

CFTC Letter No. 00-101**November 7, 2000****No-Action****Division of Trading & Markets**

Ms. Audrey R. Hirschfeld
Senior Vice President
General Counsel
New York Board of Trade
Four World Trade Center
New York, NY 10048

Re: Minimum Financial Requirements for Registrants

Dear Ms. Hirschfeld:

This is in response to your letter dated August 14, 2000, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"). You requested, on behalf of Cantor Financial Futures Exchange, Inc. ("CX"), that the Division not recommend that the Commission commence any enforcement action against a futures commission merchant or introducing broker (hereinafter collectively referred to as "Registrant") for a failure to comply with Section 4f(b) of the Commodity Exchange Act ("Act") and Commission Regulation 1.17(c)(5)(x), if the Registrant, in computing adjusted net capital, does not take full capital charge on certain non-CX futures contracts included in inter-exchange spread transactions and held in the Registrant's proprietary trading account.¹

Commission Regulation 1.17 sets forth minimum capital requirements for Registrants. Regulation 1.17(c)(5)(x) requires a Registrant, in computing its adjusted net capital, to take a capital charge on all open proprietary futures and short option positions that are not "covered".² The capital charge to be taken by a Registrant that is a member of the clearing organization that clears the futures or option contract is the applicable margin requirement of such clearing organization. For a Registrant that is a member of a self-regulatory organization, but not a clearing member of the exchange that lists the futures or option contract, the capital charge is equal to 150 percent of the maintenance margin requirement of the applicable exchange or clearing organization, whichever is greater.

CX has been designated by the Commission as a contract market in futures contracts on 30-year U.S. Treasury bonds and 10-year, 5-year, and 2-year U.S. Treasury notes ("hereinafter collectively referred to

as "U.S. Treasury futures"). CX has also been designated a contract market in futures contracts on 10-year and 5-year notes issued by Fannie Mae and Freddie Mac (hereinafter referred to as "Agency Note futures"). The CX futures contracts are cleared by the New York Clearing Corporation ("NYCC").

You represent that other designated contract markets currently list futures contracts with substantially similar terms and conditions as the CX U.S. Treasury futures and the CX Agency Note futures contracts. Contract markets often provide for reduced margin requirements on futures contracts that they list that are included in inter-exchange spread transactions when the total economic risk posed by the spread transaction is less than the total economic risk posed by the individual contracts that comprise the spread. In this regard, CX provides for reduced margin requirements on CX U.S. Treasury futures or CX Agency Note futures that are part of certain CX-recognized inter-exchange spread transactions.³

Not all contract markets, however, provide margin relief for inter-exchange spread positions involving CX futures contracts. Therefore, Registrants that hold in their proprietary trading accounts inter-exchange spreads involving CX U.S. Treasury futures contracts or CX Agency Note futures contracts and non-CX futures contracts that have substantially similar terms and conditions as the CX futures contracts may currently be required to take capital charges on the non-CX positions that do not recognize the risk reduced nature of the inter-market spread position.

Based upon the foregoing, the Division will not recommend that the Commission initiate enforcement action against a Registrant based solely upon Section 4f(b) of the Act and Commission Regulation 1.17(c)(5)(x) if, in computing its adjusted net capital, the Registrant does not take full capital charges on non-CX futures positions that are part of an inter-exchange spread transaction involving CX U.S. Treasury or CX Agency Note futures contracts, provided the following conditions are met.

- There must be a one-to-one ratio of CX futures contracts to non-CX futures contracts included in the spread transaction.
- CX must recognize the reduced risk of the inter-exchange spread transaction by requiring lower margin on the CX contracts included in the spread transaction than it requires on such CX contracts when they are not part of an inter-exchange spread transaction.
- The CX and non-CX futures contracts that comprise the spread transaction must be based on the same underlying financial instrument and the terms and conditions of the futures contracts must be substantially similar. For example, a CX U.S. Treasury bond futures contract that was spread against a 10-year U.S. Treasury note futures contract would not be eligible for this relief.
- The total capital charge on the inter-exchange spread transaction will be computed as set forth below.

1. For Registrants that clear both the CX and the non-CX contracts directly at their respective clearing organizations, the capital charge shall be the greater of: (i) two times the margin imposed by the CX clearing organization; or (ii) the margin for outright positions imposed by the non-CX clearing organization.
2. For Registrants that do not clear either the CX or the non-CX contracts, the capital charge shall be the greater of: (i) two times 150 percent of the margin imposed by CX or the CX clearing organization, whichever is greater; or (ii) 150 percent of the margin for outright positions imposed by the non-CX exchange or clearing organization, whichever is greater.
3. For Registrants that clear the CX contracts directly and do not clear the non-CX contracts, the capital charge shall be the greater of: (i) two times the margin imposed by the CX clearing organization; or (ii) 150 percent of the margin for outright positions imposed by the non-CX exchange or clearing organization, whichever is greater.
4. For Registrants that do not clear CX contracts and do clear non-CX contracts, the capital charge shall be the greater of: (i) two times 150 percent of the margin imposed by CX or the CX clearing organization; or (ii) the margin for outright positions imposed by the non-CX clearing organization, whichever is greater.

Because this position is based upon facts and representations contained in your letter, it should be noted that any different, omitted, or changed facts or conditions might require a different conclusion. This letter represents the views of the Division only and does not necessarily represent the views of the Commission or any other office or division of the Commission. If you have any questions concerning this correspondence, please contact Thomas J. Smith, Special Counsel, at (202) 418-5495.

Very truly yours,

John C. Lawton
Acting Director

cc: Barbara Lorenzen, Chairman, Joint Audit Committee

1 The Act may be found at 7 U.S.C. §1 *et seq.* (1994). Commission regulations cited herein may be

found at 17 C.F.R. Ch. 1. (2000).

2 "Cover" is generally defined by Regulation 1.17(j) as transactions or positions in a contract for future delivery on a board of trade or commodity option where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel.

3 For example, the speculative initial and speculative maintenance margins for a 6% U.S. Treasury Bond futures contract are currently \$1,796 and \$1,350, respectively, while the margin on CX U.S. Treasury Bond futures that are part of a CX approved inter-exchange spread transaction is \$330 per contract.