



U.S. COMMODITY FUTURES TRADING COMMISSION

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96-39

DIVISION OF
TRADING & MARKETS

May 6, 1996

Re: Section 4d of the Commodity Exchange Act --
Request for Relief from IB Registration
Requirements Where Company Con-tinues to Receive
Finder's Fees from Former Clients.

Dear :

This is in response to your letter dated April 5, 1996 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by your letter dated April 18, 1996 and telephone conversations with Division staff. By your letter, as supplemented, you requested relief on behalf of "A" and "X" from the introducing broker ("IB") registration requirements of Section 4d(1) of the Commodity Exchange Act ("Act")^{1/} in the context of "X's" continued receipt of finder's fees from commodity trading advisors ("CTAs") for whom "X" obtained clients while registered with the Commission as an IB.

Based upon your representations, we understand the pertinent facts to be as follows. "X" was registered with the Commission as an IB and was a member of the National Futures Association ("NFA") from April 11, 1995 until February 28, 1996. "A" was a registered associated person ("AP") and listed principal of "X" for the same period.^{2/} "A" used his contacts in the futures industry -- mainly registered APs of futures commission merchants ("FCMs") and other IBs -- to market the programs of various CTAs to members of the public. However, "X" employees seldom dealt directly with members of the public but instead dealt with other Commission registrants. In cases in which "X" employees dealt with members of the public, an AP of a particular FCM or the other IB was present. "X" did not participate in opening or in processing the paper work involved in opening accounts at an FCM or in formalizing the CTA's relationship with any client. Further, "X" did not maintain any

^{1/} 7 U.S.C. § 6d(1) (1994).

^{2/} "A" personally has had over fifteen years experience in the futures industry. NFA's registration database shows that he has been registered as an AP of various firms since the early 1980s.

ongoing relationship with persons who became clients of the CTAs for whom "X" worked.^{3/}

"X's" compensation for its services in marketing CTAs was generally done on a fee-sharing basis, i.e., "X" received a percentage of the fees collected by the CTA on the accounts that "X" introduced to a CTA. Generally, "X's" agreements with the CTAs called for it to receive fees for as long as an account remained open, with the percentages declining after the first two years of the account's opening.

In early 1996, the two employees of "X", "A" and "B,"^{4/} were hired as full-time employees of one of "X's" client-CTAs, "Y". "Y" did not wish for "A" to remain registered as an AP of an unaffiliated company and, thus, "A" had to sever ties with "X". "X" could not economically maintain its IB registration status without the participation of "A", its sole principal, and withdrew its registration. "X" no longer offers its marketing services and is dormant. However, some of the accounts introduced by "X" to its client-CTAs remain open and therefore will continue to produce income for "X". Since "X" received no other income for "finding" these accounts for its client-CTAs, it wishes to collect these fees even though it is no longer registered as an IB. If the relief requested herein is granted "X" will continue as a dormant company whose only activity will be to receive payment of the fees due from its former client-CTAs.^{5/} In this regard, you represent that "X" would be willing to cease receiving any fees from its former client-CTAs on a date two years from the date of our response to you.

^{3/} We have stated that persons who refer clients to CTAs for compensation must be properly registered with the Commission, generally either as an IB or as an AP of the CTA. See, e.g., CFTC Interpretative Letter No. 86-27 [1986-1987 Transfer Binder] Comm. Fut. L. Rep. ¶ 23,364 (November 24, 1986). Further, we note that under Commission Rule 4.34, the CTA in question would be required to properly disclose the arrangements under which a third party was compensated for referring customers to the CTA. See 17 C.F.R. § 4.34 (1995), as amended by 60 Fed. Reg. 38,146 (July 25, 1995).

^{4/} NFA's registration database indicates that "B" was a registered AP of "X" and is now a registered AP of "Y".

^{5/} The fees would be paid to the dormant company, but "A" as sole owner of "X" would be the ultimate recipient of the income produced from these fees. The CTAs from whom "X" may receive commission payments in the future are: "R"; "S"; "T"; and "U". NFA's registration database shows that these CTAs are all registered with the Commission.

Generally, a person must be properly registered to collect fees as compensation for soliciting clients on behalf of other Commission registrants, even where, as in "X's" case, the person is receiving a so-called "trailing commission." However, the Commission has stated that "the Act does not require registration as a prerequisite to the receipt of trailing commissions in all circumstances."^{6/} Based upon your representations that (1) "X" has no follow-up contact with, or responsibilities for, the accounts in question and its business activity will now be limited to accepting fees from its former client-CTAs, (2) "X" was registered as an IB at the time it solicited members of the public for its CTA-clients, and is no longer soliciting customers on behalf of its CTA-clients, and (3) "X" will cease receiving all fees from its former CTA-clients at a date not later than two years after the date of this letter, we believe that it would not be contrary to the public interest for "X" to continue to receive fees for the next two years from the accounts it introduced to its client-CTAs, as outlined above. Thus, we confirm that the Division will not recommend that the Commission take enforcement action against "X" or "A" under Section 4d(1) of the Act, based solely upon "X's" failure to remain registered as an IB while it continues, during the next two years, to collect fees owed by its former client-CTAs as described above. This relief is subject to the conditions that "A" remains registered with the Commission during the entire period in which "X" receives fees from its former client-CTAs and that all such fees will cease to be paid to "X" at a date not later than two years from the date of this letter.

The relief granted herein is applicable to "X" and "A" solely in connection with their right to receive fees as described above without maintaining "X's" registration as an IB. It does not excuse "X" or "A" from compliance with any other applicable requirements contained in the Act^{7/} or the Commission's rules promulgated thereunder. This letter is based upon the representations provided to us and is subject to compliance with the conditions set forth above. Any different, changed or omitted facts or circumstances may require us to reach different conclusions. In this regard, we ask that you notify us immediately if the matters discussed above, including but not limited to the arrangements for paying fees due to "X", change in any way from

^{6/} In the Matter of GNP Commodities Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. ¶ 25,375 at 39,283 (September 4, 1992). (although FCM's registration was revoked and its assets sold, it was allowed to receive periodic payments based on commissions paid and floor broker revenues earned on those assets).

^{7/} 7 U.S.C. § 1 et seq. (1994).

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those represented to us. Further, the views expressed in this letter are those of this Division only and do not necessarily represent the views of the Commission or any other office or division of the Commission. If you have any questions concerning this correspondence please contact me or Thomas E. Joseph, an attorney on my staff, at (202)418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel