

**CFTC Letter No. 99-47****October 7, 1999****No-Action****Division of Trading & Markets**

Re: Section 4d(2) of the Act -- Request for No-Action Position to Permit a Registered IB to Effect Transfers of Funds from Customers Securities Accounts to Customers Commodity Interest Accounts Without Registering as an FCM

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Dear :

This is in response to your letter dated September 30, 1998, to the Division of Trading and Markets ( Division ) of the Commodity Futures Trading Commission ( Commission ) as supplemented by your letter dated November 19, 1998, as well as telephone conversations with Division staff. By your correspondence, you request a no-action position on behalf of (the Company ), a registered introducing broker ( IB ), so that the Company may, upon written authorization from its customers, transfer funds between its customers securities and commodity interest accounts, without becoming registered as a futures commission merchant ( FCM ) pursuant to Section 4d(2) of the Commodity Exchange Act ( Act<sup>1</sup> ). The issue of whether FCM registration is required was raised during a recent examination of the Company by the National Futures Association ( NFA ).

Based upon your representations, we understand the facts to be as follows. The Company has been registered as a securities broker-dealer with the Securities and Exchange Commission and a member of the National Association of Securities Dealers since 1964. All securities customers accounts are carried by the Company, and all customers commodity interest accounts are carried on a disclosed basis by X , an FCM. Currently, less than one percent of the Company s total revenue is derived from commodity interest-related activity. Of the more than 1600 securities accounts carried by the Company, only 21 of these accounts trade commodity interests through X . The Company does not advertise its commodity interest-related activity, and instead offers these services to its existing securities customers merely as a courtesy.

When customers open a commodity interest account, they complete, among other documents, authorization forms permitting the transfer of funds both ways between their commodity interest and securities accounts. After the customer signs these authorization forms, funds may be transferred between the customers account at the Company and X upon a customer s oral request.

In regard to the transfer of funds from a customer's securities account at the Company to the customer's commodity interest account at X, the transfer is effected by Company personnel either drawing a check on the Company's bank account, making the check payable to X for the account of X's customer, or by effecting a wire transfer from the customer's securities account to X's bank in Chicago for credit to the customer's commodity interest account. With respect to the use of checks, the Company mails any check it draws on its bank account directly to X.

In regard to the transfer of funds from the customer's commodity interest account at X, the Company contacts X and requests it to wire the requested amount to the Company's brokerage bank account for credit to the client's brokerage account.

You have requested a no-action position based upon CFTC Interpretative Letter No. 97-13, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,986 (December 24, 1996) (the Letter). In the Letter, the Division, on the basis of facts similar to those presented here, permitted a registered IB that was also a registered securities broker-dealer to draw checks on the account of the securities clearing firm with which the IB had a clearing agreement and deliver those checks to the bank that held the IB's commodity customer segregated funds, which was located on a different floor of its building. The concern addressed by the Letter centered on the issue of whether, in drawing and delivering these checks, the IB was thereby accepting customer funds that were required to be segregated and thus was required to register as an FCM.<sup>2</sup> The Division's analysis in the Letter focused on whether the exception provided under Commission Rule 1.57(c),<sup>3</sup> which permits IBs to deposit checks in a qualifying account or forward checks drawn by a customer, was available. Though we noted that the circumstances presented in the Letter were somewhat unusual and that the exception was not applicable,<sup>4</sup> we found guidance from the provisions of that rule. The Division issued the no-action position subject to the IB demonstrating its ability to comply with certain procedures designed to safeguard customer segregated funds.

In the present case, the Company itself is carrying the securities accounts and either draws a check on its own bank account, which it then forwards to X, or effects a wire transfer between its own bank account and X's bank account. The Company also may effect wire transfers from X by requesting X to wire a particular amount to the Company's brokerage accounts for credit to the client's brokerage accounts. Provided that appropriate procedures are in place to safeguard the customer funds that are required to be segregated, we find no significant reason not to follow the approach we adopted in Interpretative Letter No. 97-13, as modified to reflect the particular facts you have presented:

1. The Company must designate specific individuals within the Company who are authorized to draw checks on the Company's bank account for transmittal to X and to effect wire

transfers from the Company to X's bank in Chicago and from X to the Company's accounts for credit to the clients' brokerage accounts;

2. The Company must maintain any cancelled checks drawn on its account concerning any transfers from the Company's bank account to X;
3. The Company must maintain the wire transfer instructions concerning any transfers between the Company's bank account and X's bank in Chicago and from X to the Company's brokerage accounts for credit to clients' brokerage accounts;
4. All checks that are forwarded to X must be sent the same day that an oral request is received<sup>5</sup> and must be sent by use of an overnight delivery service, with copies of any receipts received maintained in accordance with Rule 1.31;<sup>6</sup>
5. All wire transfers concerning any transfers from the Company's bank account to X's bank in Chicago or from X to the Company's brokerage accounts for credit to customers' accounts must be effected on the same day that an oral request is received, unless the request is received after regular business hours;<sup>7</sup>
6. The Company must maintain: (a) evidence that it is not able to withdraw funds from X's segregated account;<sup>8</sup> (b) a record in chronological order of all checks drawn on and wire transfers between the Company's bank account and X or X's bank in Chicago, including the name and account numbers of the customers' accounts and the amounts transferred for each customer; (c) a record reflecting the name of the person receiving the authorization to transfer funds and the individual who contacted the Company to initiate the transfer, if the account is carried in the name of a person, other than a natural person; and (d) a record reflecting the name of the person contacted at X to effect transfers of funds between the securities and commodity interest accounts of customers.<sup>9</sup>

Based upon your representations and the Company's ability to adopt and to comply with the procedures set forth in items one through six above, the Division will not recommend that the Commission commence any enforcement action against the Company under Section 4(d) (2) of the Act, based solely upon the Company's failure to register as an FCM in connection with the activities described herein. This no-action position is subject to our receiving from you and/or X evidence that the bank account to which the Company is permitted to transmit funds, and from which funds may be transferred to the Company upon request to X, is a qualifying entity within the meaning of Rule 1.57(c).

The position taken in this letter is applicable to the Company solely in connection with its transfer of customer funds between its bank account and X or X's bank account without the Company being registered as an FCM. It does not excuse the Company or X from

compliance with any other applicable requirements contained in the Act or the Commission's rules promulgated thereunder, and in particular, all applicable antifraud provisions of the Act and the Commission's regulations. Further, this letter, and the no-action position taken herein, is based upon the representations that have been made to us and is subject to compliance with the conditions set forth above. Any different, changed or omitted material facts or circumstances might render this letter void. You must notify us immediately in the event that the activities of the Company or X change in any material way from those as represented to us.

If you have any questions concerning this correspondence, please contact Helene D. Schroeder, an attorney on my staff, at (202) 418-5450.

Very  
truly  
yours,

John C.  
Lawton

Acting  
Director

<sup>1</sup> 7 U.S.C. § 6d(2) (1994).

<sup>2</sup> Unlike an FCM, an IB may not accept any money, securities, or property to margin, guarantee, or secure any trades or resulting contracts involving the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market. *Compare* Section 1a(12) of the Act *with* Section 1a(14) of the Act.

<sup>3</sup> Commission rules referred to herein can be found at 17 C.F.R. Ch. I (1999).

<sup>4</sup> Rule 1.57(c) permits IBs to deposit checks in qualifying accounts or forward checks drawn by customers to the FCM carrying the customer's account only if the following conditions are met: (a) the FCM carrying the customer's account must authorize the IB in writing to receive checks in the name of the FCM, and the IB must retain those authorizations in accordance with Rule 1.31; (b) the checks must be made payable to the FCM carrying the customer's account; and (c) the checks received from customers must be deposited on the same day they are received in a United States bank in a qualifying account, or the checks must be mailed or transmitted by the IB to the FCM on the same day they are received. The rule further defines a qualifying account as one that is: (a) maintained in an account name that clearly identifies the funds therein as belonging to commodity customers; (b) the bank must restrict withdrawals to withdrawals by the carrying FCM; (c) the bank must prohibit the IB or anyone acting on its behalf from withdrawing funds; and (d) the bank must provide the FCM with a written acknowledgement that it was informed that the

funds deposited therein are those of commodity customers. We found that this rule applied to those situations where an IB receives a check from and drawn by a customer and not where the IB itself draws the check on the account where the customer's funds are maintained.

<sup>5</sup> Of course, if a customer's oral request is received after regular business hours, the Company would be expected promptly to process the request on the next business day.

<sup>6</sup> This element was not required in the Letter apparently because, in that instance, unlike here, the Company delivered the checks to the FCM's bank located on a different floor of the same building occupied by the company.

<sup>7</sup> In that event, and as required with respect to the processing of checks, *see supra* note 5, the Company would be expected promptly to process the request on the next business day.

<sup>8</sup> In this regard, you represent that the Company must contact X to request a wire transfer from X's segregated account to the Company's brokerage account.

<sup>9</sup> It should be noted that any and all records that must be maintained as required herein must be kept and produced for inspection upon the request of any representative of the Commission, NFA or the Department of Justice, in accordance with Rule 1.31.