

**CFTC letter No. 03-30**  
**July 16, 2003**  
**Exemption**  
**Division of Clearing and Intermediary Oversight**

July 16, 2003

Re: Request for Exemption from Rule 155.4(a)

Dear :

This is in response to your letter dated April 22, 2003, to the Division of Trading and Markets of the Commodity Futures Trading Commission (Commission).<sup>[1]</sup> By your correspondence, you request on behalf of yourself and “X”, a registered introducing broker (IB), that the Commission grant an exemption from Rule 155.4(a)<sup>[2]</sup>, which generally requires that each IB establish and enforce internal controls to ensure, to the extent possible, that each order received from a customer that is executable at or near the market price is transmitted to the futures commission merchant (FCM) carrying the account of the customer before any order in the same commodity for any proprietary account or any other account in which an affiliated person has an interest.

Based upon your representations, we understand the facts to be as follows. Your firm is an IB guaranteed by “Y”. Your firm has clients that follow the trading systems devised by registered Commodity Trading Advisors. Your firm generally places these orders together in one bunched order with proprietary orders. You are requesting an exemption from Commission Rule 155.4(a) so that customer and proprietary account orders may be bunched contemporaneously. You state that your firm uses a standard procedure to allocate orders when you receive split fills. You note that, pursuant to Rule 155.4(a), the customer’s order is filled first and the proprietary account is at a disadvantage. You would disclose to your customers that you include proprietary accounts in the same bunched order as the customers.

As the Commission has stated, the Part 155 Rules are intended to prevent FCMs and IBs and their affiliated persons from using their knowledge of customer orders to the customer’s disadvantage and have helped the Commission to deter such practices as, among others, “front-running,” and “trading ahead.”<sup>[3]</sup> Rule 155.4(a)(1) requires that IBs establish and enforce internal controls to insure that IBs and their employees do not take advantage of their relationship with customers by using their knowledge of customer orders to trade ahead of or against the interests of such customers for their own benefit or that of their preferred customers.

The Commission has determined to deny your request. Rule 155.4 was patterned after Rule 155.3,<sup>[4]</sup> which requires that FCMs establish and enforce internal controls “to insure that FCMs and their

employees do not take advantage of their relationship with customers by using their knowledge of customer orders to trade ahead of or against the interests of such customers for their own benefit or that of their preferred customers.”<sup>[5]</sup> Rule 155.4 was designed “to ensure that the ‘customer first’ principle, which applies to orders given to an FCM, is extended to an introducing broker as well.”<sup>[6]</sup> The Commission promulgated Rule 155.4 to deter IBs and their affiliated persons from using their knowledge of customer orders to the customer’s disadvantage. The Commission has stated that Rules 155.3 and 155.4 deter abusive customer practices such as “front running” and “bucketing.”<sup>[7]</sup> Following the success of Rules 155.3 and 155.4, the Commission recently expanded Rule 155’s requirements to certain parties trading on derivatives transaction execution facilities.<sup>[8]</sup>

In addition, when the Commission recently expanded its rules concerning bunching of discretionary orders by third-party account controllers, it specifically denied extending the rule’s coverage to IBs.<sup>[9]</sup> Therefore, following the Commission’s objectives in creating Rule 155 and in light of the important customer protection issues at stake, the Commission does not find that it is appropriate to grant an exemption from Rule 155.4(a).

If you would like to discuss this matter further, please feel free to contact Lawrence B. Patent, Deputy Director, or Trabue Bland, attorney, both in the Commission’s Division of Clearing and Intermediary Oversight, at (202) 418-5439 or (202) 418-5466, respectively.

Very truly yours,

Jean A. Webb  
Secretary of the Commission

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<sup>[1]</sup> Your letter was addressed to the Director, Division of Trading and Markets. The Commission reorganized last year and the functions formerly performed by the Division of Trading and Markets, which has been eliminated, are now performed by two new Divisions, the Division of Clearing and Intermediary Oversight and the Division of Market Oversight. Rule 155.10 gives the Commission the authority to grant an exemption from Part 155. This authority has not been specifically delegated to the Division of Trading and Markets, and consequently the Commission, rather than any staff unit, is responding to your request.

<sup>[2]</sup> 17 CFR 155.4(a) (2003).

<sup>[3]</sup> 66 Fed. Reg. 53510, 53513-53514 (October 23, 2001).

<sup>[4]</sup> 17 CFR 155.3 (2003).

<sup>[5]</sup> 41 Fed. Reg. 56134, 56139 n. 18 (December 23, 1976).

<sup>[6]</sup> 48 Fed. Reg. 14933, 14954 (April 6, 1983).

<sup>[7]</sup> 66 Fed. Reg. 53510, 53513-53514 (October 23, 2001).

<sup>[8]</sup> *Id.*

<sup>[9]</sup> 68 Fed. Reg. 34790 (June 11, 2003). In adopting the rule change, the Commission required third-party account managers to adopt a standard that allocations be fair and equitable and make certain information available to customers concerning trading. As IBs were not included in the definition of “account manager,” these requirements are not applicable to IBs.