



COMMODITY FUTURES TRADING COMMISSION

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93-64

**DIVISION OF
TRADING AND MARKETS**

July 7, 1993

Re: Relief from Introducing Broker
Registration Requirements

Dear :

This is in response to your letter dated April 9, 1993, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations with Division staff. By your letter you request, on behalf of "W" relief from the introducing broker ("IB") registration requirements.

Based upon the representations in your letter, as supplemented, we understand that the facts are as follows. "W" has been registered with the Commission as a commodity trading advisor ("CTA") and a commodity pool operator ("CPO") since December 15, 1983, and has been a member of the National Futures Association in such capacities since November 27, 1985. It also is registered with the Securities and Exchange Commission as an investment adviser. You and "A" are registered as associated persons ("APs") of "W" and are listed as its principals.

"W" functions as a consultant to certain individual investors ("Clients") who utilize its services for the purpose of finding and recommending managed futures investments that best match the specified Client requirements with respect to profitability and risk. "W" generally provides investment advice to individuals, corporations, trusts, estates and charitable organizations. It offers advice with regard to commodity futures and option contracts and equity interests in partnerships and corporations that invest in commodity interests.

You represent that "W" consults with its Clients to determine a suitable investment strategy for the particular Client and makes recommendations of one or more CTAs with which a Client may invest directly (in an account managed by a CTA) or indirectly (through investing in a public or private commodity pool for which the CTA trades commodity interests). "W" does not, however, perform any commodity interest trading activities on behalf of its Clients nor does it have any discretionary authority over any of its Clients' funds.

"W"'s contracts with its Clients do not impose any management fees, but rather call for agreed upon incentive fees based on new high quarterly profits, if any.^{1/} "W" is compensated for its services by its Clients through the payment of these incentive fees generally on a quarterly basis. The incentive fee is equal to a percentage of the appreciation of the Client's account. The percentage is negotiated with each Client and ranges between 5% and 15% of profits from prior peaks in the Client's account.

"X" recently formed a new limited partnership, "Y". The CTA for the Fund is "Z" and "W" seeks to be able to recommend the Fund to certain of its Clients who may wish to include the Fund as part of their individual investment portfolio. The fee structure for investing in the Fund requires investors to pay "Z" a monthly management fee of 0.25%, calculated based upon end of month equity in an investor's account, and a 20% quarterly incentive fee, calculated on the basis of new profits in an investor's account.

In addition to these fees, "X", as the CPO of the Fund, charges a monthly management fee of 0.375% (4.5% annually), calculated on the basis of end of month equity in a pool participant's account. Of this 0.375% monthly management fee, "X" retains 0.125% for its own account and refunds to the recommending CTA (or other recommending entity) a monthly finder's fee of 0.25%. Thus, should any of "W" Clients choose to invest in the Fund, "W" would receive a finder's fee from "X" on a monthly basis which would equal 0.25% of the end of month equity for each Client account.

You represent that, while "W" seeks to introduce some of its individual Clients to the Fund, you believe that the total monthly management fee of 0.63% (7.5% annually) (the sum of "Z"'s management fee and "X"'s management fee) will negatively impact on your Clients. Consequently, you propose to return to your Clients the 0.25% monthly finder's fee that you receive from "W", effectively reducing the monthly management fees that your Clients must pay for investing in the Fund to 0.375% (4.5% annually). Thus, you state that "W" merely would act as a conduit on behalf of its Clients with respect to the finder's fees paid by "X" to "W".

^{1/} "W"'s Disclosure Document, dated February 11, 1993, submitted with the request, provides that it may be paid a management fee equal to a percentage of the month-end net asset value of an account. You represent that this provision in the Disclosure Document is intended to allow you the option of imposing a management fee in appropriate circumstances. In such circumstances, the percentage is negotiated with each Client, is fully disclosed, and is received from the Client.

As you may know, Section 1a(14) of the Commodity Exchange Act ("Act") defines an IB as:

any person (except an individual who elects to be and is 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 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.^{2/}

The Commission consistently has taken the position that persons who are compensated by the recommended CTA for referring customer orders to a CTA must register under the Act as an IB or as an AP of the CTA.^{3/}

You represent that "W" is compensated only by its own Clients, that it will refund all compensation it receives from "W" to its Clients and that it will not retain any actual or in-kind remuneration from "X". Although "W" is refunding all fees to its Clients, it is receiving compensation from a CTA for referring investors. Consequently, we cannot conclude that "W" is not acting as an IB in this instance.

^{2/} 7 U.S.C. § 2 (1988), as amended by Section 404(a)(14) of the Futures Trading Practices Act of 1992, Pub. L. No. 102-546, 106 Stat. 3590. Similarly, Commission Rule 1.3(mm), 17 C.F.R. §1.3(mm) (1992), defines the term "introducing broker" 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 any 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. . . ." Commission rules referred to herein may be found at 17 C.F.R. Ch. I (1992).

^{3/} See CFTC Interpretative Letter No. 86-27, Division of Trading and Markets, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,364 (Nov. 24, 1986); CFTC Interpretative Letter No. 77-8, Office of the General Counsel, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,430 (May 16, 1977).

However, in light of the facts that "W" is not retaining any of the remuneration paid by "X" to "W", "W" is registered as a CTA and CPO and thus has undergone the fitness screening procedures applicable to IBs, and you and "A" are registered as APs of "W", we do not believe that "W" should be required to register as an IB. Consequently, the Division will not recommend that the Commission take any enforcement action against "W" under Section 4d of the Act^{4/} based solely upon its failure to register as an IB provided that: (1) "W" remains registered as a CTA and a CPO; (2) you and "A" remain registered as APs of "W"; and (3) "W" is compensated only by its Clients and does not retain any compensation from a recommended CTA or CPO.

The views expressed herein are those of the Division of Trading and Markets only and do not necessarily represent those of the Commission or any other office or division of the Commission. The views expressed herein are based upon the representations made to us and are strictly limited to those representations. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event that "W" activities change in any way from those as represented in your letter. Finally, the views expressed herein do not relieve "W" from any other applicable requirements under the Act and the Commission's regulations.

If you have any questions concerning this correspondence, please contact me or Tina Paraskevas Shea, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel

^{4/} 7 U.S.C. §6d (1988).