

CFTC letter No. 04-25
September 7, 2004
Interpretation
Division of Clearing and Intermediary Oversight

Re: Sections 4d and 4k(1) –

Introducing Broker and Associated Person Registration Requirements

Dear :

This is in response to your letter dated July 12, 2004 to the Division of Clearing and Intermediary Oversight (the “Division”) of the Commodity Futures Trading Commission (the “Commission”), as supplemented by telephone conversations with Division staff (collectively, the “correspondence”). By the correspondence, you sought guidance as to whether “X” or you are required to be registered as an introducing broker (“IB”) or associated person (“AP”), respectively.

Based on the representations made in the correspondence, we understand the facts to be as follows. “X” has in the past provided various consulting services to a commodity pool operator (“CPO”) for an offshore fund (the “Fund”). “X’s” consulting services included providing advice as to both the Fund’s structure and the CPO’s registration obligations. In addition, “X” provided various reports to the CPO regarding risk control, changes in federal regulations relevant to the Fund’s operation, and general industry activities.^[1] Although the Fund ceased operation in February 2004, you anticipate that the Fund may resume operations in the near future and that “X” will at that time resume its consulting services for the CPO. “X’s” compensation, going forward, will be on a flat-fee basis.^[2] Pursuant to an arrangement between the CPO and the CPO’s futures commission merchant (“FCM”), “X’s” compensation will be paid by the FCM, either deducted from the CPO’s portion of commissions or deducted directly from the Fund’s account with the FCM.

Section 1a(14) of the Commodity Exchange Act^[3] defines an IB as an entity “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 or derivatives transaction execution facility who does not accept any money, securities, or property . . . to margin, guarantee, or secure any trades or contracts that result or may result therefrom.”^[4] Section 4d of the Act, in turn, requires that any person engaged in “soliciting orders or accepting orders” as an IB, be registered as such. Based on the representations made to us, it does not appear that “X” would be engaged in “soliciting or in accepting orders.” The Division’s opinion in this regard is based primarily on the following considerations: (1) “X” would be compensated for the consulting services described above and not for referring the CPO, or any other of its clients or potential clients, to any FCM; (2) “X” would not be in any way involved with order flow; and (3) “X” would not be compensated on a per-order basis or by a referral fee. Accordingly, the Division believes that “X’s”

activities do not come within the definition of an IB, and “X” does not appear to be required to be registered as an IB. Similarly, because your activities do not involve the solicitation or acceptance of customer orders, it does not appear that you are required to be registered as an AP.^[5]

This letter is based upon the representations made to us. Any different, changed, or omitted material facts or conditions might render this interpretation void. Further, this letter represents the position of this Division only and does not necessarily represent the position of the Commission or any other office or division of the Commission.

This letter does not excuse “X” or you from compliance with any other applicable requirements contained in the Act or in the Commission’s regulations issued thereunder. For example, “X” and you remain subject to all applicable antifraud provisions of the Act and the Commission’s regulations and to all applicable reporting requirements for traders set forth in Parts 15, 18, and 19 of the regulations.

If you have any questions concerning this correspondence, please contact R. Stephen Painter Jr., an attorney on my staff, at (202) 418-5416.

Very truly yours,

James L. Carley
Director

^[1] With respect to “X’s” consulting services, you have confirmed that “X” is not involved in order flow, is not involved in the solicitation or acceptance of participations in the Fund, and does not provide commodity interest trading advice.

You characterized “X’s” consulting services in the correspondence as no different in kind than those of an independent accountant, attorney, or public relations person. The Division notes in this regard that Rule 4.24(i)(2)(viii) requires that a CPO disclose in its Disclosure Document “[p]rofessional and general administrative fees and expenses[.]”

^[2] Before the Fund ceased operation in February, “X” was compensated on a per-order basis for every half-turn on certain futures contracts, options on futures contracts, and foreign currency futures contracts. At that time, “X” was a guaranteed IB of the CPO’s FCM, and you were registered as an AP of “X”. The FCM has since terminated that guarantee agreement.

^[3] The provisions of the Act and the Commission’s rules cited herein may be accessed at http://www.access.gpo.gov/uscode/title7/chapter1_.html and www.gpoaccess.gov/ecfr/, respectively.

[4] The Division has in certain circumstances construed this definition to include not just the literal acceptance of orders, but also the solicitation of customers for referral to an FCM for the institution of a trading relationship. *See, e.g., CFTC Staff Letter No. 03-19, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,478 (April 29, 2003).*

[5] Section 4k(1) of the Act prohibits any person to be associated with an IB “as a partner, officer, employee, or agent . . . in any capacity that involves (i) the solicitation or acceptance of customers’ orders . . . or (ii) the supervision of any person or persons so engaged, unless such person is registered with the Commission under this Act as an associated person . . . of such introducing broker[.]”