CFTC Letter No. 02-91
July 30, 2002
Interpretation
Division of Clearing and Intermediary Oversight

Re: Section 1a(23) and Regulation 1.3(mm) -- Request for Interpretation in Connection with the Definition of an Introducing Broker

Dear :

This is in response to your letter dated June 4, 2002, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"),[1] as supplemented by an e-mail dated June 10, 2002, and telephone conversations with Commission staff. By your correspondence, you request that the Division concur with your assessment that "Y", a subsidiary of "X", would not be an Introducing Broker ("IB") under the Commodity Exchange Act ("Act"),[2] with regard to providing customers with the ability to access the order-entry system of the futures commission merchant ("FCM") of their choice while using "X's" information services.

Facts

Based upon your representations, we understand the relevant facts to be as follows. "X" is an electronic information aggregator and distributor that provides data and technology services for displaying third party content, such as market data, newswires, cash market pricing, and weather information. Customers receive these services by way of dedicated phone lines, satellite, or the Internet.

You represented that "X" plans on providing customers of "X" data services with an integration tool to permit customers to access the order-entry system of the FCM of their choice. You represented that "X" customers will select their own FCMs and negotiate any and all fees between themselves and the FCM. "X" will not recommend, propose, or encourage customers to use any particular FCM, even in response to a customer inquiry, nor will it in any other manner solicit customers for an FCM. The customer will inform "X" of the FCM with which it has an account and "X" will work with the FCM to develop the required technology to provide the customer access to the FCM's order-entry system. When the technology has been implemented, the customer will be able to open its selected FCM's order-entry system via a mouse-click. When the customer opens the FCM's order-entry system, the customer will log into the system and enter its trade in the FCM's system as it normally would. As a result, there will be two separate applications open and running simultaneously. In fact, in a browser-based system, the mouse-click will result in a separate browser window being automatically launched to provide the customer access to the FCM's order-entry system. In this way, "X" is simply providing technology that facilitates order-entry in a more efficient manner. Absent this technology, customers would have to themselves open a second application to access their chosen FCM's order-entry system.

You have represented that this integration tool will be available to all "X" customers and that "X" is not involved in any way with the selection of an FCM for any customer. "X" does not receive any form of payment from its customers for the use of the integration tool. "X" customers who request the integration tool do not pay "X" any more for its data services than those customers who do not request the integration tool. "X" receives a transmission fee from the FCM. The fee is based on and intended to cover the costs of development, implementation, and ongoing support of the technology required for the integration tool and is not associated in any way with fees the customer might pay to the FCM for executing the trade. The FCM pays the fee to "X" even if the customer decides not to submit the order into the FCM's order-entry system for execution. You represented that, since all FCMs do not utilize the same technology in their order-entry systems, "X" must develop new and unique software for different FCMs. Additionally, "X" must re-develop applicable software whenever an FCM releases a newer version of its order-entry system.[3]

Analysis

Section 1a(23) of the Act defines an introducing broker ("IB") as:

[A]ny person (except an individual . . . registered as an associated person of a futures commission merchant) 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 or derivatives transaction execution facility 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.

Rule 1.3(mm)[4] similarly defines an IB, in relevant part, 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 a 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.

The Futures Trading Act of 1982,[5] among other things, amended the Act to require persons known as "agents" of FCMs to register as IBs, so as to "resolve[ ] any existing uncertainty as to the status of [these] agents."[6] In creating the separate IB registration category, Congress intended to "protect the public" from the "sales abuses" of such agents for which FCMs "frequently disavow[ed] any responsibility."[7]

In establishing the rules relating to IBs and their registration, the Commission noted that the intent of the Futures Trading Act of 1982 was "to require those persons who performed the type of activities traditionally engaged in by agents to register with the Commission as an [IB]."[8] The Commission

indicated that "[h]istorically, agents . . . carried all of their accounts on a fully-disclosed basis with an FCM which provided 'back office' services for those accounts."[9] The Commission further stated that "the phrase 'soliciting or accepting orders,' . . . must be construed to encompass not just the literal solicitation or acceptance 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."[10]

"X" would not have been considered an agent of an FCM prior to 1982. "X's" central business activities are the collection and distribution of data services and it is not involved with the intermediation of trading on the futures markets. "X" does not solicit customers or orders for an FCM or the trading of futures contracts. Customers indicate to "X" the FCM with which they have an existing relationship. Even in response to a customer inquiry, "X" does not recommend, propose, or encourage that customers use any particular FCM, or place any orders for futures contracts. The fees paid to "X" by the FCM are a reflection of the costs of the development and ongoing support of the required technology and are intended to cover these costs and are not associated with the placement of customer orders (the fee is paid by the FCM whether the trade is executed or not).[11] Because "X" is only recovering development and ongoing support costs from FCMs to which customers wish to establish a link, "X's" net income should be unaffected by its providing this additional service. Further, "X" is not accepting customer orders. "X" is simply providing technology that connects the customer to its FCM's order entry system. The customer is submitting its order to the FCM and not "X". The Division concurs with your assessment that "X" is not an IB and, therefore, is not required to register as such.

The Commission has not previously opined as to the registration requirements under the Act as they relate to data service providers, such as "X", that provide technology to facilitate the order entry process and do not engage in activities that would otherwise require registration. If in the future the Commission determines that such entities must be registered under the Act, "X" will have to comply with the applicable registration requirements at that time.

The position taken herein is based upon the representations that have been made to the Division. Any different, changed, or omitted facts or conditions might require the Division to reach a different conclusion. You must notify the Division immediately in the event the operations or activities of "X" change in any material way from those represented to us. Further, this letter represents the position of this Division only and does not necessarily represent the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact Michael A. Piracci, an attorney on my staff, at (202) 418-5430.

Very truly yours,
Jane Kang Thorpe
Director

---

[1] As of July 1, 2002, a reorganization of Commission staff became effective. The responsibility for addressing requests for interpretative, no-action, and exemptive letters (including letters such as your June 4, 2002, letter) is now with the Division of Clearing and Intermediary Oversight. Accordingly, for purposes of this letter, the term "Division" includes the Division of Clearing and Intermediary Oversight and its predecessor, the Division of Trading and Markets, as the context requires.

[2] 7 U.S.C. § 1 *et seq.* (2000).

[3] You have represented that approximately 20 percent of "X's" software development budget is allocated for the development and continuing support of the integration tool.

[4] 17 C.F.R. § 1.3(mm). Commission rules referred to herein are found at 17 C.F.R. Ch.1 (2002).

[5] Pub. L. No. 97-444, 96 Stat. 2294 (1983).

[6] H.R. Rep. No. 97-565, pt. 1, at 49 (1982).

[7] *Id*.

[8] 48 Fed. Reg. 35248, 35250 (August 3, 1983), *quoting* 48 Fed. Reg. 14933, 14935 (April 6, 1983).

[9] *Id*.

[10] *Id*.

[11] Agents were generally compensated by being "allocated a percentage of the commissions charged by the FCM on the trades made by the agent's customers." *Id*.