



DIVISION OF
TRADING AND MARKETS

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, NW, Washington, DC 20581
(202) 254 - 8955
(202) 254 - 8010 Facsimile

March 9, 1993

93-15

Re: Request for Exemption from Rule 3.1

Dear :

This is in response to your letter dated February 9, 1993, in which you request that the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") grant an exemption to the "Company", a registered introducing broker ("IB") regarding the listing of "X" as a principal of the Company.

Based upon the representations made in your letter, as supplemented, we understand the relevant facts to be as follows. As noted above, the Company is a registered IB. In September, 1989, the Company entered into a subordinated loan agreement with X, effective July, 1989, whereby the Company loaned X \$75,000 (the "Agreement"). In June, 1989, the Company had entered into an Investment Banking Contract (the "Contract") with X and X's company. You represent that the Company and X had agreed that the Company's fees resulting from its services performed under the Contract would serve to offset the \$75,000 subordinated note held by X.

You represent that the Company currently has more than \$400,000 in equity capital and that X and X's company have incurred more than \$35,000 in fees under the Investment Banking Contract. Accordingly, you state that the Company's debt to X should be reduced to approximately \$40,000, thus leaving X with less than a ten percent interest in the Company. You state, however, that X has contested the fees accrued under the Contract and, consequently, the Company's books reflect the full \$75,000 debt originally owed to X, which amount represents more than ten percent of the Company's capital.

The National Futures Association has requested that the Company list X as a principal on the Company's Form 7-R and file a Form 8-R and fingerprint card for X. You represent that: (1) the Company believes that it does not owe X more than approximately \$40,000 and thus does not believe that X is a "principal" of the Company; and (2) in any event, the Company has attempted to comply with NFA's request but X refuses to cooperate.^{1/}

^{1/} We note that Division staff attempted to contact X to obtain additional information but were unsuccessful in this effort.

Accordingly, you request that the Division grant the Company relief for a period of one year from the requirement that it list X as a principal. You state that you believe that the controversy surrounding the amount owed to X should be resolved by this time and that, in any event, the subordinated note will have matured, thus making the issues presented herein moot.

Commission Rule 3.1(a)(3), as amended^{2/} includes in the definition of the term "principal," among other persons, any person who has contributed ten percent or more of the capital of a registrant. The rule clarifies that the above provision applies generally to a person who contributes capital by means of subordinated debt, except where such person is one of several specified highly regulated institutions.^{3/}

We are concerned that a registrant clearly identify persons who may have a significant impact on the operations of a registrant, whether it be through stock ownership or assistance in meeting regulatory capital requirements through subordinated loans. A registrant whose stockholders, officers and directors cannot contribute sufficient regulatory capital from their own funds is effectively subject to the control of persons who do provide such capital -- including subordinated lenders.

It appears that X should have been listed as a principal of the Company when the Agreement was executed in September of 1989. At that time the Company presumably would have been in a favorable position to obtain all necessary papers and signatures from X. Based, however, on the current facts viewed in a light most favorable to the Company, the Company's subordinated debt to X no longer represents ten percent or more of the Company's total capital.^{4/}

^{2/} The amended rule is found at 57 Fed. Reg. 23136, 23144 (June 2, 1992).

^{3/} Specifically, the rule excludes from the definition of the term "principal" "those contributors of subordinated debt that are FDIC-insured banks, U.S. branches of unaffiliated foreign banks subject to U.S. regulation, and insurance companies regulated under federal or state law, except where such institutions 'control' the registrant or applicant in a manner that would otherwise bring them within the definition of the term 'principal' under Rule 3.1(a)(1) or (a)(2)." 57 Fed. Reg. at 23139.

^{4/} The Division has noted that a registrant may make a change in its list of principals on file with the NFA if, at the time of the registrant's annual update of registration data, a lender's financial interest in the registrant is no longer at the ten percent or more level and it is unlikely to return to that level. See Division of Trading and Markets Interpretative Letter No. 92-

Based on the foregoing, the Division will not recommend that the Commission take any enforcement action against the Company under Commission Rule 3.10(a)(2)^{5/} if the Company now fails to list X as a principal on the Company's Form 7-R, and file a Form 8-R and fingerprint card on X's behalf. Specifically, we note that (1) X is no longer required to be listed as a principal of the Company if the facts are viewed most favorably to the Company; (2) you represent that the Company has attempted to comply with NFA's request to list X as a principal but has been unable to obtain X's cooperation in this endeavor; (3) Division staff have been unsuccessful in their efforts to contact X for additional information; and (4) the Agreement matures on October 31, 1993. The position taken herein is applicable on a prospective basis only with respect to listing X as a principal of the Company and is effective only through October 31, 1993. It is not intended to cover any period of time when X maintained or maintains a ten percent or greater interest in the Company, nor is it intended to cover any time period after the maturity date of the Agreement.

This letter is based on the representations you have made to us and is strictly limited to the facts stated above. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In this regard, we request that you notify us immediately in the event these facts change in any way from those represented to us. Finally, this letter represents the position of the Division of Trading and Markets only. It does not necessarily reflect the views of the Commission or any other office or division of the Commission.

If you have any questions regarding this letter, please contact me or Lawrence Eckert, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel

17, [1990-92 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,514 (October 8, 1992).

^{5/} 57 Fed. Reg. 23136, 23144 (June 2, 1992).