CFTC Letter No. 98-22

March 25, 1998

Division of Trading & Markets

Re: Rule 166.4 -- Request for Interpretative Advice Concerning "V"s' operation as a Branch Office of "W"

Dear :

This is in response to your letter dated January 5, 1998 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by letters dated February 27, 1998 and March 2, 1998 and telephone conversations with Division staff. By your correspondence, you request interpretative advice concerning the relationship between "V" and "W". You request advice as to whether the former offices of "V", in operating as branch offices of "W", will be in compliance with Rule 166.4[1] if they use, for all purposes, including in promotional materials and disclosure documents, the name "V", a division of "W"."

Based upon your representations, we understand the pertinent facts to be as follows. "V" is a corporation organized in "P". It has two offices, one of which is located in "Q", and the other of which is located in "R". "V" also is registered as an introducing broker ("IB"), though it does not presently act in this capacity or hold itself out as an IB. Previously, "V" was guaranteed by "X", a futures commission merchant ("FCM") that has filed an application to terminate its registration. "X" terminated its guaranteed IB agreements, including its guarantee of "V", in November 1997, after its adjusted net capital had fallen below the required minimum level. Though "V" would like to become an independent IB, it cannot meet the minimum net capital requirement set forth in Commission Rule 1.17(a)(1)(ii), which incorporates by reference NFA Interpretative Notice I-97-04 ("Notice").[2] The Notice applies to IBs, such as "V", that employ a certain number of associated persons ("APs") from disciplined firms[3] and requires such IBs to operate pursuant to a guarantee agreement or maintain $250,000 in adjusted net capital.[4]

Rather than operate as an IB, "V's" two offices have become branch offices of "W". "W" is a corporation organized in "P" and is registered as an independent IB. "V" seeks advice as to whether it will be in compliance with Rule 166.4 if it uses the name "V", a division of "W" in all of its promotional materials and disclosure documents.

Rule 166.4 provides that "[e]ach branch office of each Commission registrant must use the name of the firm of which it is a branch for all purposes, and must hold itself out to the public under such name." Although the Rule does not address specifically the issue you have raised -- whether a separately incorporated IB, in operating as a branch office of another IB, may use that IB's name

in conjunction with its own name -- we believe that use of both names contravenes both the purposes and policies for the separate registration categories set forth in the Commodity Exchange Act (the "Act"). [5] The Commission has further made clear that registrants may not operate separately incorporated branch offices.

Rule 166.4 was adopted at the same time that the Commission adopted rules implementing amendments to the Act that required the registration of IBs and APs of IBs, CTAs and CPOs. The amendments required those persons who formerly could be characterized as "agents" of the FCMs to register with the Commission as IBs and required the registration of the APs of these former "agents." In adopting the rules, the Commission discontinued the "no-action" positions it had provided to these agents and their APs in the interim before they could become registered. 48 Fed. Reg. 35248, 35252 (Aug. 3, 1983).[6] At the time, it was believed that a "not insubstantial" number of country elevators and cash grain merchants, which formerly had acted as agents of FCMs, and whose activities were often incidental to their principal business, might, in the absence of final rules, have difficulty deciding whether to apply for registration as an IB or a branch office of an FCM. The "no-action" positions enabled such persons to continue operating until such a decision could be made. When the "no-action" positions were abandoned, the Commission gave as its rationale the fact that the Futures Trading Act of 1982 specifically contemplated the separate existence and business identity of IBs upon the elimination of the former statutory category of "agents" of FCMs. *See* 48 Fed. Reg. at 35252-53.

Soon after Rule 166.4 was adopted, the Division issued an interpretation in which it advised a requester that a branch office that maintained a separate legal existence was required to elect either to operate as an IB or to forsake its separate identity and become a "proprietary branch office of the FCM." CFTC Interpretative Letter No. 84-10 [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,252 (May 29, 1984). Upon subsequent review, the Commission found the Division's position consistent with the Act and the Commission's own statements on the issue and thus found that the operation of non-proprietary branch offices contravened the specific intent of Congress to require the registration of IBs. CFTC Interpretative Letter No. 84-26 [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,472 (Dec. 6, 1984).

