



COMMODITY FUTURES TRADING COMMISSION

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DIVISION OF  
TRADING AND MARKETS

95-47

April 26, 1995

Re: Request for Relief Pursuant to Rule 1.3(y)

Dear :

This is in response to your letter dated February 10, 1995, as supplemented by telephone conversations with Division staff, in which you request on behalf of "X", a registered futures commission merchant ("FCM"), and "Y", that the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") provide no-action relief to "X" such that "X" may classify the accounts of the members of "X" and "Y's" Boards of Directors (the "Directors") as customer accounts rather than as proprietary accounts as defined in Commission Rule 1.3(y).<sup>1/</sup>

Based upon the representations made in your letter, as supplemented, we understand the relevant facts to be as follows. "X" is a wholly-owned subsidiary of "Y". "Y" has fourteen Directors. These Directors serve a term of three years and are eligible for re-election thereafter. "Y" currently has 55,000 patrons. "X" has six Directors consisting of three "Y" Directors and three "Y" employees. "X's" Directors serve a term of one year and are eligible for re-election. "X" has approximately 1,200 patrons. Directors of "X" and "Y" are often customers of "X" prior to their board membership who continue their customer relationship with "X" after their terms expire.

"X" currently is carrying the trading accounts of six "Y" Directors. The accounts are traded by the six individual Directors solely for hedging purposes. Currently, the accounts contain no open futures or options on futures positions and only two of the six accounts have cash balances. Additionally, trading volume of the accounts has historically been very low, having traded a total of twenty-five grain futures contracts and six options on grain futures contracts in the last two years.

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<sup>1/</sup> Commission rules referred to herein are found at 17 C.F.R. Ch. I (1994).

Classification of a trading account as either a customer account or a proprietary account has implications in five areas: (1) segregation; (2) minimum financial requirements or minimum capital; (3) registration; (4) recordkeeping; and (5) bankruptcy.<sup>2/</sup> Generally, in each of these areas, certain benefits and protections are afforded to customer accounts which are not afforded to proprietary accounts. Therefore, if a particular account is classified as a customer account rather than as a proprietary account, the owners of such an account will receive the benefits and protections which result from the customer classification.

In the instant case, classifying the accounts of the Directors of "X" and "Y" as customer accounts rather than as proprietary accounts would have the most significant effect in the event of a bankruptcy of "X", because "X" is already registered with the Commission and the customer classification would serve to enhance segregation and capital requirements. The Commission's bankruptcy rules give customer accounts a preference over accounts which would be classified as proprietary in the event of a distribution following the filing of a petition in bankruptcy by or against an FCM. An improper classification of a proprietary account as a customer account might dilute the protections afforded to other customers should a bankruptcy of the FCM occur. However, given the facts and representations as set forth above, the Division believes that it would not be inconsistent with the purpose and intent of Rule 1.3(y) to grant the relief you have requested, upon the conditions specified below. Specifically, we note: (1) the apparent low volume of trading activity which occurs in the Directors' accounts; (2) the small number of Director accounts compared to the total number of patrons of "X" and "Y"; (3) the often short-term nature of a Director's tenure; and (4) the fact that the Directors generally are long-standing customers of "Y" and "X" who continue their customer relationships following the expiration of their terms as Directors. Accordingly, subject to the conditions specified herein, the Division will not recommend that the Commission take any enforcement action against "X" based solely on "X's" classification of the accounts of "Y's" and "X's" Directors as customer accounts rather than as proprietary accounts pursuant to Rule 1.3(y).<sup>3/</sup>

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<sup>2/</sup> The Commission's bankruptcy rules contain definitions of "customer," "public customer" and "non-public customer" which are derived from the distinction between customer and proprietary accounts in Commission Rules 1.3(k) and 1.3(y). See 17 C.F.R. §190.01(k), (bb) and (hh) (1994).

<sup>3/</sup> See CFTC Interpretative Letter No. 87-2, [1987-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,652 (June 8, 1987) (proper (continued...))

This position is based upon the conditions that: (1) the Directors do not participate in or supervise trading for "X" or "Y"; and (2) the Division receives, within thirty days from the date of this letter, a written acknowledgement whereby each Director agrees that, in the event that "X" is placed in receivership or bankruptcy, any claim made by a Director with respect to funds deposited in accounts carried by "X" will be subordinated to the claims of other customers as if such accounts were treated as proprietary accounts pursuant to Rule 1.3(y). Further, any new Director must submit such an acknowledgment within thirty days from the date such Director's term begins, should the Director wish to maintain the customer account classification.

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

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3/ (...continued)

classification of accounts owned by officers or employees of affiliated companies should be determined on a case-by-case basis); CFTC Interpretative Letter No. 85-2, [1984-86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,491 (February 8, 1985) (no-action position taken with respect to an FCM's classification of a pool's trading account as a customer account where participants in the pool included non-supervisory associated persons and clerical personnel of the company).