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Division of Clearing and
Intermediary Oversight

Ananda Radhakrishnan
Director

CFTC Letter No. 09-27
Interpretation
June 25, 2009
Division of Clearing and Intermediary Oversight

Re: Section 1a(6) – Commodity Trading Advisor Definition
Section 4m – Commodity Trading Advisor Registration

Dear :

This is in response to your letter dated May 1, 2009, to the Division of Clearing and Intermediary Oversight ("Division") of the Commodity Futures Trading Commission ("Commission" or "CFTC"), as supplemented by your email dated May 28, 2009 (collectively, "correspondence"). By the correspondence, you request that the Division confirm your view that "A", an investment adviser registered as such with the Securities and Exchange Commission ("SEC"), does not come within the statutory definition of the term "commodity trading advisor" ("CTA") in Section 1a(6) of the Commodity Exchange Act ("Act") and therefore is not required to be registered with the Commission as a CTA under Section 4m(1) of the Act, or in any other capacity.[1]

Based upon the representations made in the correspondence, we understand the relevant facts to be as follows: "A" offers to its clients a "comprehensive portfolio management program." It wishes to offer as part of the portfolio a "managed futures account," *i.e.*, an account

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[1] 7 U.S.C. §§1a(6) and 6m(1) (2000), respectively. The Act can be accessed through the Commission's website, Uwww.cftc.govU. Commission regulations referred to in this letter are found at 17 C.F.R. Ch. I (2009). Like the Act, they can be accessed through the Commission's website.

Regulation 140.99 governs the issuance of Commission staff responses to requests for exemptive, no-action and interpretative letters ("Letters"). Specifically, Regulation 140.99(b)(4) provides that "Commission staff will not respond to a request for a Letter that is made by or on behalf of an unidentified person." Accordingly, while your request for a Letter refers to both "A" and other investment advisers registered with the SEC or the securities regulatory authority of one of the States, the Division is restricting its response to "A".

over which an unaffiliated, third-party CTA ("TPCTA") has discretionary trading authority.[2] "A" would recommend that a customer open a managed account with a TPCTA based on such factors as whether including a managed account program in the customer's portfolio makes sense in light of the customer's particular investment needs and how a particular TPCTA program would complement the customer's overall investment portfolio. You explain that "[m]ost importantly, however, is the way in which a particular managed account program fits with the concept of Modern Portfolio Theory in terms of balancing the assets in a customer's account." As compensation for these and the other services it provides (*i.e.*, advice on trading securities), "A" would receive from the customer a percentage of the total funds the customer has committed to the overall portfolio management program, including those funds held at a futures commission merchant ("FCM") for commodity interest trading and over which the TPCTA has discretionary trading authority.[3] However, any fees charged the customer by the TPCTA would remain with the TPCTA.

Section 1a(6)(A) of the Act defines the term "commodity trading advisor" to include any person who –

> (i) 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 –
> (I) any contract of sale of a commodity future delivery made or to be made on or subject to the rules of a contract market or derivatives transaction execution facility;
> (II) any commodity option authorized under section 4c; or
> (III) any leverage transaction authorized under section 19; or
> (ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).

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[2] The customer would provide this authority to the TPCTA by way of a power of attorney or other similar means.

For the purpose of this letter, it is presumed that the TPCTA is registered as a CTA with the Commission or has qualified for an exemption from such registration. Exemptions from CTA registration are discussed below.

[3] The flow of the customer's funds would be as follows: "A"'s customer would deposit funds to be committed to the portfolio management program with a broker-dealer registered as such with the SEC. The customer would then authorize the transfer of funds from the broker-dealer to the FCM with whom its managed futures account would be carried. Neither "A" nor the TPCTA would have any authority to effect such a transfer.

In analyzing this definition as it applies to your request, we note that the CTA definition is not dependent on whether a person provides advice on a discretionary basis (*e.g.*, pursuant to a power of attorney or other similar means). Nor is it dependent on compensation being received from trading recommendations made on a discretionary basis or the results of the performance of a TPCTA, or as commissions from the account as traded by a TPCTA. What is required, however, is that a person advise others about "the value of or the advisability of" trading the financial instruments referred to in Section 1a(6)(A)(i) of the Act. While Section 1a(6)(B) specifies certain persons who are excluded from the statutory CTA definition (*e.g.*, an FCM) when, as provided for in Section 1a(6)(C), the furnishing of advisory services is "solely incidental to the conduct of their business or profession (*e.g.*, where the FCM provides the services to customers who carry commodity futures and option accounts with it), it does not include a registered investment advisor ("RIA") among any of the persons so excluded. Moreover, while pursuant to the authority in Section 1a(6)(C) the Commission has adopted in Regulation 4.6 certain additional exclusions from the CTA definition, "A" is not among the persons specified in the rule *(i.e.*, it is not a State-regulated insurance company or subsidiary thereof nor is it a person who is excluded from the commodity pool operator ("CPO") definition by Regulation 4.5). Accordingly, based upon the foregoing, the Division believes that "A" would come within the statutory CTA definition in recommending the managed futures account programs of TPCTAs to its customers.[4]

