products, or would such options merely replicate those already available on-exchange?

4. What factors, if any, suggest that there is a demand for agricultural trade options? Has the need for such options changed over the years? If so, in response to what factors?

B. Risks

5. Are there additional potential risks resulting from permitting the offer or sale of trade options on the enumerated agricultural commodities that were not identified in the Division's analysis?

6. How transparent is the pricing of the instruments discussed in response to question No. 3 likely to be?

7. What role can industry or trade groups take in promoting best sales practices? Is some degree of uniformity in instruments necessary or desirable to prevent fraud?

8. What are the likely credit relationships in offering such contracts? Will customers have the bargaining power to address credit issues arising because of the asymmetrical nature of option-related credit exposures?

9. What systems do first-handlers currently have in place to address operational risk? What oversight is there of their operations, and by whom? Are current systems adequate to respond to the demands stemming from offering agricultural trade options? Are there impediments to first-handlers, and others, developing the necessary operational infrastructure?

10. Are there mechanisms in place to contain possible effects to a local or regional economy from the financial failure of a single elevator? Does such a failure, if due to adverse experience in trade options, have a different result or impact than one due to other reasons?

C. Nature of the Parties

11. Should restrictions be placed on who could offer trade options? For example, should vendors be subject to net worth or other financial capacity restrictions? Should vendors of agricultural trade options be registered with the Commission? What if any criteria should be conditions of such registration? If registration is not required, should vendors be required to notify the Commission? Should option vendors be limited to commercial agricultural interests or other types of entities which are subject to a registration requirement or government oversight—such as CFTC registrants, banks or insurance companies?

12. Should the use of trade options be limited to sophisticated users? If so, what criteria are appropriate to determine the sophistication of a party? Would other restrictions on users (such as net worth or other measures of financial capacity) be appropriate? If trade options are not limited to such users, should sophisticated users be exempt from any or all of the trade option requirements? Are parties which meet the eligibility requirements of Parts 35 and 36 of the Commission's rules appropriately defined as sophisticated for this purpose?

13. Are minimum transaction size requirements a practical means of limiting access to trade options? If so, what is an appropriate transaction size in the various commodities that would assure that options are available to only sophisticated participants? Should parties be exempt from transaction size limitations if they can demonstrate sophistication through some other criteria? If so, what substitute criteria would be appropriate?

14. Is an educational requirement appropriate as a condition to enter into a trade option contract for customers and/or vendors? What type of condition would be appropriate with regard to education? Should an option customer be required to demonstrate some level of proficiency with respect to option transactions, and if so, how would proficiency be determined? If trade option vendors were permitted to conduct educational seminars, what restrictions or disclosures might be required of vendors to prevent abuses? What resources for offering such educational opportunities exist or can be made available?

D. Restrictions on the Instruments or Their Use

15. What uses of agricultural trade options should be deemed appropriate? Should restrictions on the use or design of trade options be by regulation? Or should the Commission issue general guidance on this issue?

16. Under what circumstances, if any, should the writing of agricultural options by producers be considered to be an appropriate business-related use of a trade option? More specifically, is it appropriate for producers to write covered calls under the trade option exemption? To what degree, if any, is the writing of options to offset the cost of purchasing an option, appropriate?

17. Should the Commission adopt regulations or provide guidance to restrict trading strategies by option users which result in the increase of risk? What types of trading strategies might be restricted? Should trade option customers be allowed to enter and exit a position multiple times? What means could the Commission use to limit such a trading strategy? What obligations would be appropriate for the Commission to place on trade option vendors with respect to monitoring the appropriateness of the trading activity of their customers?

18. To what extent should option vendors be permitted to bundle options to create risk-return payouts different from a simple put or call option?

E. Regulation of Marketing

19. What types of risk disclosure should be required of vendors as related to the offer and sale of trade options? Should such disclosure be through a mandated uniform risk-disclosure statement? What information should be required to be disclosed?

20. What types of information and at what intervals should vendors be required to notify a customer with

respect to the financial status of a trade option position? What form should trade confirmation take?

F. Cover Requirements

21. Should the Commission compel counterparties to cover market risks, or should the issue of providing cover be left to negotiation between the counterparties? Should parties be permitted to waive the right to have a counterparty provide some sort of cover or guarantee?

22. If cover is required, should parties be allowed to combine different forms of cover—*i.e.,* collateral, hedging, minimum capital, guarantees, etc.—to satisfy the requirement?

23. Should cover be required on the vendor's gross or net trade option position? Should parties be allowed to offset their exposure on a trade option position against other non-trade option positions within the operation? At what level of a multi-enterprise firm should the firm be allowed to net their trade option exposure?

