U.S. COMMODITY FUTURES TRADING COMMISSION
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46-53

DIVISION OF
TRADING & MARKETS

December 4, 1996

Re: Request for Relief from the Clearing Requirement of Rule 1.57(a)(1)

Dear :

This is in response to your letter to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") dated October 14, 1996, as supplemented by letters dated October 21, 1996 and October 22, 1996 and telephone conversations with Division staff. You request on behalf of "X", a guaranteed introducing broker ("IB") of "Y", a registered futures commission merchant ("FCM"), relief permitting "Y" to provide execution but not clearing services for certain customers introduced by "X".

Based upon the representations made in your letter, as supplemented, we understand the pertinent facts to be as follows. "X", as an IB of "Y", introduces the following institutional customers to "Y": registered FCMs, domestic and foreign banks, insurance companies, Fortune 1000 corporations, investment advisers and investment companies. Several of these customers have requested that "X" do "give-up" business with them. Although "Y" would be providing execution services for these customers, it would not be clearing such trades.

In support of your request, you represent that, in connection with the "give-up" trades in commodity interest contracts for these institutional customers, "X" will limit to $2 million the amount of money, securities, or property (or credit extended in lieu thereof) required by FCMs other than "Y" from these institutional customers to margin the "give-up" trades. You further represent that, notwithstanding that certain of "X's" customers will elect to have their transactions cleared by FCMs other than "Y", "X" has a business relationship only with "Y" and receives no compensation from other FCMs through which the transactions are cleared. In addition, "Y" is substantially capitalized and will have sufficient adjusted net capital to meet any obligations it may have to "X's" customers, without regard to whether those customer accounts are carried by "Y". Specifically, "Y" represents that, as of September 30, 1996, it had

adjusted net capital of approximately $43 million and excess net capital of $20.5 million.[1/] Further, "Y" reaffirms that, as provided in the Guarantee Agreement it executed with "X", it accepts joint and several liability for all obligations of "X" under the Commodity Exchange Act ("Act")[2/] and the regulations promulgated thereunder "with respect to the solicitations of, and transactions involving, all customer transactions of "X"."

As you may know, Rule 1.57(a)(1) provides, in pertinent part, that an IB that has entered into a guarantee agreement with an FCM must open and carry customer accounts with such guarantor FCM on a fully-disclosed basis. In order to protect the IB's customers, the FCM that has entered into the guarantee agreement with the IB must carry all of the customer accounts introduced by the IB.[3/]

Based upon our evaluation of the information provided in your letter, as supplemented, we believe that granting your request would not be contrary to the "customer protection" objective of Rule 1.57(a)(1).[4/] This opinion is based principally upon your representations as to the $2 million limit in margin funds related to the "give-up" trades, the substantial capital held by "Y" and the purpose of the requested relief, which is to comply with the requests of certain institutional customers that their trades be cleared by FCMs other than "Y".

Accordingly, based upon the above representations, the Division will not recommend that the Commission take any enforcement action under Rule 1.57(a)(1) against "X" or "Y" if "X" introduces to "Y" certain institutional customers who employ "Y's" execution services but choose to clear their transactions with other FCMs. The no-action position taken in this letter does not affect any other duties or responsibilities of "X" or "Y".

1/ If "Y" itself cleared the "give-up" trades, its minimum adjusted net capital requirement would increase by a maximum of $80,000 (i.e., 4 percent of $2 million), assuming the margin it required from the institutional customers for the "give-up" trades did not exceed the amount assessed by the FCMs clearing such trades.

2/ 7 U.S.C. § 1 et seq. (1994).

3/ See 57 Fed. Reg. 23136 at 23137 (June 2, 1992).

4/ See, e.g., CFTC Interpretative Letter No. 96-7, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,609 (December 18, 1995).

The position taken herein is based upon the representations that have been made to us. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In this regard, we request that you notify us immediately in the event the operations and activities of "X" or "Y" change in any way from those as represented to us. Finally, this letter represents the position of this Division only. It does not necessarily reflect the views of the Commission or of any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact me or Natalie A. Markman, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel