COMMODITY FUTURES TRADING COMMISSION
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DIVISION OF
TRADING AND MARKETS

9559

May 26, 1995

Re: Request for No-Action Position

Dear :

This letter responds to your letter dated January 20, 1995 in which you request confirmation from the Division of Trading and Markets ("Division") that the Division will not recommend that the Commodity Futures Trading Commission ("Commission") initiate an enforcement proceeding against "X" if "X" reports to certain customers an average price calculated by "X" with respect to trades executed on certain non-domestic exchanges. An average price would be reported when multiple prices are received on an order or series of orders for the same customer or for the accounts of several customers when the accounts are controlled by a single investment manager. Based upon the representations made in your letter, we understand the facts to be as described below.

"X", which is registered with the Commission as a futures commission merchant ("FCM"), has affiliates worldwide which are members of the futures exchanges in their respective cities and countries. "X's" customers are primarily institutional investors that may use the services of domestic and non-domestic investment managers. These investment managers prefer to maintain their accounts with "X", rather than with "X's" affiliates, in order to take advantage of the efficiencies afforded by maintaining both U.S. and foreign positions through a central location. Non-domestic transactions on behalf of these customers are executed and cleared through omnibus accounts maintained by "X" with its affiliates. Several of these customers have asked "X" to provide average pricing for transactions entered into on their behalf on non-domestic exchanges. "X" wishes to provide this service in accordance with the procedures set forth below.1/

1/ You state that "X" would not offer average pricing with respect to any contracts executed on an exchange that prohibits average pricing. In any event, the "X" affiliate, which is a clearing member of the exchange on which the transaction is executed, would clear and report the transaction to the exchange and to "X" at the actual execution price.

Eligible Accounts

Average pricing would be made available only to those "X" customers who request it. The program initially would be made available to "X" customers who are U.S. and non-U.S. clients of approximately 20 investment managers, including multiple hedge funds with the same advisor. Appropriate disclosure regarding average pricing would be made to all "X" customers. No "X" proprietary account would be included in the average pricing program, although it is possible that "X" or an entity that would be a proprietary account of "X" could invest in one or more hedge funds that would take advantage of average pricing. "X" would not have an interest greater than ten percent in such hedge fund.[2/]

Average Pricing Procedures

"X's" average pricing system essentially would follow the same procedures currently used in average pricing systems at the Chicago Board of Trade, the Chicago Mercantile Exchange and other U.S. contract markets. The average prices, however, would be calculated by "X" rather than by the applicable exchange. Average pricing would be available for futures transactions only in the same commodity and the same contract month and for option transactions only in the same commodity, contract month, put or call, and strike price. Average pricing could be used when multiple fills are received on a single order or for a series of orders throughout the same trading day. If an order for multiple clients of a single investment manager is not filled completely, trades would be allocated among the clients in accordance with a pre-established allocation program.

Transactions would be cleared through the appropriate clearing organization at the actual execution price and this price would be reported to "X" by its affiliates.[3/] "X" then would calculate the average price for those accounts included in

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2/ You note that "X" reserves the right to include proprietary accounts in its average pricing system at a later date. This letter does not address whether "X" may include proprietary account orders with customer orders in its average pricing program.

3/ You note that "X" would have the underlying records that confirm the actual execution prices for all transactions subject to the average pricing program. "X" also would be required to maintain records reflecting the calculation of the average price and the subsequent allocations to customer accounts. These records would be maintained in accordance with Commission Regulation 1.31 and would be available for inspection by the Commission and the affected customers upon request.

the program as follows. Each execution price would be multiplied by the quantity executed at that price and the sum of each of these products then would be divided by the total quantity. If necessary, the average price calculation would be carried five decimal points beyond the minimum tick value established by the relevant exchange and then rounded in favor of the customer. All transactions to which an average price has been assigned would be identified as such on the daily and monthly confirmation statements provided to the customers. These procedures are consistent with those previously approved in connection with exchange rules establishing average pricing systems.

Commission Regulation 1.33 requires that an FCM provide written monthly and confirmation statements to each customer. Among other things, the monthly statement must show the open futures contracts and the prices at which they were acquired ("acquisition prices") and, for option customers, the confirmation statement must show the actual amount of the option premiums.

As described by your proposal, all transactions to which an average price has been assigned would be identified on the daily and monthly confirmation statements provided to the customers. In connection with its review of proposed exchange average pricing systems, the Division stated that prices determined according to the approved methodology could be reported to customers as acquisition prices under Commission Regulation 1.33. The Division will deem the requirements of Regulation 1.33, that monthly statements reflect acquisition prices and that confirmation statements reflect the actual amount of option premiums, to be fulfilled if the average prices are reflected in such statements, provided that the underlying records reflecting actual execution prices, average price calculations, and allocations are maintained at "X" in accordance with Regulation 1.31, and are available for review by the Commission and affected customers.

In view of the foregoing, subject to the facts and conditions stated herein and based on your representations as to the manner in which average pricing would be accomplished in-house at "X", the Division would not recommend any enforcement action against "X" under Commission Regulation 1.33 if "X" reports to customers average prices for trades executed by "X" affiliates on non-domestic exchanges that do not preclude average pricing. "X" would remain subject to other provisions of the Act and Commission regulations, including Commission Regulation 30.9.

Please be advised that the Division's conclusion is based on its understanding of the facts and circumstances as represented. Any different, omitted or changed facts or conditions might require a different conclusion. Of course, this conclusion is also subject to any further regulatory action which the Commission may take in this area. Finally, you should note that the views expressed herein are solely those of the Division and are not binding on the Commission or any other division or office of the Commission.

Very truly yours,

Andrea M. Corcoran
Director