



Department of the Treasury Financial Crimes Enforcement Network

Guidance

FIN-2006-G011

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Subject: Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to Certain Introduced Accounts and Give-Up Arrangements in the Futures Industries

The Financial Crimes Enforcement Network is issuing this guidance to clarify the obligations of futures commission merchants subject to the final due diligence rules implementing section 312 of the USA PATRIOT Act (the “section 312 rules”).¹ Specifically, this guidance addresses (1) how accounts introduced by introducing brokers in commodities to futures commission merchants should be treated for the purposes of complying with the due diligence rule for correspondent accounts for foreign financial institutions² (the “correspondent account rule”) and the due diligence rule for private banking accounts³ (the “private banking rule”) and (2) how the correspondent account rule applies to futures commission merchants operating in give-up arrangements.

1. Application of the Section 312 Rules to Certain Introduced Accounts

An introducing broker in commodities (“introducing broker”) solicits or accepts orders from the public for the purchase or sale of commodity futures contracts.⁴ However, an introducing broker may not accept money, securities, or other property for the purpose of margining, guaranteeing, or securing solicited or accepted trades or contracts.⁵ To conduct its business, an introducing broker will enter into an agreement with a futures commission merchant,⁶ under which the introducing broker will introduce customers to the futures commission merchant.⁷ The introduced customer will establish an account

¹ The due diligence provisions of the section 312 rules apply to “[a] futures commission merchant or introducing broker registered, or required to be registered, with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*), except persons who register pursuant to section 4(f)(a)(2) of the Commodity Exchange Act,” among other covered financial institutions. 31 C.F.R. § 103.175(f)(ix).

² 31 C.F.R. § 103.176.

³ 31 C.F.R. § 103.178.

⁴ See 7 U.S.C. 1a(23) (defining “introducing broker”).

⁵ Compare 7 U.S.C. 1a(23) and 7 U.S.C. 1a(20) (defining “futures commission merchant”).

⁶ 7 U.S.C. 1a(20).

⁷ The agreement between an introducing broker and a futures commission merchant will establish terms for the introduction of accounts to the futures commission merchant, such as compensation arrangements, the

directly with the futures commission merchant, in which the futures commission merchant will clear and carry the introduced customer's commodity futures trades until they are offset or settled. We have been asked to clarify the obligations of the futures commission merchant under the section 312 rules.

A. The Correspondent Account Rule

Typically, an introducing broker – and not a futures commission merchant – will solicit orders from an introduced account.⁸ However, a futures commission merchant will execute an account agreement directly with an introduced foreign financial institution so that it can accept money, securities, or other property to margin, guarantee, or secure trades or contracts cleared and carried for the foreign financial institution. The execution of the account agreement by a futures commission merchant establishes a “formal relationship” with the introduced foreign financial institution, subjecting the futures commission merchant to compliance with the due diligence provisions of the correspondent account rule.⁹

An introducing broker may not accept money, securities, or other property for the purpose of margining, guaranteeing, or securing solicited or accepted trades or contracts,¹⁰ and we do not view the solicitation or acceptance of orders for the purchase or sale of commodity futures contracts alone as constituting the establishment, maintenance, administration, or management of a correspondent account for a foreign financial institution that would subject an introducing broker to compliance with the due diligence provisions of the correspondent account rule.¹¹ However, an introducing broker may administer or manage a correspondent account for a foreign financial institution by offering and performing services for the foreign financial institution beyond the solicitation or acceptance of orders, which would subject the introducing broker to the due diligence provisions of the correspondent account rule.

ability of an introducing broker to use the futures commission merchant's name in sales literature and, if applicable, how the introducing broker should place orders.

⁸ Arrangements between introducing brokers and futures commission merchants also exist whereby the introducing broker will not engage in transactional activity after the introduction of an account to a futures commission merchant. In such circumstances, the futures commission merchant will solicit and accept trades from the account and will pay the introducing broker a trailing commission. The existence of such a relationship does not alter our conclusions.

⁹ See 31 C.F.R. § 103.175(d)(1)(i) and (d)(2)(iii). See also 31 C.F.R. § 103.176(a) (“[a] covered financial institution shall establish a due diligence program . . . designed to enable the covered financial institution to detect and report . . . any known or suspected money laundering activity conducted through or involving any correspondent account established, maintained, administered, or managed by such covered financial institution in the United States for a foreign financial institution”).

¹⁰ See *supra* note 5.

¹¹ See also 31 C.F.R. § 103.175(d)(2)(iii) (emphasis added) (for the purposes of the correspondent account rule, the term “account” is defined as “any formal relationship established by a futures commission merchant to provide regular services, including, but not limited to, those established to effect transactions in contracts of sale of a commodity for future delivery, options on any contract of sale of a commodity for future delivery, or options on a commodity”).

We caution that this clarification should not be interpreted as limiting the anti-money laundering obligations of an introducing broker under our rules. An introducing broker's anti-money laundering program should contain risk-based policies, procedures, and controls for assessing the money laundering risk posed by customers, including foreign financial institutions; for monitoring and mitigating that risk; and for detecting and reporting suspicious activity attempted or conducted through the introducing broker.¹²

B. The Private Banking Rule

In the preamble to the section 312 rules, we described how introducing and clearing firms in the securities and futures industries may apportion due diligence functions for the purposes of complying with the private banking rule.¹³ We have been asked to clarify whether we meant to require futures commission merchants to perform due diligence on introduced private banking accounts pursuant to the private banking rule.¹⁴

We did not intend such a requirement in all instances. When a futures commission merchant imposes minimum aggregate account requirements on an introduced account for a non-U.S. person and additionally assigns an officer, employee, or agent to act as a liaison between the futures commission merchant and the beneficial owner or owners of the introduced account,¹⁵ then the introduced account will be considered a private banking account of the futures commission merchant, subjecting the futures commission merchant to compliance with the due diligence provisions of the private banking rule.¹⁶

¹² See 31 C.F.R. § 103.120(c) (anti-money laundering program requirements for futures commission merchants and introducing brokers) and 31 C.F.R. § 103.17(a)(2) (suspicious activity reporting requirements for futures commission merchants and introducing brokers).

¹³ In the preamble at footnote 68, we stated that “where [introducing and clearing firms in the securities and futures industries] maintain a private banking account for a customer . . . [a]ny apportionment of [due diligence] functions between such entities should include adequate sharing of information to ensure that each institution can satisfy its obligations under this rule. For example, an introducing firm would be responsible for informing the clearing firm of the customers holding private banking accounts and for obtaining the necessary information from and about these customers, while both firms would be responsible for establishing adequate controls to detect suspicious activity.” *Final Rules*, 71 Fed. Reg. at 508.

¹⁴ See also *Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to the Securities and Futures Industries*, FIN-2006-G009 at Section 3 (May 10, 2006), at http://www.fincen.gov/reg_guidance.html.

¹⁵ A “private banking account” is defined as “an account (or any combination of accounts) . . . maintained at a covered financial institution that . . . requires a minimum aggregate deposit of funds or other assets of not less than \$1,000,000 . . . [i]s established on behalf of or for the benefit of one or more non-U.S. persons who are direct or beneficial owners of the account [and is] assigned to, or is administered or managed by, in whole or in part, an officer, employee, or agent of a covered financial institution acting as a liaison between the covered financial institution and the direct beneficial owner of the account.” 31 C.F.R. § 103.175(o).

¹⁶ 31 C.F.R. § 103.178.

The imposition of minimum aggregate account requirements on an introduced account by a guaranteed introducing broker,¹⁷ and the assignment of a liaison to the introduced account, will subject both the guaranteed introducing broker and the futures commission merchant to the due diligence provisions of the private banking rule. A similar conclusion may be reached with respect to independent introducing brokers, depending on the nature of the relationship between the introducing broker and the futures commission merchant.

