CFTC Letter No. 99-28

July 9, 1999

No-Action

Division of Trading & Markets

Re: Section 4d of the CEA - Request for No-Action Relief from Introducing Broker Registration

---

Dear :

This is in response to your letter dated April 21, 1999 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") by which you requested a no-action position with regard to introducing broker ("IB") registration requirements as applied to certain grain elevators that may enter into a fee-splitting arrangement with "X", a registered futures commission merchant ("FCM"). Specifically, "X" proposes to split the fee paid by agricultural producers who sign up for its "Z" agricultural marketing program with the grain elevators that originally referred the producer to "X". Your letter was supplemented by information obtained during telephone conversations between Division staff and "A" of "X".

Based upon the representations contained in your correspondence, we understand the relevant facts to be as follows. "X" is a registered FCM and a clearing member on the "B" and the "C". It is a subsidiary of "Y". "X" has over 45 branch offices throughout the central and northwestern United States. It focuses its business on agricultural hedging in the grain and livestock area. Its customer base consists of country elevators, commercial grain companies and agricultural producers.

"X" provides a marketing plan service, known as the "Z" Program, for grain and livestock producers. The program helps producers develop marketing plans for corn, wheat, soybeans, cattle, hogs or other agricultural products that can be hedged using exchange-traded futures and option contracts. Under this program, "X" develops a marketing plan that fits each individual producer's needs and situation. In developing this plan, "X" works directly with producers to complete a producer profile that includes information on the producer's costs, acres, yields, cash flow needs, and historical marketing habits. "X" then analyzes this data and produces a final marketing plan. Final marketing decisions remain in the producer's hands. There is no obligation for the producer to use futures and options in their marketing. Producers are charged for this service a one-time fee which is due upon completion of the producer profile.

Since producers historically have often contacted grain elevators for help in marketing their grain and livestock product, "X" believes that grain elevators can be a conduit for introducing

marketing plan customers to "X". To compensate elevators for making the referral, "X" wishes to split the fee received for its "Z" service with the grain elevator. This is a flat, one-time fee and is not based upon a producer's commodity futures or options trading.

This fee-splitting program would be offered only to grain elevators that are members of the "Y" cooperatives.[1] The grain elevators would not advertise the "Z" program. However, grain elevators currently (and will continue to) host presentations at which registered associated persons ("APs") of "X" speak. The topics of these talks are wide-ranging and can include general presentations on the use of futures in hedging farm output as well as marketing presentations concerning specific "X" services. In addition to providing a location for these presentations, the host grain elevators may also publicize these events.

"X" believes that it should be able to split the "Z's" fees with the referring elevators without the elevators' being required to register with the Commission as IBs, and is requesting that the Division provide it with a no-action position with respect to the fee-splitting arrangement.[2]

Section 1a(14) of the Commodity Exchange Act[3] ("Act") defines an IB as:

> any 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.[4]

In turn, Section 4d of the Act[5] requires that any person engaged in soliciting or accepting orders for futures contract as an IB be registered as such.

The registration requirements of the Act are an important element of customer protection. To assure that these requirements reach all persons involved in customer solicitation, the registration requirements have been construed flexibly to require the registration of persons who participate even indirectly in such solicitations.[6] With respect to IB registration, the Commission has stated clearly that it would require:

> registration as an introducing broker 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 . . . for referral to an FCM for the institution of a trading relationship and the execution of those orders. Similarly, the Commission believes that persons who are currently compensated on a per-trade basis or by a referral fee . . . would be deemed to be the "agent" of a futures

> commission merchant for the purposes of the acceptance of those customer orders. As such, any person who continues to engage in those activities would be within the definition of, and generally required to register as, an introducing broker.[7]

In responding to interpretative and no-action letter requests, the Division has consistently applied the principles enunciated by the Commission to require registration of persons who, for compensation, refer customers to Commission registrants.[8] Thus, the Division has stated that companies involved in referring customers to Commission registrants though various means were required to register as IBs, including companies that: (1) generated a list of potential customers and sold the lead list to Commission registrants;[9] (2) conducted a telephone survey in order to develop a database of potential customers for a Commission registrant;[10] (3) sold a service that provided potential futures customers with the names of APs who may be able to provide specific futures related services;[11] and (4) included advertisements for an FCM in its mailings to subscribers who had purchased its futures-related information services in return for the FCM's providing common customers with a per trade commission "rebate" that could be used by the customer to pay for the information services.[12]

As in the above described situations, the grain elevators in question will receive compensation for directing customers to "X". While under the proposed arrangement, customers will be referred to "X" in order to use its marketing program, and are under no obligation to open a futures or options account with "X", it is likely that some customers will use "X" to execute the futures and options transactions called for under the marketing plan. Moreover, as the Division stated previously, "any contact initiated by [a party] that is intended to establish or to culminate in a customer relationship is conduct that entails the `solicitation of customers,' and may be characterized as indirect solicitation of customers' orders, even though [customers] are under no obligation to open accounts [with an FCM]."[13] In this regard, the Division found that a company that sold futures related information services was, "initiating a contact that [was] intended to result in new customers for [an FCM] and qualifie[d] as solicitation" when it provided an FCM access to its customer list.[14] Given the Division's previous reasoning, it appears that the fee-splitting arrangement proposed by "X" would entail behavior that could be characterized as indirect solicitation of customer orders by the grain elevators in question and, thereby, require the elevators to register as IB.

After careful consideration of your request, the Division does not believe that the facts represented by you are significantly different from the facts involved in the requests previously denied by the Division, and cited herein, to warrant granting relief. Thus, the Division declines to provided you with the requested no-action position with respect to IB registration. If you have any question on this correspondence, please contact me or my colleague Thomas E. Joseph at (202) 418-5430.

Very

truly
yours,

Lawrence
B. Patent

Associate
Chief
Counsel

[1] Any grain elevator that is a customer of "X" would be considered a member of the "Y" cooperatives and therefore eligible for the program.

[2] "X" also requested a no-action position with regard to any requirements that the grain elevators register as commodity trading advisors ("CTAs"). In light of the response concerning IB registration set forth herein, the Division is not addressing any question related to CTA registration in this letter. However, this letter does not excuse "X" or any grain elevator from any obligation to register as a CTA should its activities implicate the statutory definition of a CTA and the CTA registration requirements of the CEA.

[3] 7 U.S.C. § 1a(14)(1998).

[4] Commission Rule 1.3(mm), 17 C.F.R. § 1.3(mm)(1999) 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; . . . .

[5] 7 U.S.C. § 6d (1994).

[6] As was noted during Congressional deliberations leading up to the creation of the Commission:

> in order to adequately protect the investing public, registration requirements and fitness checks should be impose on commodity solicitors, advisors and all other individual who are involved either directly or indirectly in influencing or advising the investment of customers' funds.

Subcommittee on Special Small Business Problems of the House Permanent Select Committee on Small Business, H.R. Rep. No. 963, 93rd Cong., 2d Sess., 36-37 (1974).

[7] 48 Fed. Reg. 35248, 35250(August 3, 1983), *citing* 48 Fed. Reg. 14933, 14935 (April 6, 1983).

[8] A natural person who receives compensation from a Commission registrant for customer referrals may

register as an AP of that registrant. A corporate or business entity that received such compensation would be required to register as an IB.

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

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

[11] CFTC Interpretative Letter No. 98-76, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,477 (November 18, 1998). The matching service intended to charge customers a one-time flat fee of $40 for the service and to charge APs an annual fee of $500 to be listed in the services database. *Id* at 47,254.

[12] CFTC Interpretative Letter No. 95-51, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,420 (May 1, 1995). The Division believed that the rebate was a form of indirect compensation because it effectively allowed the information provider to give its customers a discount without losing revenue, thereby helping it maintain its customer base. *Id.* at 42,854.

[13] *Id*. at 42,853 *citing* CFTC Interpretative Letter 93-40, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,731 at 40,383 (May 5, 1993).

[14] CFTC Interpretative Letter No. 95-51, *supra*, n.12 at 42,853. The information company received what the Division believed was indirect compensation for this access. *See id.* at 42,854.