

**CFTC letter No. 02-112**

**November 20, 2002**

**Interpretation**

**Division of Clearing and Intermediary Oversight**

Re: Regulation 1.3(k) and 1.3(y) -- Request for Interpretation in Connection with the Definitions of Customer and Proprietary Account

Dear :

This is in response to your letter dated October 29, 2002, to the Division of Clearing and Intermediary Oversight (the "Division") of the Commodity Futures Trading Commission ("Commission"), in which you request that the Division concur with your assessment that the account of "X" registered futures commission merchant ("FCM"), carried on the books and records of "Y", also a registered FCM, is not a proprietary account and should be carried as a customer account under the Commodity Exchange Act<sup>[1]</sup> and the Commission rules thereunder.

Based upon your representations, we understand the relevant facts to be as follows. "Y" is a full-service FCM. "X" has no customers and is engaged solely in trading for its own account. "X" is currently wholly-owned by "Y". "Y" is proposing to be purchased by two entities owned by the adult, independent, children of the current co-managing members of "Y". As a result of this proposal, neither "Y" nor the current co-managing members of "Y" would own "X". "X" would be wholly-owned and operated by independent third parties. "Y" would continue to carry the trading account of "X". Instead of charging "X" round-turn commissions on trading for its account, "Y" is proposing to enter into an arrangement by which it will receive a share of the net profits of "X".

Commission Rule 1.3(k)<sup>[2]</sup> provides that a "owner or holder of a proprietary account as defined in [Rule 1.3(y)] shall not be deemed to be a customer within section 4d of the Act." The funds held for a proprietary account, therefore, are not customer funds and not subject to, among other things, the segregation requirements of the Act and Commission rules.<sup>[3]</sup> A proprietary account, as defined in Rule 1.3(y), includes, among other things, an account owned ten percent or more by the FCM on whose books the account is carried or by a general, limited, or special partner of the FCM, an officer, director, or owner of ten percent of the FCM, or a business affiliate that directly or indirectly is controlled by or is under common control with the FCM.

While "Y" will receive a portion of "X's" profits as commission for "X's" trading, "Y" will not be an owner of the "X" account or an owner of "X". Generally, to be a business affiliate requires some commonality of ownership. Accordingly, the Division concurs with your assessment that "X's" account would not fall within the definition of a proprietary account and should be carried on the books and records of "Y" as a customer account, subject to the sections of the Act and Commission rules applicable to such accounts.

The position taken herein is based upon the representations that have been made to the Division. Any different, changed, or omitted facts or conditions might require the Division to reach a different conclusion. You must notify the Division immediately in the event the operations or activities of “Y” or “X” change in any material way from those represented to us. Further, this letter represents the position of this Division only and does not necessarily represent the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact Michael A. Piracci, an attorney on my staff, at (202) 418-5430.

Very truly yours,

Lawrence B. Patent  
Deputy Director  
Compliance and Registration

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<sup>[1]</sup> 7 U.S.C. § 1 *et seq.* (2000).

<sup>[2]</sup> Commission rules referred to herein are found at 17 C.F.R. Ch. I (2002).

<sup>[3]</sup> *See, e.g.,* Commission Rule 1.20.