

CFTC Letter No. 01-60
June 13, 2001
Other Written Communication
Division of Trading and Markets

Re: Rules 4.41(b)(1), 4.35(a)(6)(i) and 4.35(a)(7)(i)—Questions Concerning Certain Performance Presentations on an Internet Website that Provides Commodity Interest Trading Advice and Management of Commodity Interest Accounts.

Dear:

This is in response to your electronic mail (“e-mail”) message dated March 19, 2001 (“March Letter”) to the Division of Trading and Markets (the “Division”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”), as supplemented by an e-mail dated April 1, 2001. By your correspondence, you seek, on behalf of your company XXX (“XXX”), clarification of the requirements under the Commodity Exchange Act (the “Act”)^[1] and Commission rules^[2] applicable to certain promotional presentations on XXX’s proposed Internet website. Additionally, you note that the March Letter was sent in response to the Division’s reply to your letter of January 30, 2001 (the “January Letter”).

Based on the representations made in your correspondence, we understand that in addition to matters described in the January Letter, the facts are as follows. XXX will offer, on a subscription basis, commodity interest trading advice via e-mail notifications and a company website. By so doing, XXX is acting as a commodity trading advisor (“CTA”) as defined in section 1a(6) of the Act.^[3] XXX will offer this service without registering as a CTA, relying upon the CTA registration exemption provided in CFTC Rule 4.14(a)(9).^[4] You acknowledge that prior to undertaking the management of client accounts, XXX must register with the CFTC, secure National Futures Association (“NFA”) membership, and file a disclosure document with the NFA and CFTC.

In your March Letter, you pose two questions concerning the use of certain performance results for promotional purposes on XXX’s internet website. Both questions are copied below, and each is followed by the Division’s response. The Division’s response is based upon the information you provided.

Hypothetical Performance Presentations

Question 1: “First, the exact wording to be used in connection with hypothetical performance results as specified by the NFA (Disclosure Document Guide for CPOs and CTAs) is different than that specified in the regulations (CFTC 4.41(b)(1)(i)). In a literal sense, it appears as if the wording specified by the

NFA would not comply with the regulations. Our question: Can we choose between the two versions?"

All CTAs, regardless of whether they are required to register, are subject to Commission Rule 4.41.^[5] Rule 4.41 prohibits CTAs from advertising in a manner that employs any fraudulent device or involves any transaction or course of business that operates as a fraud or deceit upon any existing or prospective pool participant or client. Rule 4.41 expressly applies to “any publication, distribution or broadcast of any report, letter, circular, memorandum, publication, writing, advertisement or other literature or advice, including the texts of standardized oral presentations and of radio, television, seminar or similar mass media presentations.” Rule 4.41 applies to the circumstances you have described.

Under Rule 4.41(b), presentation by a CTA of the performance of a simulated or hypothetical commodity interest account must prominently display the prescribed cautionary statement of either Rule 4.41(b)(1)(i) **or** Rule 4.41(b)(1)(ii). Rule 4.41(b)(1)(i) specifies precise language for the required disclaimer, while 4.41(b)(1)(ii) permits the use of a statement prescribed by a registered futures association (such as NFA). Both of these cautionary statements warn of the limitations of hypothetical performance results and of the dangers of relying upon these results as an indicator of actual performance. The use of either the CFTC or the NFA cautionary statement is permitted under Rule 4.41 (b).

NFA members (“Members”) must ensure compliance with all applicable NFA Compliance Rules, some of which may provide for more rigorous requirements than a particular CFTC rule. NFA Compliance Rule 2-29^[6] addresses the content and uses of promotional material and other communications with the public. Thus, while CFTC Rule 4.41 permits the inclusion of either cautionary statement, NFA members who choose to present hypothetical performance figures are required to use the disclaimer specified in NFA Compliance Rule 2-29(c)(1).^[7]

Presentation of Proprietary Trading Results

Question 2: “One of the sections in our web site will be titled “ X.” Included will be a proprietary trading capsule performance table calculated in accordance with CFTC [Rule] 4.35(a)(6)(i) and with labeling and discussion in accordance with CFTC [Rule] 4.35(a)(7)(i). Our question: In referencing a compounded annual rate-of-return of proprietary performance on the web site (with an explanation of how "compounded" is defined and calculated), may we significantly understate the actual performance?"

The CFTC rules to which you refer specify how to calculate performance results generally, as well as additional disclosures regarding proprietary performance. CFTC Rule 4.35(a)(7)(i) provides that proprietary trading results must be “prominently labeled as proprietary” and must be accompanied by “a discussion of any differences between such performance and the performance of the offered trading program, including, but not limited to, differences in costs, leverage and trading.”

You have asked whether you may significantly understate the proprietary rates of return. Performance

results may not be understated (or overstated). However, as your letter acknowledges, proprietary accounts may “. . . achieve superior performance than that of client accounts due to lower fees, a more aggressive trading posture, and other factors.” Where proprietary accounts are subject to fees, commissions, and expenses that differ from the program offered to clients, a pro-forma presentation, adjusted for the effects of such factors, must be made in addition to the presentation of results calculated in accordance with Rule 4.35(a)(6)(i).^[8] A pro-forma presentation must be clearly labeled as such and should include complete information on the rationale for determining each adjustment and the method for computing the amount of the adjustments.

This letter is based upon the representations made to us. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion.

If you have any questions regarding this letter, please contact me or Kevin Walek of my staff at (202) 418-5463.

Very truly yours,
John C. Lawton
Acting Director

cc: Jane Pfeiffer, Compliance
National Futures Association

^[1] 7 U.S.C. 1 et seq. (1994), as amended by Pub. L. 106-554, 114 Stat. 2763, The Commodity Futures Modernization Act of 2000 (“CFMA”), (to be codified as amended in scattered sections of 7 U.S.C.).

^[2] Commission rules referred to herein are codified at 17 CFR Ch. 1 (2001).

^[3] The term “commodity trading advisor” is defined under §1(a)(6) of the Act to mean, among other things, any person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading in commodity interests.

^[4] Section 4m(1) of the Act generally requires all persons who come within the CTA definition to register as CTAs. CFTC Rule 4.14(a)(9), however, provides an exemption from this requirement for a CTA who does not direct client accounts or provide advice based on, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients.

^[5] In addition to CFTC Rule 4.41, all CTAs are subject to the antifraud provisions of the Act. 7 U.S.C. 6 (o) provides that no CTA may use “any means or instrumentality of interstate commerce, directly or indirectly--(A) to employ any device, scheme or artifice to defraud any participant or client or prospective client; or (B) to engage in any transaction, practice or course of business which operates as a

fraud or deceit upon any participant or prospective client or participant.”

[6] Section 17(p)(3) of the Act (7 U.S.C. §21(p)(3)) requires that the rules of a registered futures association such as NFA “establish minimum standards governing the sales practices of its members and persons associated therewith for transactions subject to the provisions of this Act.”

[7] NFA Compliance Rule 2-29(c) includes specific requirements regarding use of hypothetical performance results. *See also* NFA Interpretive Notice ¶9025, Compliance Rule 2-29: Use of Promotional Material Containing Hypothetical Performance Results (Board of Directors, February 1, 1996; revised August 29, 1996).

[8] 60 Fed. Reg. 38146, 38168 (July 25, 1995).