

COMMODITY FUTURES TRADING COMMISSION

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DIVISION OF TRADING AND MARKETS

July 30, 1993

Re: Relief from Providing the Rule 1.55 Risk Disclosure Statement

Dear :

MILITARIA.

This is in response to your letter dated February 11, 1993, as supplemented by telephone conversations with Division staff, wherein you request on behalf of "A" relief from Rule 1.55(a), $\frac{1}{2}$ which requires a futures commission merchant ("FCM"), or in the case of an introduced account an introducing broker ("IB"), to provide each new customer with a risk disclosure statement containing the language set forth in Rule 1.55(b) and to receive an acknowledgment, signed and dated by the customer, confirming that he received and understood the disclosure statement before a commodity futures account may be opened for the customer. $\frac{2}{2}$

Based upon the representations in your letter, as supplemented, we understand the facts to be as follows. "A" is a registered IB and securities broker/dealer with approximately ten institutional clients, some of whose funds are managed by investment advisers and money managers. "A" does not have any natural persons as clients. The trading strategies for these clients range from execution of a basket of stocks to index arbitrage. To accommodate approximately nine of these customers, "A" places futures trades through certain floor brokers on behalf of these customers pursuant to instructions from the customer. For example, the customer calls "A" and tells "A" it wishes to have a certain futures transaction executed on its behalf and further instructs "A" as to which FCM it wishes to carry the trade. "A" then transmits these trades to certain floor brokers who give

 $[\]frac{1}{2}$ Commission rules referred to herein are found at 17 C.F.R. Ch. 1 (1993).

²/ Rule 1.55(c) requires the FCM, or in the case of an introduced account the IB, to retain the acknowledgment in accordance with Rule 1.31.

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them up to the appropriate FCM on behalf of the client. 3 You represent that these clients each have a pre-existing relationship with the FCM it wishes to have carry and clear these trades and that the trades are carried in accounts previously opened by these customers at those FCMs. For these nine clients, the FCM carrying and clearing their accounts is not "B", with which "A" has an "introducing" relationship and which it uses as its clearing firm unless otherwise instructed by the client. support of the request, you represent that "A" receives no compensation for placing these trades on behalf of the nine clients it currently accommodates this way. "A" does not provide these nine clients with the Rule 1.55(a) risk disclosure statement but, rather, these clients, according to their representations to you, have received the Rule 1.55(a) risk disclosure statement directly from the FCMs to which "A" is instructed to give up the trades.

Generally, in the case of an introduced account it is the IB's responsibility to provide each new customer with a risk disclosure statement. Specifically, Rule 1.55(a) requires that:

No futures commission merchant or, in the case of an introduced account, no introducing broker may open a commodity futures account for a customer unless the futures commission merchant or introducing broker first: (1) Furnishes the customer with a separate written disclosure statement . . .; and (2) receives from the customer an acknowledgment signed and dated by the customer that he received and understood the disclosure statement.

It is, therefore, "A's" responsibility to provide any customer, on whose behalf we understand it to have opened accounts, in the first instance with the Rule 1.55 risk disclosure statement and any other applicable disclosures and maintain all required acknowledgments of such disclosures. However, based on the facts set forth above, including that these customers are institutional customers who have pre-existing accounts at FCMs other than "B", that "B" did not solicit, and played no role in opening these accounts, that trades for these customers are placed in those pre-existing accounts, and that the futures trades being entered are related to securities trading conducted for these customers by "A", the Division will not recommend that the Commission take enforcement action against "A" under Rule 1.55 if it fails to provide these clients with, and maintain acknowledgment of the receipt and understanding by such clients of, the risk disclosure statement required by that rule, provided that "A" can verify by

In the event that there is an error made in either receiving a customer order or transmitting a customer order to a floor broker, "A" has represented that such an error trade would be placed in its own error account such that the customer would suffer no adverse impact.

obtaining clear written evidence that the customer has previously been given the Rule 1.55 risk disclosure statement by the FCM carrying the account in which these trades will be placed.

Finally, the fact that "A" transmits these customer orders to floor brokers raises concerns addressed in Commission Rule 1.57. Rule 1.57(a)(2) states in pertinent part that each IB must:

(2) Transmit promptly for execution all customer and option customer orders to: (i) a carrying futures commission merchant; or (ii) a floor broker, if the introducing broker identifies its carrying futures commission merchant and that carrying futures commission merchant is also the clearing member with respect to the customer's or option customer's order.

When the Commission adopted Rule 1.57 it was concerned that if IBs were permitted to transmit customer orders to any clearing member the IB would disclose to the floor broker the omnibus account of its carrying FCM, rather than the individual, fullydisclosed account of its customer. Not only would this violate Rule 1.35(a-1)(1) $\frac{4}{}$, but such conduct could lend itself to certain abusive practices such as the unlawful allocation of trades within that omnibus account. For these reasons, the Commission requires an IB when transmitting an order to a floor *:oker to identify the customer account at its carrying FCM and Lnat r. M must be the clearing member with respect to the customer's order. 5/ Under the circumstances you have presented, "A's" procedures appear to address the concerns underlying Rule 1.57(a)(2). All FCMs which will carry the trades for these nine clients will also be the clearing FCMs for those trades. "A", when transmitting trades for such clients to the floor broker identifies the client, by account number, in each case and further instructs the floor broker to give up the trade on a fully-disclosed basis to the FCM specified by the customer. Therefore, the Division will not recommend that the Commission take enforcement action against "A" under Rule 1.57(a)(2) for accommodating these nine clients or any future clients who meet the criteria specified above in the manner described herein.

You should be aware that this letter does not excuse "A" from compliance with any otherwise applicable requirements

Rule 1.35(a-1)(1) requires that each FCM and IB receiving a customer's order or option customer's order to immediately prepare upon receipt of any such order a written record of the order which must include the account identification and order number, the date and time the order is received, and in the case of option customers' orders, the time the order is transmitted for execution.

<u>See</u> 48 Fed. Reg. 35248, 35271 (August 3, 1983).

contained in the Act, as amended, or in the Commission's regulations thereunder. For example, "A" remains subject to Section 4b of the Commodity Exchange Act (the "Act"), 7 U.S.C. §6b (1988 & Supp. IV 1992), and to the reporting requirements for traders set forth in Parts 15, 18, and 19 of the Commission's regulations. In addition, the Division notes that it is not excusing or in any way limiting the Commission's ability to proceed against "A" for any past violation of the Act, 7 U.S.C. §1 et seq. (1988 & Supp. IV 1992) or of the Commission's regulations thereunder. The noaction relief provided herein is prospective only.

The positions taken in this letter are based upon the representations that have been made to us. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. Finally, this letter represents the views of the Division of Trading and Markets only. It does not necessarily represent the views of the Commission or any other office or Division of the Commission.

If you have any questions concerning this correspondence, please feel free to contact Susan C. Ervin, Chief Counsel of the Division, or Mary Cademartori, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Andrea M. Corcoran Director