

CFTC Letter No. 97-12**December 24, 1996****Division of Trading & Markets**Re: Registration as a Futures Commission Merchant

Dear :

This is in response to your letter dated November 7, 1996, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations with Division staff. You asked for an interpretation as to whether it is necessary for the "Company", a registered introducing broker ("IB"), to register with the Commission as a futures commission merchant ("FCM"). This issue was raised as a result of a recent examination of the Company carried out by the National Futures Association ("NFA"). We contacted NFA staff to obtain additional information which bears on this issue. We are treating your letter as a request for a "no-action" position.

Based on the representations in your letter, and on our discussions with your staff and NFA staff, we understand the pertinent facts to be as follows. The Company has been registered as a securities broker-dealer with the Securities and Exchange Commission and has been a member of the National Association of Securities Dealers since 1978. All securities customers' accounts are carried on a disclosed basis by "Y". All customers' commodity interest accounts are carried on a disclosed basis by "X". Currently, less than one percent of the Company's total revenue is derived from commodity-related activity. The Company does not advertise its commodity interest business, but offers commodity interest services to existing customers merely as a courtesy.

When customers open a commodity interest account, they complete, among other documents, authorization forms to permit the transfer of funds both ways between the commodity interest and the securities accounts at "X" and "Y". After the customer signs these authorization forms, funds will be transferred between accounts at the two firms upon a customer's oral request. The Company does not take possession or have control of customer funds required to be segregated under the Commodity Exchange Act (the "Act").¹

In regard to transfers of funds from a customer's securities account at "Y" to the customer's commodity interest account at "X", the transfer is effected by Company

personnel drawing a check on a "Y" bank account, making the check payable to "X's" Customer Segregated Account, and then depositing the check in "X's" segregated bank account. "X" has a segregated account with a bank in the same building as the Company, and the deposit merely requires Company personnel to carry the check to the first floor banking facility. NFA staff questioned whether the ability to draw checks payable to "X's" segregated account constituted the handling of customer funds under the Act and Commission rules thereunder and whether that, coupled with the Company's handling of commodity interest orders, effectively brought the Company within the definition of an FCM.

You have requested an interpretation from the Division whether, based upon the foregoing, it is necessary for the Company to register as an FCM. An FCM is defined in section 1(a)(12) of the Act as an individual, association, partnership, corporation, or trust that--

(A) is engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market; and

(B) in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

Commission Rule 1.57(c),² which defines the permissible operations of an IB, includes among other provisions:

An [IB] may not accept any money, securities or property (or extend credit in lieu thereof) to margin [commodity trades or positions]: *Provided, however,* That an [IB] may deposit a check in a qualifying account or forward a check drawn by a customer or option customer if:

- (1) The [FCM] carrying the customer's or option customer's account authorizes the [IB], in writing, to receive a check in the name of the [FCM], and the [IB] retains such authorization in its files in accordance with § 1.31;
- (2) The check is payable to the [FCM] carrying the customer's or option customer's account;
- (3) The check is deposited by the [IB], on the same day upon which it is received, in a . . . qualifying account . . . ;
- (4) . . . a qualifying account shall be deemed to be an account:

- (i) Which is maintained in an account name which clearly identifies the funds therein as belonging to commodity . . . customers of the [FCM] carrying the . . . account;
- (ii) For which the bank . . . restricts withdrawals to withdrawals by the carrying [FCM];
- (iii) For which the bank . . . prohibits the [IB] or anyone acting upon its behalf from withdrawing funds; and
- (iv) For which the bank . . . provides the [FCM] . . . with a written acknowledgment . . . that it was informed that the funds deposited therein are those of commodity . . . customers. . . .

The restrictions on an IB's handling of checks representing customers' commodity interest account margin deposits assume that such checks are received by an IB from its customers. The Company, however, actually prepares the check, at the customer's authorization, which is then deposited into an "X" segregated bank account. Given these somewhat unusual circumstances, in regard to the procedures in place, we would expect the Company to be able to provide to NFA's or the Commission's auditors, if and when requested, the following:

1. An authorization from "Y" to the Company authorizing specific individuals to draw checks on the "Y" bank account that is used to transfer funds from "Y" to "X's" segregated bank account;
2. The canceled checks drawn on the account;
3. Copies of deposit slips showing the deposit of the transfer check into an "X" segregated account;
4. Evidence that the Company is not able to withdraw funds from the "X" segregated account;
5. A record in chronological order of all transfers made by the Company between "Y" and "X" including the name/account numbers of the customers' accounts involved and the amounts transferred for each customer; and
6. The name of the person receiving the authorization to transfer funds, and the individual calling the Company to initiate a transfer, if the account is carried in the name of other than an individual.³

You include with your November 7, 1996 letter copies of transfer authorization forms used by the Company. We note an error in the form which is used for authorizing transfers of funds from a commodity interest account at "X" to a securities account at "Y" (the one that has "TO: "X" at the top of the form and "TO: "Y" at the bottom). In the "TO: "Y" section in the second line, the word "securities" should actually be "commodities." (A copy is enclosed.)

Based upon your representations and the Company's ability to provide upon request the documentation referred to in items 1-6 set forth above, the Division will not recommend that the Commission take any enforcement action under Section 4d(2) of the Act against the Company based solely upon Company's failure to register as an FCM. This no-action position does not affect any other duties or responsibilities of the Company, "X" or "Y".

The position taken herein is based upon 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 that the operations or activities of the Company, "X" or "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 and does not necessarily represent the views of the Commission or of any other unit of the Commission's staff.

If you have any questions concerning this correspondence, please contact me or Teresa Dondlinger Trissell, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin

Chief Counsel

¹ See 7 U.S.C. § 6d(2) (1994).

² Commission rules referred to in this letter are found at 17 C.F.R. Ch. I (1996).

³ See also CFTC Interpretative Letter No. 90-17, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,919 (August 23, 1990).