



COMMODITY FUTURES TRADING COMMISSION

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DIVISION OF
TRADING AND MARKETS

September 2, 1994

Re: Identification of Order Entry Firm as Introducing
Broker

Dear :

This is in response to your letter to the Division of Trading and Markets ("Division") dated September 23, 1993, as supplemented by telephone conversations with Division staff, wherein you request on behalf of "X", a registered futures commission merchant ("FCM"), relief from Rules 1.33(f) and 1.46(a)^{1/} such that the confirmation, monthly and purchase-and-sale statements required by those rules to be issued by "X", are not required to indicate that certain customers' accounts have been introduced by "Y", a registered commodity pool operator and independent introducing broker ("IB").

Based upon the representations made in your letter as supplemented, we understand the facts to be as follows. "Y" specializes in order entry and trade processing for managed accounts and, to a lesser extent, for non-discretionary customer accounts. Specifically, "Y" accepts orders from commodity trading advisors ("CTAs"), IBs and customers and then routes the orders to the floor of the appropriate exchange. In the case of orders received from CTAs, "Y" primarily accepts orders from CTAs whose customers' accounts are cleared by "X" and from CTAs whose customers' orders are executed by "X" but are "given up" to and cleared by another FCM.^{2/} In either case, "Y" performs the non-discretionary aspects of order placement and daily reconciliation.^{3/} To a lesser extent, "Y" provides these same order

^{1/} Commission rules referred to herein are found at 17 C.F.R. Ch. I (1993).

^{2/} All CTA accounts referred to herein are carried and/or executed by "X". You represent that "Y" is currently accepting orders from ten CTAs.

^{3/} You describe daily reconciliation or "check-out" as the process by which an FCM's back office personnel confirms that all
(continued...)

entry services to both independent IBs and those IBs guaranteed by "X" that introduce CTA-managed accounts. In the case of an independent IB using "Y", that IB's CTA-managed accounts are cleared by "X".

In addition, "Y" works directly with customers of other IBs and associated persons ("APs") of "X". Here, the customers, the majority of whom are institutional, are provided the same order entry facilities that "Y" offers to an IB or CTA, thereby enabling the customers to deal directly with an "order desk," which you describe in your letter as "a group of individuals whose attention is concentrated on the servicing of customer accounts and who are always available to respond to customer demands." Here, the customer is told by the AP or IB when an account is first opened that the AP or IB who has solicited that customer's account may not be involved in the day-to-day handling of the customer's orders and that "Y" will be responsible for performing the actual order entry function. The customer is provided with the name of a contact person at "Y" and with "Y's" phone number. You represent that the employees of "Y" performing the order entry function are all registered APs of "Y".

You have requested that the Division confirm your view that "Y" is not introducing the customer accounts referred to herein for which it acts as an "order desk," irrespective of whether such accounts are managed by CTAs, introduced by IBs or handled directly by "X" and its APs. Accordingly, you ask that "X" not be required to insert in the confirmation, monthly and purchase-and-sale statements required by Rules 1.33(f) and 1.46(a), respectively, a legend that their accounts have been introduced by "Y".

Rule 1.33 requires every FCM to provide written monthly and confirmation statements to each of its commodity customers, option customers and foreign futures and foreign options customers. Rule 1.33(f) states, with respect to introduced accounts, that:

(f) Introduced accounts. Each statement provided pursuant to the provisions of this section, must, if applicable, show that the account for which the futures commission merchant is providing the statement was in-

3/ (...continued)

trades requested by the CTA and confirmed by the FCM have in fact been executed at the prices, in the quantities, and in the markets that previously have been orally confirmed by the FCM's employees on the trading floor.

troduced by an introducing broker and the names of the futures commission merchant and introducing broker.

In addition, Rule 1.46(a) requires every FCM to provide each customer with a purchase and sale statement which shows the financial result of the transactions involved. Rule 1.46(a) states in pertinent part that such statement must indicate, if applicable, "that the account was introduced to the futures commission merchant by an introducing broker and the names of the futures commission merchant and introducing broker."

In support of your request, you state that "Y's" handling of the orders it receives from CTAs, IBs and customers encompasses the types of activities enumerated in the "clerical capacity" exemptions found in Rule 1.3(mm) and in §4k(1) of the Commodity Exchange Act (the "Act"), 7 U.S.C. §4k(1) (1988 & Supp. IV 1992). In this connection, you note that all "Y" employees performing order entry functions are registered APs of "Y". In addition, you state that "Y": (1) does not solicit the accounts for which it performs order entry functions; (2) plays no role in the opening of these accounts; and (3) performs only mechanical, non-discretionary aspects of placement of orders for execution and daily reconciliation. Finally, you represent that the CTA or IB engaging "Y", or "X" if one of its APs engages "Y", is the party ultimately responsible for the customer account in question.

Based upon the foregoing, including that "Y" did not solicit and played no role in opening any of the accounts discussed herein, the Division will not recommend that the Commission take enforcement action against "X" under Rules 1.33 and 1.46 if it fails to provide a legend on the confirmation, monthly and purchase-and-sale statements indicating that certain customers' accounts have been introduced by "Y".

You should be aware that this letter does not excuse "X", "Y" or any other IB or CTA referred to herein from compliance with any otherwise applicable requirements contained in the Act or in the Commission's regulations thereunder.^{4/} For example,

^{4/} To the extent that "X" has contact with the CTAs managing customer accounts either carried or cleared by "X", we suggest that "X" communicate to these CTAs that it may be desirable for them to include a statement in their Disclosure Documents to the effect that in certain instances the CTA may not be involved in the entry of customer orders and that "Y" will perform the actual order entry. See, e.g., CFTC Interpretative Letter No. 93-26 [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,703

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"X" remains subject to Section 4b of 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.^{4/} In addition, the Division notes that it is not excusing or in any way limiting the Commission's ability to proceed against "X", "Y" or any other IB or CTA referred to herein 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 no-action 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 me or Associate Chief Counsel Lawrence B. Patent at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel

^{4/} (...continued)

(March 31, 1993) and CFTC Interpretative Letter No. 93-63 [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,782 (July 7, 1993). In those cases, the CTA/CPO was required to disclose in its Disclosure Document that the original books and records required by Commission rules would be kept at other than the CTA/CPO's main business office, as is required, and to disclose the location where such books and records would be kept.

^{5/} In our view, "Y" is "X's" agent with respect to order handling functions. "X" cannot shield itself from liability with respect to the performance of those functions by means of "Y's" involvement, including liability for having "selected the floor broker" executing the customer orders referred to herein for purposes of Section 5a(11)(C), 14(a)(1), 17(b)(10)(C) and 22(a)(3) of the Act, 7 U.S.C. §§ 7a(11)(C), 18(a)(1), 21(b)(10)(C) and 25(a)(3) (1988 & Supp. IV 1992). "X" also remains liable for recordkeeping responsibilities under Commission Rule 1.35 and for prompt execution of customer orders.