24. If the customer has a short option position, should the vendor have an obligation to ascertain whether the customer has adequately covered the position?

25. If parties are required to provide cover in the form of a one-to-one offsetting position in an exchange-traded option, what would constitute a ''one-to-one'' offset? That is, for trade option transactions occurring at fractional sizes of exchange contracts, would parties be required to round a position up or down? Would individual trade options be required to be offset individually, or could the overall position of the seller be hedged? How would trade options be covered for those enumerated commodities which are no longer actively traded on an exchange? What type of accounting procedure should be required to match trade options to offsetting exchange contracts?

26. In setting a minimum capital requirement in lieu of or in combination with various forms of cover, how should the overall level of market price risk be determined, and what level of capital would be deemed sufficient to cover the risk?

27. Should third-party guarantees be permitted as a form of cover? If so, what forms and what level of guarantee would be appropriate as cover for a trade option position? Should the total potential exposure on a trade option position be guaranteed? Who are appropriate parties to supply a guarantee?

G. Internal Controls

28. At a minimum, what types of internal controls should an option vendor have in place?

29. What is the most cost effective means to assure that vendors implement the minimum level of internal controls? What regulatory oversight mechanisms are necessary and in place? Should vendors be audited to assure compliance, or is a review by a certified public accountant sufficient?

30. Overall, in light of the above questions, should the Commission lift the prohibition on trade options on the enumerated agricultural commodities?

Issued in Washington, DC, this 3rd day of June, 1997, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 97–14890 Filed 6–6–97; 8:45 am]

BILLING CODE 6351–01–P

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR Parts 10, 123, 128, 141, 143, 145 and 148

RIN 1515–AC11

Increase of Maximum Amount for Informal Entries to $2000

AGENCY: Customs Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: Under the current Customs Regulations, shipments of merchandise generally must be valued at $1,250 or less in order to qualify for informal entry procedures. This regulatory value limit reflects the previous statutory maximum that the Secretary of the Treasury could establish by regulation under 19 U.S.C. 1498(a)(1) prior to its amendment by section 662 of the North American Free Trade Agreement Implementation Act which raised the statutory maximum to $2,500. As a consequence of this increase in the statutory maximum, and consistent with the regulatory discretion conferred by the statute to establish a level within that limit, Customs proposes in this document to amend the Customs Regulations to increase the informal entry value limit to $2,000.

DATES: Comments must be received on or before August 8, 1997.

ADDRESSES: Written comments (preferably in triplicate) may be addressed to the Regulations Branch, U.S. Customs Service, Franklin Court, 1301 Constitution Avenue, N.W., Washington, D.C. 20229. Comments submitted may be inspected at the Regulations Branch, Office of Regulations and Rulings, Franklin Court, 1099 14th Street, N.W., Suite 4000, Washington, D.C.

FOR FURTHER INFORMATION CONTACT: Operational Aspects: Linda Walfish, Office of Field Operations (202–927–0042).

Legal Aspects: Jerry Laderberg, Office of Regulations and Rulings (202–482–6940).

SUPPLEMENTARY INFORMATION:

Background

All merchandise imported into the customs territory of the United States is subject to entry and clearance procedures. Section 484(a), Tariff Act of 1930, as amended (19 U.S.C. 1484(a)), provides that the ''importer of record'' or his authorized agent shall: (1) Make entry for imported merchandise by filing such documentation or information as is necessary to enable Customs to determine whether the merchandise may be released from Customs custody; and (2) complete the entry by filing with Customs the declared value, classification and rate of duty applicable to the merchandise and such other documentation or other information as is necessary to enable Customs to properly assess duties on the merchandise and collect accurate statistics with respect to the merchandise and determine whether any other applicable requirement of law is met. Part 142, Customs Regulations (19 CFR Part 142), implements section 484 and prescribes procedures applicable to most Customs entry transactions. These procedures are referred to as formal entry procedures and generally involve the completion and filing of one or more Customs forms (such as Customs Form 7501, Entry/Entry Summary, which contains detailed information regarding the import transaction) as well as the filing of commercial documents pertaining to the transaction.

As originally enacted, section 498, Tariff Act of 1930 (subsequently codified at 19 U.S.C. 1498), authorized the Secretary of the Treasury to prescribe rules and regulations for the declaration and entry of, among other things, imported merchandise when the aggregate value of the shipment did not exceed such amount, but not greater than $250, as the Secretary shall specify in the regulations. Regulations implementing this aspect of section 498 are contained in Subpart C of Part 143, Customs Regulations (19 CFR Part 143) which is entitled ''Informal Entry''. The informal entry procedures set forth in Subpart C of Part 143 are less