Section 4m(1) of the Act provides that is unlawful for any CTA "unless registered under the Act, to make use of the mails or means or instrumentality of interstate commerce in connection with his business" as a CTA. Section 4m(1) does contain certain exemptions from CTA registration, but they are not applicable to the facts you have presented (because, *e.g.*, it appears that "A" will be providing commodity interest trading advice to more than fifteen persons). Similarly, Regulation 4.14 contains certain other exemptions from CTA registration, but again they are not applicable to the facts you have presented (because, *e.g.*, "A" will not be restricting its customers to those stated in Regulation 4.14(a)(8) nor will its advice to its customers that they have a managed futures account component in their portfolios be "impersonal" in nature as required for the CTA registration exemption in Regulation 4.14(a)(9)).

Section 4m(3) of the Act also provides for exemption from the registration requirements of Section 4m(1), for any CTA that is registered with the SEC as a RIA –

> whose business does not consist primarily of acting as a commodity trading advisor, as defined in section 1a(6), and that does not act as a commodity trading advisor to any investment trust, syndicate, or

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[4] *See* CFTC Staff Letter No. 90-16, [1990 – 1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,918 (Aug. 21, 1990), in which staff discussed the application of Regulation 4.31 Disclosure Document obligations of a person who selected CTAs for clients (for the purpose of the letter, a "selecting CTA") as opposed to a person who merely recommended CTAs to clients (for the purpose of this letter, a "recommending CTA").

> similar form of enterprise that is engaged primarily in trading in any commodity for future delivery on or subject to the rules of any contract market or registered derivatives transaction execution facility.

"A" is a RIA. Based upon the representations you have made to us, it appears that "A's" business may not consist primarily of acting as a CTA, inasmuch as "A" would be recommending the use of a managed futures account in connection with providing other services as contemplated by modern portfolio theory.[5] Based upon those representations, it is unclear whether "A" would meet the remaining criterion of the exclusion, because you have not indicated whether any of the persons to whom "A" would be making these recommendations would be in the nature of the collective investment vehicles identified in the regulation – *e.g.*, commodity pools.[6] Assuming, *arguendo*, that none of "A's" customers would be in the nature of these identified entities, "A" may be able to claim the exemption from CTA registration in Section 4m(3).[7]

Finally, based upon the representations you have made to us, it appears that "A" would not be engaging in any activity that would require it to register in any other capacity with the Commission (*i.e.*, as an FCM, introducing broker, CPO, or an associated person of any of the foregoing).

This letter is based upon the representations made to the Division, and is applicable to "A" solely in connection with its recommending a managed futures account component in its portfolio management program. Any different, changed, or omitted facts or conditions might render the view expressed herein void. You must notify the Division immediately in the event the operations or activities of "A" change in any material way from those represented to us.

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[5] The Division emphasizes, however, that neither it, the Commission, nor any other member of the Commission's staff has issued any finding on, or interpretation of, the use of the term "primarily" in Section 4m(3), and this letter should not be construed to imply any such finding on the part of the Division, the Commission, or any other Commission staff member.

[6] Note that this criterion does not mention, nor is it in any way dependent upon, the registration status of the entity's operator. *See* Regulation 4.5, which provides an exclusion from the CPO definition for certain "otherwise regulated persons" in connection with their operation of certain "qualifying entities," and Regulations 4.13(a)(3) and (a)(4), which make exemption from CPO registration available based upon, among other things, the investment characteristics of prospective pool participants.

[7] Like the CTA registration exemption in Section 4m(1), the exemption in Section 4m(3) is self-executing. If a person meets its criteria, the person needs to take no further action to claim the relief available thereunder.

The views expressed in this letter do not relieve "A" from any other obligation under the Act and the Commission's regulations issued thereunder. For example, it remains subject to all applicable anti-fraud provisions of the Act[8] and to all obligations that apply to CTAs, regardless of their registration status.[9]

Further, this letter represents the views of this Division only and does not necessarily represent the views of the Commission or any other division or office of the Commission. If in the future the Commission or its staff adopts a definition of the term "primarily" for the purpose of Section 4m(3), "A" would be subject to compliance with that definition at that time.

If you have any questions concerning this correspondence, please contact either Barbara S. Gold or Christopher W. Cummings of my staff, at (202) 418-5450.

Very truly yours,

Ananda Radhakrishnan
Director

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8 *See*, *e.g.*, Sections 4b and 4(*o*) of the Act.

9 *See*, *e.g.*, Regulations 4.30 and 4.41.