U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5430
Facsimile: (202) 418-5536

DIVISION OF
TRADING & MARKETS

96-07

December 18, 1995

Re: Rule 1.57/Request for No-Action Relief

Dear :

This is in response to your letter to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") dated November 14, 1995, as supplemented by telephone conversations with Division staff, in which you request the Division to confirm that it will not recommend that the Commission take any enforcement action against "X", a guaranteed introducing broker ("IB") of "Y", a registered futures commission merchant ("FCM") and clearing member of the Chicago Board of Trade, if "Y" provides execution but not clearing services for certain customers introduced by "X".

Based upon the representations made in your letter, as supplemented, we understand the pertinent facts to be as follows. "X", as "Y's" introducing broker, introduces certain institutional customers to "Y". Although "Y" will be providing execution services for "X's" customers, it will not necessarily be clearing such trades. Nonetheless, as noted below, "Y" represents that it will be jointly and severally liable for all obligations of "X" under the Commodity Exchange Act, and the rules and regulations thereunder, with respect to solicitation of and transactions involving all customer accounts of "X".

In support of your request, you represent that, notwithstanding that certain "X" customers elect to have their transactions cleared by FCMs other than "Y", "X" has a business relationship only with "Y" and receives no compensation from other FCMs through which the transactions are cleared. Moreover, you represent that "Y" is substantially capitalized and will at all times have sufficient adjusted net capital to meet any obligations it may have to "X's" customers, without regard to whether those customer accounts are, in fact, carried by "Y". Specifically, you represent that as of September 30, 1995, "Y" had adjusted net capital of approximately $ XXX million, and excess net capital of $ XXX million.

Further, you note that the Guaranty Agreement that "Y" will execute with "X" provides that "Y" is liable for all accounts introduced by "X" whether cleared through "Y" or another FCM. In this regard, you represent that "Y" reaffirms that, as provided in the Guaranty Agreement, it accepts joint and several liability for all obligations of "X" under the Commodity Exchange Act ("Act"),[1/] and the regulations thereunder "with respect to the solicitation of and transactions involving all customer accounts of "X"."

In 1992, the Commission amended Rule 1.57(a)(1) to read, in pertinent part, as follows:

> [A]n introducing broker which has entered into a guarantee agreement with a futures commission merchant . . . must open and carry such customer's account with such guarantor futures commission merchant on a fully-disclosed basis[.][2/]

In adopting this amendment, the Commission intended to clarify that an FCM that has entered into a guarantee agreement with an IB must carry all of the customer accounts introduced by the IB.[3/] Additionally, the Commission wished to ensure that guarantee agreements between FCMs and IBs serve their intended objective of protecting the customers of the IB.

Based upon our evaluation of the information provided in your letter, as supplemented, we believe that granting your request would not be contrary to the "customer protection" objective of the rule. This opinion is based principally upon your representations as to the substantial capital held by "Y". We further note your representation that the customers referred to herein are institutional customers who have requested that the trades be cleared by FCMs other than "Y".

Accordingly, based upon the above representations, the Division will not recommend that the Commission take any enforcement action under Rule 1.57(a)(1) against "X" or "Y" if "X"

1/ 7 U.S.C. § 1 et seq. (1994).

2/ 57 Fed. Reg. 23136, 23143 (June 2, 1992); 17 C.F.R. 1.57(a)(1) (1995).

3/ See 57 Fed. Reg. at 23137. The amendment effectively codified the Division's position set forth in CFTC Interpretative Letter No. 88-4 [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,098 (Jan. 26, 1988).

introduces customers to "Y" who employ "Y's" execution services, but choose to clear their transactions with other FCMs. The "no-action" position taken in this letter does not affect any other duties or responsibilities of "X" or "Y".

The position taken herein is based on the representations that have been made to us. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In this regard, we request that you notify us immediately in the event the operations and activities of "X" and "Y" change in any way from those as represented to us. Finally, this letter represents the position of the Division of Trading and Markets only. It does not necessarily reflect the views 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 L. Goldsholle, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel