CFTC Letter No. 99-01

December 23, 1998

Division of Trading & Markets

Re: Interpretation of Rule 1.57(a)

Dear :

This is in response to the letter dated January 23, 1998 from "X", a registered futures commission merchant ("FCM"), to Mr. Bob Agnew of the Southwestern Regional Office of the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"). "X's" letter was referred to this office for reply. Subsequently, "X" submitted additional information to this office by letter dated January 28, 1998, as supplemented by letters from "Y" dated February 4, February 20, and December 3, 1998, and from "Z" dated March 9, 1998. By this correspondence, "Y", a registered commodity pool operator ("CPO") and a registered introducing broker ("IB") guaranteed by "Z", a registered FCM, requests confirmation that it may open an account with "X" for a commodity pool operated by "Y" and that such action is permissible under Rule 1.57(a).[1] Since the requirements of that rule relate to the obligations of an IB, we believe that it is appropriate to address this letter to "Y" despite the fact that the original request for interpretation was submitted by "X".

Rule 1.57(a) requires that an IB that has entered into a guarantee agreement with an FCM (an "IBG") must open and carry a customer or option customer account with its guarantor FCM on a fully-disclosed basis. By this rule, the Commission sought to make clear that an IBG must introduce *all* of its customer and option customer accounts to its guarantor FCM on a fully-disclosed basis.[2] The purpose of the guarantee agreement is to protect the IBG's customers. The FCM that is a party to the agreement guarantees performance by the IBG of, and is jointly and severally liable for, all obligations of the IBG under the Act and the rules, regulations, and orders promulgated thereunder with respect to the solicitation of and transactions involving all customer and option customer accounts.[3]

Based upon the representations made in "X's" January 23, 1998 letter, as supplemented, we understand the relevant facts to be as follows. "Y" will serve as the CPO of the "Pool".[4] "Y" will open an account in the name of the Pool with "X" for execution of trades on both United States contract markets and foreign exchanges.[5]

You have asked us to confirm that it is permissible for "Y" to open an account in the name of the Pool at "X" under Rule 1.57(a). The Division believes that, if an entity is registered

as an IBG and CPO and clearly separates its activities such that, when it is performing CPO functions, it is not also acting as an IB, then the restriction of Rule 1.57(a) would not apply with respect to the Pool account. In support of your request, you have represented that no owner of an account introduced by "Y" to "Z" will be a participant in the Pool. You have also represented that, with respect to the Pool, "Y" will receive management and incentive fees, but will not share in the per-trade commission charges that are assessed for trades executed on the Pool's behalf. Based on the foregoing, the Division believes that "Y's" proposed arrangement with "X" whereby "X" will be acting as the FCM with respect to trades executed for the Pool for which "Y" will serve as the CPO would not be inconsistent with Rule 1.57(a).[6]

This letter does not excuse "Y", "X" or "Z" from compliance with any other applicable requirements contained in the Commodity Exchange Act ("Act")[7] or the rules promulgated thereunder. For example, all parties remain subject to all antifraud provisions of the Act, to the reporting requirements for traders set forth in Parts 15, 17, 18 and 19 of the rules, and to all applicable provisions of Part 4 of the rules concerning CPOs and commodity trading advisors. Moreover, this letter is applicable solely to the issue of whether "X's" acting as FCM for the Pool's account with "Y" acting as the CPO of the Pool is inconsistent with the duties of any of the parties under Rule 1.57(a).

This interpretation is based on the representations made to us. You must notify us immediately in the event that the operations or activities of "Y", "X" or "Z" change in any material way from those represented to us. Any different, changed or omitted facts or circumstances might render void the views expressed herein. Moreover, this letter represents the views of the Division only and does not necessarily represent 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 Lawrence B. Patent, the Division's Associate Chief Counsel, at (202) 418-5439.

Very truly yours,
I. Michael Greenberger
Director

[1] Commission rules referred to herein are found at 17 C.F.R. Ch. I (1998).

[2] *See* 56 Fed. Reg. 37026 at 37030 (Aug. 2, 1991).

[3] *See* 48 Fed. Reg. 35248 at 35264, 35305 (Aug. 3, 1983).

[4] "Y" is serving as the CPO because it is the general partner of the Pool.

[5] "Z" provided the Division with a copy of a memorandum dated March 9, 1998 that was sent by "A" at "Z" to "B" at "X" stating that "Y" was authorized to open an account in the name of the Pool with "X".

[6] We note that, pursuant to Rule 4.24(e)(6), "Y" must disclose in the Pool's Disclosure Document "X's" name as the FCM through which the Pool will execute its trades. Further, pursuant to Rule 4.24(i), "Y" must disclose all compensation it will receive for acting as the Pool's CPO, including any compensation to be received from "X".

[7] 7 U.S.C. §1 et seq. (1994).