2. Application of the Correspondent Account Rule to Futures Commission Merchants in Give-up Arrangements

A give-up arrangement occurs when a futures market participant uses one entity, a futures commission merchant, as its “carrying broker” and uses one or more other entities, frequently a futures commission merchant, as its “executing broker.”¹⁸ An executing broker will direct any trades it executes on order of a futures market participant to the account the market participant has established with its carrying broker, pursuant to the give-up arrangement. We have been asked to clarify how the correspondent account rule applies to futures commission merchants acting as carrying brokers and executing brokers in give-up arrangements.

Although an executing broker in a give-up arrangement will facilitate trades for a market participant, and the give-up arrangement may be formalized by a written agreement,¹⁹ the give-up arrangement essentially serves as an order acceptance, trade routing, and compensation protocol among the executing broker, the market participant, and its carrying broker.²⁰ Indeed, only the carrying broker accepts money, securities, or other property from the market participant for the purpose of margining, guaranteeing, or securing its trades, and only the carrying broker executes account-opening documents with the market participant to clear and carry its executed trades until they are offset or

¹⁷ Introducing brokers may be “independent” or “guaranteed.” Independent introducing brokers are subject to minimum net capital requirements established by the Commodity Futures Trading Commission and may introduce accounts to one or more futures commission merchants. *See* 17 C.F.R. § 1.17(a)(1)(iii) (minimum net capital requirements for introducing brokers). Guaranteed introducing brokers have no minimum net capital requirements and may introduce accounts only to one futures commission merchant. *See* 17 C.F.R. § 1.17(a)(2)(ii) (minimum net capital requirements not applicable to an introducing broker operating pursuant to a written, binding guarantee agreement with a futures commission merchant that meets minimum requirements established by the Commodity Futures Trading Commission at 17 C.F.R. § 1.10(j)).

¹⁸ An executing broker in a give-up arrangement may be a futures commission merchant or a floor broker. *See* 7 U.S.C. 1a(16) (defining “floor broker”).

¹⁹ The market participant, the executing broker, the carrying broker, and the market participant’s advisor, if any, may enter into a written agreement specifying their rights and responsibilities, but there is no regulatory obligation to do so. *See, e.g.*, International Uniform Brokerage Execution Services (“Give-up”) Agreement, available at <http://www.futuresindustry.org/downloads/regulatory/intlgu1.pdf>.

²⁰ A give-up arrangement may include four parties rather than three parties. *See id.* We would reach the same conclusions with respect to executing and carrying brokers operating in four-party give-up arrangements.

settled.²¹ Accordingly, a futures commission merchant operating as the carrying broker in a give-up arrangement – and not a futures commission merchant operating as an executing broker – is subject to compliance with the due diligence provisions of the correspondent account rule.²²

We caution that this interpretation should not be construed as limiting the anti-money laundering obligations of futures commission merchants under our rules. The anti-money laundering program of a futures commission merchant should contain risk-based policies, procedures, and controls for assessing the money laundering risk posed by its operations, including the executing brokerage activities of the futures commission merchant; for monitoring and mitigating that risk; and for detecting and reporting suspicious activity attempted or conducted through the futures commission merchant.²³

²¹ See 31 C.F.R. §§ 103.175(d)(1)(i) and (d)(2)(iii). The executing broker will not accept money, securities, or property for the purpose of margining, guaranteeing, or securing trades it executes for a market participant. Rather, the executing broker will direct any trades it executes for the market participant to the market participant's account at its carrying broker. Thus, the executing broker serves in substantially the same role as an introducing broker in situations where an introducing broker solicits orders from an introduced account at a futures commission merchant. See *supra* Section 1.A.

²² In the event that a market participant's carrying broker does not accept an order transmitted to it, the executing broker – if it is a futures commission merchant – then may execute account-opening documents with the market participant for the purpose of clearing and carrying the executed trade for the market participant. At the time it executes account-opening documents with the market participant, the executing broker will become a carrying broker, subjecting it to compliance with the due diligence provisions of the correspondent account rule.

²³ See *supra* note 12.