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COMMODITY FUTURES TRADING COMMISSION
2033 K Street, NW, Washington, DC 20581
(202) 254 - 8955
(202) 254 - 8010 Facsimile

DIVISION OF
TRADING AND MARKETS

July 29, 1993

Re: Rule 1.57/Request for No-Action Position

Dear :

This is in response to your letter to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") dated June 25, 1993 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". Upon entering into their guarantor/introducing broker relationship, both "Y" and "X" anticipated that all accounts introduced by "X" would be cleared through "Y". Nonetheless, although the institutional clients introduced by "X" have selected "Y" as their executing broker, they generally have directed that their accounts be cleared through other FCMs. In this regard, you note that in many, if not all cases, the institutional customers introduced by "X" were clearing their transactions with FCMs other than "Y" prior to directing their execution business to "Y".

In support of your request, you represent that, notwithstanding that certain "X" customers elect to have their transactions cleared with 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 has a substantial cushion over the capital required to support outstanding customer positions. Specifically, you represent that as of March 30, 1993 "Y" had adjusted net capital of approximately $56.7 million, and excess net capital of $51 million.

Further, you note your understanding that the standard guarantee agreement entered into between "Y" and "X" pursuant to Commission Rule 1.10(j) 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 Guarantee Agreement, it accepts joint and several liability for all obligations of "X" under the Commodity Exchange Act, as amended[1/] (the "Act") 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 their 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), as amended[4/] against "X" or

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[1/] 7 U.S.C. § 1 et seq. (1988 & Supp. IV 1992)

[2/] 57 Fed. Reg. 23136 at 23143 (June 2, 1992); 17 C.F.R. 1.57(a)(1) (1993).

[3/] See 57 Fed. Reg. 23136 at 23137. The amendment effectively codifies 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).

[4/] 57 Fed. Reg. at 23143.

"Y" if "X" 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 Susan C. Ervin, the Division's Chief Counsel, at (202) 254-8955.

Very truly yours,

Andrea M. Corcoran
Director