



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and
Intermediary Oversight

Ananda Radhakrishnan
Director

CFTC letter No. 06-29
October 24, 2006
Interpretation
Division of Clearing and Intermediary Oversight

Re: Section 1a(23) and Regulation 1.3(mm) -- Request for Interpretation in
Connection with the Definition of an Introducing Broker

Dear :

This is in response to your letter dated September 20, 2006, to the Division of Clearing and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”), as supplemented by telephone conversations with Commission staff. By your correspondence, you request that the Division concur with your assessment that “A”, would not be an Introducing Broker (“IB”) under the Commodity Exchange Act (“Act”),¹ with regard to providing its customers a software program with the ability to route orders to a designated contract market (“DCM”) or Derivatives Transaction Execution Facility (“DTEF”) on behalf of the futures commission merchant (“FCM”) of their choice.

Facts

Based upon your representations, we understand the relevant facts to be as follows. “A” is a registered securities broker-dealer and an indirect wholly owned subsidiary of subsidiary of “B”.

“A” currently provides software applications (“Applications”) that allow institutional customers (“Users”) to gather, aggregate, and analyze market data from multiple sources, including exchanges, electronic communication networks, alternative trading systems and other liquidity sources (collectively, “Liquidity Sources”) in the securities and “spot” foreign exchange currency markets. These Liquidity Sources have different bid/ask spreads, depth of order books, speed, and certainty of execution. The Applications transmit aggregated information from these fragmented Liquidity Sources to the Users and permit the Users to use the Applications’ single interface to execute orders across all such aggregated Liquidity Sources. “A” is seeking to make

¹ 7 U.S.C. § 1 *et seq.* (2000).

the same type of Applications available for commodity futures and options contracts traded on a DCM.²

“A” is not a member of, nor does it have trading rights on, any Liquidity Source or DCM. “A” will enter into agreements with DCMs and related service providers to be able to route orders electronically directly to those DCMs’ order entry systems.

Transactions in the Liquidity Sources effected through the Applications by a User are currently identified as being placed by that User’s securities broker-dealer. With regard to the DCMs, “A” proposes to offer to registered futures commission merchants (“FCMs”) and certain institutional customers³ of FCMs Applications through which those Users, would be able to view trading data for futures or options contracts traded on one or more DCMs and submit orders for those contracts for execution through the order-routing system operated by “A” on behalf of the User’s FCM to the relevant DCMs’ electronic trading facility. The User would be able to use the Applications to place orders to be executed on the relevant DCMs and carried through any FCM available through the Application with which such User has an existing customer account relationship. The User would indicate at the time it places each order which FCM it wants to carry that order. Upon execution, the resulting position would be carried through the selected FCM. Participating FCMs will have the ability to specify credit, margin and similar trading limits pertaining to each of their Users. The Applications will preclude Users from executing orders in excess of such limits. For each DCM, “A” would not itself be a member of, or have trading privileges on, the relevant DCM but would, to the extent required by the DCMs, have an agreement with the DCMs to permit the routing of orders to that DCM for the account of the relevant FCM.

“A” intends to make the Applications available to any FCM that wishes to give its customers the ability to bypass the FCM’s order routing portal and submit orders directly to a DCM using the Applications. It will not restrict the use of the Applications to any particular FCM or group of FCMs. “A” would not solicit or accept funds or other property for trading in commodity futures or options from Users in connection with the transactions executed through the Applications on a DCM.

“A” will charge Users a fee for each transaction executed on or subject to the rules of a DCM through the Applications that will vary with the size of the transaction. Fees may be paid directly by a User or through the User’s FCM. “A”’s fees and commissions will be separate from, and in addition to, any fee or commission agreed upon between the customer and its FCM.

² Currently, there are no registered DTEFs. If and when a DTEF is registered with the Commission, “A” would seek to make the same type of applications available for commodity futures and options traded on a DTEF.

³ Users would be limited to institutions that have an existing customer relationship with one or more FCMs and which are “eligible contract participants” as defined in Section 1a(12) of the CEA.

The Applications assist “A”’s customers in trading decisions, but do not provide express “buy” or “sell” signals. You represented that “A”’s customers that would use Applications have pre-existing relationships with their own FCMs and negotiate any and all fees between themselves and the FCM. The Applications software will reside on the “A”’s servers and customers will access the Applications through an application programming interface or a downloadable program interface that interacts with “A”’s servers.

“A” will not recommend, propose, or encourage customers to use any particular FCM, even in response to a customer inquiry, nor will it solicit customers for an FCM in any other manner.

When the technology has been implemented, the customer will be able to directly access its selected DCM’s order-entry system through the Applications screen, without going through the FCM’s order entry system. As a result, the customer will log-on and place orders with the DCM, for the account of the relevant FCM, directly through the Applications screen. By providing a method of entering trades which allows direct access to the DCM’s order entry system without opening a separate application or going through the FCM’s trading portal, “A” is providing technology that facilitates order-entry in a more efficient manner.

The orders will be routed directly from the customer’s computer terminal to the Liquidity Source for the account of the relevant FCM, without passing through the FCM’s computers.

Analysis

Section 1a(23) of the Act defines an introducing broker (“IB”) as:

[A]ny person (except an individual . . . registered as an associated person of a futures commission merchant) 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 (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

Rule 1.3(mm)⁴ similarly defines an IB, in relevant part, as:

Any person who, for compensation or profit, whether direct or indirect, is engaged in soliciting or in accepting orders (other than in a clerical capacity) for the purchase or sale of any commodity for future delivery on or subject to the rules of a contract market who does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

⁴ 17 C.F.R. § 1.3(mm). Commission rules referred to herein are found at 17 C.F.R. Ch.1 (2006).

The Futures Trading Act of 1982,⁵ amended the Act to require persons known as “agents” of FCMs to register as IBs, so as to “resolve[] any existing uncertainty as to the status of [these] agents.”⁶ In creating the separate IB registration category, Congress intended to “protect the public” from the “sales abuses” of such agents for which FCMs “frequently disavow[ed] any responsibility.”⁷

In establishing the rules relating to IBs and their registration, the Commission noted that the intent of the Futures Trading Act of 1982 was “to require those persons who performed the type of activities traditionally engaged in by agents to register with the Commission as an [IB].”⁸ The Commission indicated that “[h]istorically, agents . . . carried all of their accounts on a fully-disclosed basis with an FCM which provided ‘back office’ services for those accounts.”⁹ The Commission further stated that “the phrase ‘soliciting or accepting orders,’ . . . must be construed to encompass not just the literal solicitation or acceptance of customers’ orders, but also the solicitation of customers . . . for referral to an FCM for the institution of a trading relationship and the execution of those orders.”¹⁰

“A”’s central business activities are the collection, distribution, and transmission of data services, rather than the solicitation of trading on the futures markets. “A” does not solicit customers or orders for an FCM in connection with the trading of futures contracts, but rather offers an FCM’s existing customers the means to execute orders directly through a DCM’s order entry system without requiring the direct use of facilities of the FCM for execution.

Customers will indicate to “A” the FCMs with which they have an existing relationship. Even in response to a customer inquiry, “A” does not recommend, propose, or encourage that customers use any particular FCM, or place any orders for commodity futures or options contracts.

The fees paid to “A” by the FCM or the User are negotiated between “A” and the FCM or User, and are not associated with the fees paid to the carrying FCM for the placement of customer orders—the fee is paid by the FCM or User based on the size of the transaction executed with the DCM, not based on the FCM’s commission or the price of the contract traded. Because “A” is collecting a fee based on the size of the transaction executed with DCMs, using

⁵ Pub. L. No. 97-444, 96 Stat. 2294 (1983).

⁶ H.R. Rep. No. 97-565, pt. 1, at 49 (1982).

⁷ *Id.*

⁸ 48 Fed. Reg. 35248, 35250 (August 3, 1983), *quoting* 48 Fed. Reg. 14933, 14935 (April 6, 1983).

⁹ *Id.*

¹⁰ *Id.*

Applications, and to which customers wish to establish a link, “A”’s net income may be affected by its providing this service.

The Division concurs with your assessment that “A” is not an IB and, therefore, is not required to register as such.¹¹

The position taken herein is based upon the representations that have been made to the Division. Any different, changed, or omitted facts or conditions might require the Division to reach a different conclusion. You must notify the Division immediately in the event the operations or activities of “A” change in any material way from those represented to us. Further, this letter represents the position of this Division only and does not necessarily represent the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact Peter B. Sanchez, an attorney on my staff, at (202) 418-5437.

Very truly yours,

Ananda Radhakrishnan
Director

¹¹ The Staff has only twice previously opined as to the registration requirements under the Act as they relate to data service providers, such as “A”, that provide technology to facilitate the order entry process and do not engage in activities that would otherwise require registration. In CFTC Staff Letter 02-91, July 30, 2002, the entity did not receive a per-contract compensation from the FCMs. In CFTC Staff Letter No. 04-15, March 22, 2004, the entity received a per-trade fee that varied with the number of contracts executed. If in the future the Commission determines that such entities must be registered under the Act, “A” may have to comply with the applicable registration requirements at that time.