COMMODITY FUTURES TRADING COMMISSION
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DIVISION OF
TRADING AND MARKETS

95-51

May 1, 1995

Re: Request for Interpretation Regarding Scope of Registration Requirements Under Section 4d(1) of the Commodity Exchange Act

Dear :

This is in response to your letter dated February 8, 1995 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by additional communications with Division staff, in which you request an interpretation as to whether a proposed business arrangement between "W" and "X" would require "W" to register as an introducing broker ("IB").

Based on the representations made in your letter and in subsequent communications with the Division staff, we understand the pertinent facts to be as follows. "X" is a registered futures commission merchant ("FCM") and a member of the National Futures Association. Pursuant to negotiations between "X" and "W", a business arrangement has been proposed between the two companies.

"W", through its separately incorporated subsidiary "Y", offers two satellite-delivered services, "Z" services", to farmers and traders via their personal computers.[1/] These services offer a wide array of market news, commentary, charting capability, weather information and ten-minute snapshot quotes from commodity exchanges other than those located in New York.[2/] Subscribers

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1/ "W" has four subsidiaries. "W" and its subsidiaries provide customers with a wide range of information and data of interest to participants in the futures markets through a variety of means including publications such as "V".

2/ In addition to the "Z" services, "Y" publishes a weekly newsletter that reports and analyzes news affecting markets and prices and contains buying and selling strategies for grain, wheat, oilseeds, cotton, pork and beef producers. "Y" also runs a twenty-

(continued...)

are charged a flat monthly fee for the "Z" services. Neither "W" nor "Y" is registered with the Commission in any capacity.

Under the terms of the proposed "W"-"X" business arrangement, each "Z" subscriber who is also a customer of "X" will receive a credit equal to 15% of the commission charged by "X" to the customer. "X" will use this credit to pay all or a portion of the monthly service fee owed by the customer for the "Z" services. "X" will notify "W" each month of the accrued commission for each mutual customer and "W" will invoice "X" for all or a portion of each customer's monthly bill. In the event the accrued credit is less than the entire "W" invoice, "W" will bill the customer for the difference. In the event that the accrued credit exceeds the invoice amount, "W" will bill "X" for the full amount of the monthly invoice.

Unused credits will carry forward from month to month, but all accrued credits will be wiped out at each calendar year end. "W" will show to each of its customers, on its customer invoice, any payment received from "X" on the customer's behalf. In no event will "X" make to "W" any payment in excess of a customer's current invoice. In the event a customer discontinues his or her "Z" service, accrued credits will not be paid to "W". In the event a customer closes his or her account at "X" but continues to receive one of the "Z" services, accrued credits will be paid to "W" but not past the end of the calendar year.[3/]

The solicitation of "W's" "Z" services' customers will occur by way of promotional material prepared by "X". The material will clearly identify "X" as offeror and will instruct any interested party to contact "X" directly. "W" has agreed to include the "X" offer in its mailings to its current customers so that "W" can protect the confidentiality of its customer list.

In your letter, you request an interpretation as to whether Section 4d(1) of the Commodity Exchange Act ("Act")[4/] would

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2/ (...continued)
four-hour 900 hotline that provides updated market information and recommendations.

3/ You contend that payments under the proposed arrangement would not result in "W's" receiving additional funds in excess of its regular invoice amount, nor would "W" be receiving funds based upon its solicitation of an account. "W" would receive the same revenue regardless of whether the customer opened an account at "X" and regardless of the customer's level of trading. Only the source of the revenue would change.

4/ 7 U.S.C. § 6d(1) (1988).

require "W" to register with the Commission as an IB because of the proposed business arrangement between "X" and "W".[5/] Commission Rule 1.3(mm) defines an IB 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.

We believe that the arrangement described above would result in "Y's" acting as an IB.[6/] Although you contend that "W" would not be involved in the solicitation of the account," "X" is contacting the "Z" services' subscribers because their purchase of these specialized services identifies them as persons who are predisposed to use the services of an FCM. Any "contact initiated by [a party] that is intended to establish or to culminate in a customer relationship is conduct that entails the 'solicitation of customers,' and may be characterized as indirect solicitation of customers' orders, even though [customers] are under no obligation to open accounts [with a FCM]."[7/] "Y", by giving "X" either direct or indirect access to its customer list, is initiating a contact that is intended to result in new customers for "X" and qualifies as solicitation.

5/ Your incoming letter makes reference to Section 4k(1) of the Act which applies to certain persons "associated with a futures commission merchant . . . in any capacity that involves . . . the solicitation or acceptance of customers orders . . ." 7 U.S.C. § 6k(1) (1988 & Supp. V 1993). The definition of an associated person ("AP") states that it applies only to a natural person, and therefore, a corporation such as "W" could not be an "AP." Commission Rule 1.3(aa). Commission rules referred to herein are found at 17 C.F.R. Ch. I (1994).

6/ Given "W's" corporate structure, "Y" could register as the IB with "W" listed as a principal. This position is based on our understanding that "Y" is a separately incorporated entity, "Y" oversees the "Z" services, and that only customers of the "Z" services will receive the offer from "X".

7/ CFTC Interpretative Letter 93-40, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,731, at 40,383 (May 5, 1993) (discount by FCM to customers of publisher of home study investment course advertised in home study manual and other publications by the same publisher would be solicitation by the publisher).

Moreover, although "Y" would receive no additional compensation or revenues under the terms of the business arrangement, the arrangement would allow "Y's" "Z" services customers to reduce their overall information and trading costs. In effect, the arrangement allows "Y" to offer a discount to its customers without losing revenue and acts to help it maintain its customer base. "Y", therefore, is indirectly compensated for making its customer pool available to "X".[8/]

In addition, "Y" through sales of services that offer trading strategies and recommendations to customers also appears to be engaged in the business of advising members of the public about trading in the commodity interest markets.[9/] As such, we believe that "Y" should be registered with the Commission as a CTA, unless "Y" can demonstrate to us that it is excluded from the definition of CTA or exempted from the registration requirements.[10/]

Under these circumstances, it would be contrary to the purposes of the IB registration provisions to allow "W", through its subsidiary "Y", to solicit for "X" if "Y" remains unregistered. However, we do not believe that in this case the purposes of the Act would require "Y" to register both as a CTA and an IB. Accordingly, the Division would not recommend enforcement action against "W" or "Y" under Section 4d(1) of the Act, based solely upon "Y's" failure to register as an IB, if "Y" registered as a CTA and listed "W" as a principal, and "X" instituted the proposed arrangement as described in your communications with us.[11/]

8/ This position is similar to previous positions. See, CFTC Interpretative Letter No. 75-6, [1975-1977 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 20,753 (August 13, 1975) (conduct contributing to maintenance of a customer base is "compensation or profit" as used in definition of commodity trading adviser ("CTA")).

9/ For example, "Y" publishes a weekly newsletter that recommends specific positions in futures and options on futures for hedging purposes.

10/ The Act and Commission rules thereunder exclude certain persons from the definition of CTA as well as exempt certain persons from registration requirements. See, e.g., § 1a(5) of the Act, 7 U.S.C. § 1a(5) (Supp. V 1993); § 4m(1) of the Act, 7 U.S.C. § 6m(1) (1988); and Rule 4.14.

11/ We take no position on the question of whether registering as an IB would preclude the need for "Y" to register as a CTA. Furthermore, we note that the question of whether "Y" must register as a CTA is independent of whether "Y" decided to institute the arrangement with "X" described in your request.

The views expressed herein are based on the representations made to us. Any different, changed or omitted facts might require us to reach a different conclusion. The views set forth in this letter apply to "W" solely in connection with the issue of whether it must register as an IB if "X" and "W", through "Y", were to institute the proposed business relationship as described by you.

Further, this letter does not excuse "W" or any of its subsidiaries from compliance with any other applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, "W", its subsidiaries and "X" remain subject to the antifraud provisions of Section 4o of the Act.[12/] This letter represents the views of this Division only and does not necessarily represent the views of the Commission or of any other office or division of the Commission. If you have any further questions concerning this correspondence, please do not hesitate to contact me or Thomas E. Joseph, an attorney on my staff, at (202)254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel

12/ 7 U.S.C. § 6o (1988).