In a subsequent interpretation, the Division made clear that a branch office must be clearly identified as such and must, through all means of communication, hold itself out to the public as a branch office separate and distinct from other business entities that share the same facilities. In CFTC Interpretative Letter No. 89-08, 1989 WL 508630 (July 19, 1989), the Division was asked whether branch offices of registrants could operate at the facilities of certain agricultural businesses, such as cattle feedyards and grain elevators, to provide clearing services for the futures and options transactions of producers that deal with the agricultural businesses. The Division was specifically asked whether the agricultural businesses could continue to use their own names when answering the telephone, notwithstanding the fact that certain callers would be requesting brokerage services. The Division opined that "separate entrances, clear signs and other denotations of the branch office's status as a branch of [the registrant] and indicia of the independent nature of

the branch office from the host business are essential to compliance with Rule 166.4."

We believe that the positions taken by the Commission and its staff dictate that the former "V" branch offices may not, consistently with Rule 166.4, continue to use the "V" name in conjunction with the "W" name. The "V" branch offices have chosen to forego their separate IB legal identity and instead to operate as proprietary branch offices of another IB. They must therefore operate for all purposes as branch offices of that IB. In this respect, they must forego their separate incorporation and registration status, and they may not use the "V" name in any promotional materials and disclosure documents. The former "W" branch offices must be identified exclusively as branch offices of "W".

This letter is based on the representations made in your letter, as supplemented. Any different, changed, or omitted facts or circumstances might require us to reach a different conclusion. Nothing in this letter should be construed as limiting in any way the Commission's ability to institute enforcement proceedings or other action against "V" for any past violation of the Act or Commission rules as a result of "V's" continuing to maintain its separate incorporation and registration status while operating as a branch office of "W".

If you have any questions concerning this correspondence, please contact Helene D. Schroeder, an attorney on my staff, at (202) 418-5450.

Very truly yours,

I. Michael Greenberger

Director

[1] Commission rules referred to herein are found at 17 C.F.R. Ch. I (1997).

[2] Commission Rule 1.17(a)(1)(ii) requires than an independent IB maintain minimum adjusted net capital equal to or in excess of the greatest of $30,000, the amount required by NFA, or, if it is also a securities broker-dealer, the amount required by the Securities and Exchange Commission.

[3] As of February 10, 1998, "V" employed 13 APs of which 10 previously were employed by disciplined firms.

[4] The Notice also requires "W", in operating as an IB, to tape record its sales solicitations for a period of two years. In operating as branch offices of "W", "V" would not be subject to the tape recording requirements provided by the Notice. The "V" branch offices, however, would be subject to other NFA restrictions that apply to "W", including the conditions set forth in a December 17, 1997 NFA Business Conduct Committee Decision ("Decision") against "W". Among other things, the Decision requires "W",

for a period of three years, to retain an independent consultant that has the facilities to tap randomly into "W's" phone lines in order to monitor "W's" telephone solicitations of customers. NFA also is authorized to participate randomly in this monitoring activity of "W".

[5] 7 U.S.C. § 1 *et seq.* (1994).

[6] The "no-action" positions were provided to agents of FCMs and their APs that followed certain procedures outlined in a letter provided to all registered FCMs. S*ee* 48 Fed. Reg. 15890 (April 13, 1983). The Commission subsequently provided additional guidance based upon certain questions that arose in the implementation and interpretation of the "no-action" positions. 48 Fed. Reg. 19362 (April 29, 1983) (making make clear that APs of FCMs whose registrations were not transferred to the IBs nor included as APs of existing or newly-designated branch offices could remain associated with the FCMs if they are compensated directly by the FCM).