96-86

U.S. COMMODITY FUTURES TRADING COMMISSION

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DIVISION OF
TRADING & MARKETS

COMMODITY FUTURES TRADING COMMISSION RECEIVED FOR PUBLIC RECORD
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November 25, 1996

Re: Account Classification -- Request for Relief from Rule 1.3(y)

Dear :

This is in response to your letter dated July 31, 1996, to the Division of Trading and Markets ("Division"), as supplemented by facsimile transmissions received September 30 and November 13, 1996 and telephone conversations with Division staff, in which you request on behalf of "V", a registered futures commission merchant ("FCM"), that the Division provide relief to "V" such that "V" may continue to treat the account of "W" as a customer account for the purposes of Section 4d(2) of the Commodity Exchange Act ("Act")[1/] and rules promulgated thereunder, rather than being required to reclassify the account as a proprietary account.[2/]

Based upon the representations made in your letter, as supplemented, we understand the relevant facts to be as follows. "V" executes and clears commodity interest trades on behalf of "W", a Mexican entity and banking subsidiary of "X", a Mexican holding company, and has been doing so since June 22, 1995. Effective March 29, 1996, "Y", "V's" ultimate parent company,[3/] purchased a 16 percent equity interest and a 20 percent voting interest in "X" when it acquired approximately 951 million

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1/ 7 U.S.C. §6d(2)(1994).

2/ Commission Rules 1.3(y), 1.20-1.30, 1.32 and 1.36. See also Commission Rule 1.17, which defines certain accounts classified as proprietary under Commission Rule 1.3(y) as "noncustomer accounts" for purposes of Rule 1.17 since they are not owned by the FCM itself or general partners of the FCM. Commission rules referred to in this letter are found at 17 C.F.R. Ch. I (1996).

3/ "V" is a wholly-owned subsidiary of "Z" which is in turn a wholly-owned subsidiary of "Y".

shares of Series B voting common stock of "X".[4/] You represent that "Y" is prohibited from acquiring more than 20 percent of "X's" voting stock under Mexican law.

In further support of your request, you represent that none of "W's" trading is funded or handled, either through the process of offering trading advice and decisions or through operational processing, by "Y" or its employees. You further represent that "V" does not hold customer segregated funds at "X", "W" or any other subsidiary of "X". "V" would notify the Commission prior to establishing a relationship to hold customer segregated funds at "X", "W" or any other subsidiary of "X" and prior to offering any services with respect to "W's" trading activities.

Commission Rule 1.3(y) defines the term "proprietary account." Rule 1.3(y)(2)(viii)[5/] includes in this definition the commodity trading account of "a business affiliate that, directly or indirectly, is controlled by or is under common control with" the futures commission merchant carrying such account. "V" does not have a direct interest in "W". However, "Y's" acquisition of the interest in "X", mentioned above, arguably placed "V" and "W" under common control. In this regard, you state that "X's" Series A common stock is available for purchase only by Mexican nationals and that controlling shares are limited to Series A shares.

Determining whether an FCM and a party whose account is carried by the FCM are under common control may require case-by-case analysis. Although, as you point out, classification of an account as a customer account is advantageous to the owners of the particular account, the Division must also be concerned that protections afforded to other customers are not diluted by improper account classification. Under circumstances somewhat similar to those you present (involving classification of accounts owned by officers or employees of affiliated companies), the Division has indicated that factors to be considered in classifying an account may include whether an FCM's holding

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4/ "Y" staff hold eight of forty-four seats on "X's" and "W's" Board of Directors.

5/ We note that your letter refers to Rule 1.3(y)(2)(iv) as a provision which might require "V" to reclassify the account of "W" from customer to proprietary (or to noncustomer for purposes of Rule 1.17). This provision requires the classification as proprietary of an account of, among others, an owner of ten percent or more of the capital stock of a corporate FCM. As "W" does not appear to own any interest in "V", Rule 1.3(y)(2)(iv) appears inapplicable on the facts you present.

company has a majority or minority ownership interest in the affiliated entity and whether that entity is operating as a securities broker-dealer or is otherwise engaged in financial services.[6/] In this case "V" and "W", "V's" ultimate parent has only a minority ownership interest in "W's" parent and although "W" provides financial services as a bank, it does not operate as a securities broker-dealer or FCM.[7/] Moreover, "Y" is precluded from obtaining a controlling interest in "X", as Series A shares cannot be acquired by "Y" as a matter of law.

Based upon the foregoing, the Division will not recommend that the Commission take any enforcement action against "V" based solely upon its classification of the account of "W" as a customer account rather than as a proprietary account pursuant to Rule 1.3(y). This letter is based upon 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 that these facts change in any way from those represented to us, particularly with respect to any intention to hold customer segregated funds at "X", "W", or any subsidiary of "X". 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.

6/ See CFTC Interpretative Letter No. 87-2, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,652 (June 8, 1987).

7/ See also 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 owners of 20 percent of participation interests in the pool were non-supervisory associated persons and clerical personnel of the company).

Although "W" does not operate as a securities broker-dealer, it has a sister corporation that owns a firm registered as a securities broker-dealer under U.S. law.

If you have any questions regarding this letter, please contact me or Lawrence Eckert, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel