U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5438
Facsimile: (202) 418-5547
jcarley@cftc.gov

Division of Clearing and
Intermediary Oversight

James L. Carley
Director

CFTC letter No. 05-14
July 25, 2005
No-Action
Division of Clearing and Intermediary Oversight

Re: No-Action Relief from Commission Rules 1.14 and 1.15

Dear :

This is in response to your letter dated March 8, 2005, to the Division of Clearing and Intermediary Oversight ("Division") of the Commodity Futures Trading Commission ("Commission"). By your correspondence, you request that "X" not be required to comply with certain risk assessment reporting and recordkeeping requirements set forth in Commission Rules 1.14 and 1.15.[1]

Based upon your representations, we understand the facts to be as follows. "X" is a wholly-owned subsidiary of "Y". "X" is registered with the Commission as a futures commission merchant ("FCM"), and with the Securities and Exchange Commission ("SEC") as a broker-dealer ("BD"). "X" is also registered as an investment advisor under the Investment Advisors Act of 1940. "X" sells foreign securities on an agency basis to U.S. institutional customers that clear through its Paris affiliate. "X" also participates in private placement and advisory activities and engages in proprietary matched book transactions using repurchase and reverse repurchase agreements collateralized by U.S. government securities. "X" currently does not engage in any futures activities on behalf of customers or on a proprietary basis.

Rules 1.14 and 1.15 set forth certain risk assessment recordkeeping and reporting requirements, respectively, for FCMs, which permit the Commission to obtain information concerning activities of FCM affiliates that could pose material risks to the FCM. The Commission adopted these rules in response to the failures of certain FCMs operating within holding company structures.[2] Specifically, Rule 1.14 requires an FCM to maintain and preserve certain records and information regarding, among other things, the organizational structure of which the FCM is a part, and the FCM's policies and systems for: (i) monitoring and controlling

[1] Commission rules referred to herein may be found at 17 C.F.R. Ch. I (2005).

[2] 59 Fed. Reg. 66674 (December 28, 1994).

risks arising from the activities of its affiliates; (ii) financing and capital adequacy; and (iii) establishing and maintaining internal controls with respect to market, credit and other risks created by the FCM's proprietary and noncustomer clearing activities. Rule 1.15 requires an FCM to file with the Commission, generally on an annual basis, the information required to be maintained under Rule 1.14. An FCM that is dually registered with the SEC as a BD may file SEC Form 17-H in partial compliance with the Commission's rules.[3] The relief available to FCM/BDs under this provision, however, does not extend to certain policies, procedures and systems detailing the market, credit and other risks created by the firm's proprietary and noncustomer clearing activities arising from its function as a clearing member for futures and options contracts.[4]

In support of your request, you stated that "X" has not conducted any futures brokerage activities since its inception and does not plan to conduct such activities in the future. You also stated that "X", as a BD/FCM, files with the SEC a Form 17-H and makes available for inspection by the SEC all supporting documentation. However, the Commission did not grant a complete exemption from Rules 1.14 and 1.15 for firms filing a Form 17-H with the SEC. The Commission did not exempt SEC filers from the filing of risk management policies in accordance with Rule 1.15(a)(1)(ii), which the Commission noted should require only a one-time filing (absent material changes). Further, if certain affiliates of the FCM would be considered material affiliated persons ("MAPs") under the Commission's rules, but were not so identified in the SEC filings, the SEC filing must be supplemented to include those MAPs. In addition, an FCM that experiences substantial capital reductions must report them in accordance the early warning requirements of Commission Rule 1.12.

"X" bases its request for relief from compliance with the Commission's risk assessment rules on its assertion that it has conducted no futures-related activity since its inception and that it has no present intention to conduct such activity. The Commission also noted when it adopted its risk assessment rules that the risk management policies requirement pertains to activities involving instruments, such as securities or swaps, that are generally outside of the Commission's transactional jurisdiction.[5] Firms that are registered FCMs must comply with the regulatory requirements pertaining to FCMs, regardless of the extent, at any given time, of their involvement in commodities activities.[6] Accordingly, based upon the representations in your letter, the Division does not believe that "X" has demonstrated special circumstances to justify granting the relief sought. "X" may, however, continue to rely upon the exemption from certain

[3] Rules 1.14(b)(1) and 1.15(d)(1)(referencing SEC Rules 240.17h-1T and -2T, respectively).

[4] Rules 1.14(a)(1)(ii) and 1.15(a)(1)(ii).

[5] 59 Fed. Reg. 66674, at 66684-85.

[6] *See, e.g.*, Commission Rules 4.13(e)(1) and 4.14(c)(1), pertaining to commodity pool operators and commodity trading advisors, respectively; *see also* Premex, Inc. v. CFTC, 785 F.2d. 1403 (9th Cir. 1986).

provisions of Commission Rules 1.14 and 1.15 applicable to those firms that file Form 17-H with the SEC.

If you have any questions concerning this correspondence, please contact Andrew Chapin, an attorney on my staff, at (202) 418-5465.

Very truly yours,

James L. Carley
Director