

CFTC Letter No. 97-74**August 25, 1997****Division of Trading & Markets**

Re: Rule 3.10 -- Regulatory Requirements For Forming an FCM or IB

Dear :

This is in response to your letter dated July 29, 1997 to the Commodity Futures Trading Commission (the "Commission"), which has been referred to the Division of Trading and Markets (the "Division") for reply. By your correspondence, as supplemented by telephone conversations with Division staff, you inquire generally about the regulatory requirements under the Commodity Exchange Act (the "Act")¹ for forming a futures commission merchant ("FCM")² or introducing broker ("IB")³. You also inquire about the applicability of the FCM registration requirements for the "Bank", as further described below.

With regard to the general issue of forming an FCM or IB, Rule 3.10⁴ requires that applicants for registration as an FCM or IB complete and submit a Form 7-R and a certified financial report (using Form 1-FR-FCM or 1-FR-IB, respectively) together with the appropriate registration fee, to the National Futures Association ("NFA"), an industry-wide self-regulatory organization.⁵ In addition, each Form 7-R must be accompanied by a Form 8-R completed by each natural person who is a principal⁶ of the applicant together with the fingerprints of that principal on a fingerprint card provided by NFA. A firm applying for registration as an FCM or IB must also submit a Form 8-R and fingerprint card for each individual salesperson or supervisor of salespersons. Such persons are known as "associated persons" or "APs" and, unlike principals, must show proof of having taken and passed the National Commodity Futures Examination (the "Series 3 Exam.")⁷

The Act also requires that registrants attend ethics training periodically to ensure that registrants understand their responsibilities under the Act. Rule 3.34 implements the statutory mandate and requires that an individual registered as an FCM, IB or AP attend a four-hour ethics training session within six months of becoming registered and thereafter attend a one-hour session every three years. The initial training requirement can also be satisfied by attending a four-hour session within six months prior to filing of an application for registration.

Although nothing in the Act or Commission rules prohibits a bank from registering as an FCM or

IB, because of minimum financial requirements as well as restrictions imposed by banking regulators, banking enterprises generally employ a subsidiary or other affiliate to act as an FCM or IB. We further note that if the Bank deals with U.S. customers only with respect to trading of futures and options on exchanges outside of the U.S., you should review the applicability of Part 30 of the Commission's rules governing foreign futures and options trading.

We trust that the foregoing information will be helpful. If you have any further questions, please feel free to contact me or Monica S. Amparo, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin

Acting Director

¹ 7 U.S.C. § 1 *et seq.* (1994).

² An FCM is defined as "an individual, association, partnership, corporation or trust that (A) is engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market; and (B) in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom." 7 U.S.C. § 1a(12) (1994).

³ An IB is defined as "any person (except an individual who elects to be and is registered as an associated person of a futures commission merchant) engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market who does not accept any money, securities or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom." 7 U.S.C. § 1a(14).

⁴ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1997).

⁵ We understand that you have already contacted NFA for FCM and IB registration material.

⁶ Rule 3.1 defines "principal" to include a general partner, officer, director, branch office manager, or other person performing similar functions having the power, directly or indirectly, to exercise a controlling influence over the activities of the entity. In addition, a principal includes a holder or beneficial owner of ten percent or more of the outstanding shares of any class of stock or any person who has contributed ten percent or more of the capital of the entity.

⁷ A person can be both a principal and an AP, in which case only one Form 8-R and fingerprint card

must be filed, in addition to proof of passing the Series 3 Exam.