95-42

COMMODITY FUTURES TRADING COMMISSION
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DIVISION OF
TRADING AND MARKETS

March 23, 1995

Re: Request For Exemption From IB Registration Requirements of Section 4d of the Commodity Exchange Act

Dear :

This is in response to your letter to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") dated February 17, 1995, as supplemented by telephone conversations with Division staff and your facsimile transmission dated March 3, 1995, by which you request confirmation that, under the facts set forth below, "X" is exempt from the introducing broker registration requirements of Section 4d of the Commodity Exchange Act (the "Act"), 7 U.S.C. § 6d (1988 & Supp. V 1993).

Based on the representations made in your letter, as supplemented, we understand the pertinent facts to be as follows. "X" is registered with the Commission as a commodity pool operator ("CPO") and commodity trading advisor ("CTA"). "X's" sole client is the "Client", which has agreed to pay "X" $#### per year for its trading signals and interest rate forecasting research. The Client executes all transactions in its futures account at its own discretion with "Y", the futures commission merchant ("FCM") of its choice, and the Client has authorized the FCM to allocate $6 per round-turn trade to "X" in satisfaction of the $#### yearly fee. Although the Client's fee authorization to the FCM does not limit total fee allocations to $####, "X" and the Client currently have an oral agreement limiting the FCM's total allocation of fees to $####. The Client, which is responsible for monitoring and reconciling fee transactions each month, will notify the FCM once the $#### yearly fee has been satisfied. "X" does not foresee similar fee arrangements being established with future clients. "X's" current Disclosure Document outlines a fee structure consisting of management and incentive fees and its marketing efforts focus on establishing accounts under the fee arrangement outlined in "X's" Disclosure Document.

Commission Rule 1.3(mm)[1/] defines the term introducing broker as:

> Any person who, for compensation or profit, whether direct or indirect, is engaged in soliciting or 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 . . . to margin, guarantee, or secure any trades or contracts that result or may result therefrom . . . .

The Commission has made it clear that:

> [T]he phrase "soliciting or accepting orders" . . . must be construed to encompass not just the literal solicitation 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 . . . . Similarly, the Commission believes that persons who are currently compensated on a per-trade basis . . . would be within the definition of, and generally required to register as, an introducing broker.[2/]

Thus, the Division has previously stated that "any solicitation or acceptance of orders or any compensated referral of customers for trading will bring one within the definition of an introducing broker and require registration as such, unless an exclusion from the definition of introducing broker is applicable."[3/]

Commission Rule 1.3(mm) excludes from the term "introducing broker" any CTA which, acting in its capacity as a CTA, *is not compensated on a per-trade basis or which solely manages*

1/ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1994).

2/ 48 Fed. Reg. 35248, 35250 (August 3, 1983), citing 48 Fed. Reg. 14933, 14935 (April 6, 1983).

3/ CFTC Interpretative Letter No. 93-40, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,731, at 40,380, 40,383 (May 5, 1993).

discretionary accounts pursuant to a power of attorney, regardless of whether that CTA is registered or exempt from registration in such capacity. It is clear that because "X" does not solely manage discretionary accounts and is compensated on a per-trade basis, "X" does not fall within the exclusion from the definition of the term "introducing broker" under Rule 1.3(mm). However, we note that the Commission's final rule defining the term "introducing broker" expressly eliminated the form and manner of compensation as a dispositive factor requiring registration as an introducing broker.[4/]

Based upon the foregoing representations, and subject to the conditions set forth below, the Division will not recommend that the Commission take any enforcement action against "X" under Section 4d(1) of the Act based solely upon its failure to register as an introducing broker in connection with its activities with respect to the Client. This position is subject to the conditions that: (1) "X" does not accept compensation with respect to customers other than the Client in a form other than incentive and management fees that are not remitted to "X" on a per-trade basis by the FCM; and (2) "X" and the Client commit to writing their oral agreement limiting the FCM's total yearly allocation of fees to "X" to a specific dollar amount.

This position is based upon the representations you have made to us. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event the operations and activities of "X" change in any way from those as represented to us. Further, this position is applicable solely to "X" in connection with its activities with respect to the Client.

This letter relieves "X" solely from the introducing broker registration requirements of Section 4d of the Act in connection with its activities with respect to the Client and does not excuse it from compliance with any other applicable requirements of the Act or the Commission's rules thereunder. For example, "X" remains subject to the antifraud provisions of Section 4o of the Act, 7 U.S.C. § 6o (1988 & Supp. V 1993), to the reporting requirements for traders set forth in Parts 15, 18, and 19 of the Commission's rules, and all other applicable provisions of Part 4 of the Commission's rules.

4/ 48 Fed. Reg. 35248, at 35251.

Finally, the position expressed herein is that of the Division of Trading and Markets only. It does not necessarily represent the position of the Commission or of any other office or division of the Commission. If you have any questions concerning this correspondence, please contact me or Gary J. Dernelle, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel