

CFTC Letter No. 00-105**November 15, 2000****No-Action****Division of Trading & Markets**

Re: Section 4d(1) – No-Action Relief in Connection with Registration as an
Introducing Broker

Dear :

This is in response to your letter dated September 14, 2000, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations with Commission staff, in which you request an interpretation as to whether linking elevators with the futures commission merchant ("FCM") of their choice, on an electronic trading platform, would require "X" to register as an introducing broker ("IB") under the Commodity Exchange Act ("Act").¹

Based upon your representations, we understand the relevant facts to be as follows. "X" is an online agricultural marketplace where producers, dealers, elevators, and manufacturers conduct business. As part of "X", producers and elevators buy and sell grain on an electronic platform. Each elevator approves producers from whom they want to purchase grain, and the platform permits password protected online negotiating between the producers and the elevators. All participants have fair and impartial access to post bids and offers with no preferential access afforded to any participant.

You represented that, for the trading platform to be effective, the elevators must be able to simultaneously hedge their purchases from producers in the futures market. Accordingly, as part of the trading platform, "X" will offer an integration tool that permits elevators to be linked to their chosen FCMs so as to permit simultaneous hedging of purchases in the futures market. You also represented that without such an integration tool an elevator's risk management position could be adversely affected, e.g., it could buy grain at the high of the day, yet not be aware of this until it later seeks to hedge its purchase and is forced to hedge at a lower value.

You represented that the elevators will select their own FCMs and negotiate any and all fees between themselves and the FCM. Additionally, the elevators are responsible for all margin obligations created by any trade directed to the FCM. "X" is not involved in any way in the selection of an FCM for any elevator and does not receive any payment from an FCM in relation to any aspect of this integration tool.

Section 1a(14) of the Act² 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 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)³ 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.

Section 4d(1) of the Act⁴ requires any person soliciting or accepting orders for futures contracts as an IB to be registered as such.

The registration requirements of the Act are an important part of customer protection. The registration requirements, as they pertain to persons involved in customer solicitation, "have been construed flexibly to require the registration of persons who participate even indirectly in such solicitations."⁵ In establishing the rules for registration as an IB, the Commission indicated its intent to:

require registration as an [IB] by any person who is compensated for the referral of customers to an FCM. Specifically, the Commission is of the opinion 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.⁶

Accordingly, in response to interpretive and no-action letter requests, the Division has consistently stated that persons who refer customers to Commission registrants for compensation must register.⁷ Those who have been required to register as IBs include persons who: (1) generated a list of potential customers and sold the list to Commission registrants;⁸ (2) were hired by a Commission registrant to conduct a telephone survey in order to develop a database of potential customers for the registrant;⁹ (3) sold a service that provided potential futures customers with the names of APs who may be able to provide specific futures-related services;¹⁰ and (4) received a portion of the fee paid to an FCM by customers referred to the FCM.¹¹ The Division has also stated that a provider of futures-related information services which included advertisements for an FCM in its mailings to customers in return for the FCM providing customers with a per trade commission "rebate" that could be used to pay for the

information service must register as an IB. In the Division's view, this arrangement was a form of indirect compensation because it allowed the corporation providing futures-related information services to offer a discount without losing revenue and helped it to maintain its customer base.¹²

It could be argued that "X" is indirectly compensated for routing orders to FCMs because the ability by elevators to simultaneously place a hedging order with an FCM contributes to "X" being able to maintain its customer base of elevators. However, based upon your representations, and in particular upon your representations that: (1) without this tool, elevators might not be willing to undertake the risks presented by purchasing cash grain through the trading platform; (2) this tool will facilitate a reasonable business purpose, i.e., the hedging of cash purchases by elevators; (3) "X" has no involvement in selecting the FCMs that any elevator uses; and (4) "X" does not receive any direct compensation from such FCMs, the Division will not recommend that the Commission commence any enforcement action against "X" based solely upon its failure to register as an IB under Section 4d(1) of the Act.

This letter does not excuse "X" from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, "X" remains subject to all of the antifraud provisions of the Act and the Commission's regulations issued thereunder.

The positions taken herein are based upon the representations that have been made to us. Any different, changed, or omitted facts or conditions might require us to reach a different conclusion. You must notify us 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 Lawrence B. Patent, Associate Chief Counsel, or Michael A. Piracci, an attorney on my staff, at (202) 418-5430.

Very truly yours,

John C. Lawton
Acting Director

1 7 U.S.C. § 1 *et seq.* (1994).

2 7 U.S.C. § 1a(14) (1994).

3 17 C.F.R. § 1.3(mm). Commission rules referred to herein are found at 17 C.F.R. Ch.1 (2000).

4 7 U.S.C. § 6d.

5 CFTC Interpretative Letter No. 99-28, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,718 (July 9, 1999).

6 48 FR 35248, 35250 (August 3, 1983), *citing* 48 FR 14933, 14935 (April 6, 1983).

7 A natural person who receives compensation from a Commission registrant for customer referrals may register as an associated person of that registrant. A corporate or business entity that receives such compensation is required to register as an IB.

8 CFTC Interpretative Letter No. 96-45, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,715 (May 18, 1996).

9 CFTC Interpretative Letter No. 90-8, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,831 (May 7, 1990).

10 CFTC Interpretative Letter No. 98-76, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,477 (November 18, 1998) (the service intended to charge customers a one time flat fee and to charge APs an annual fee to be listed in the service database).

11 CFTC Interpretative Letter No. 99-28, *supra*, n. 5.

12 CFTC Interpretative Letter No. 95-51, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,420 (May 1, 1995); *see also* Interpretative Letter No. 75-6, [1975-1977 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 20,093 (August 13, 1975) (conduct contributing to maintenance of customer base is "compensation or profit" as used in definition of commodity trading advisor).